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IN RETIREMENT



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New Considerations for Couples as the Retirement Landscape Shifts

Fundamental change has shaken the foundation of the U.S. retirement system. A recent report from the U.S. Government Accountability Office confirms that the three traditional pillars of that system—Social Security, employer-sponsored retirement plans, and individual savings—no longer provide adequate retirement security for a growing number of Americans.¹ For widows and widowers, the outlook can be particularly unnerving.

The biggest developments on the retirement landscape have centered, of course, on the shift from defined benefit pension plans to defined contribution savings plans in the workplace, followed by the demise of retiree healthcare plans and modifications to the Social Security program. These developments have made it increasingly difficult for married couples to plan for retirement and generate a secure and adequate level of income once they've stopped working. A number of economic and societal trends are contributing to the uncertain outlook, too, including rising healthcare costs, increasing longevity, and mounting household debt. The upshot? Many future retirees now face the prospect of either working longer than planned to supplement their retirement savings or settling for a lower standard of living than they were expecting.

These fundamental changes and trends, while problematic today, portend even more dire consequences in the future, especially for married couples. Among the key issues:

- As employers shift more financial responsibilities and risks to employees, individuals are responsible for funding a greater share of their retirement and healthcare costs. This creates a potentially significant personal liability that is even greater for married couples trying to plan for two lives.
- As traditional pension plans and employer-provided retiree medical plans become less prevalent, individuals are assuming more responsibility for managing longevity risk—even as average life expectancies continue to rise.
- In conjunction with longer life expectancies, couples are bringing much higher levels of debt into retirement than in the past, further increasing personal liability.
- Compared to their parents and grandparents, individuals today can expect to receive reduced lifetime Social Security benefits due to increases in the Full Retirement Age, which is the age at which Social Security recipients can receive 100% of their Social Security retirement benefit.
- For a wide range of reasons, many Americans are saving for retirement at levels that put them at risk of not being able to maintain their standard of living once they stop working.

¹ U.S. Government Accountability Office, "The Nation's Retirement System," October 2017.

The net result of all these changes is that many married couples today are saddled with increasing personal liabilities but have fewer assets to meet them.

The Shift in Retiree's Balance Sheets				
1980–1990s			2018	
FINANCIAL ASSETS	LIABILITIES		FINANCIAL ASSETS	LIABILITIES
Full Social Security at 65	Healthcare costs		Full Social Security at 66-67	Increasing healthcare costs, due to longevity and healthcare inflation
Employer-sponsored defined benefit pension plan	Small mortgages (or none at all)		Employer-sponsored defined contribution plan (e.g., 401(k) plan)	Large amount of debt (e.g., mortgage and student loan debt)
Employer-sponsored retiree medical insurance			Personal Savings	
Personal Savings				

All these issues are magnified, unfortunately, when one partner in a marriage dies—especially if that partner is the husband. Given the longer life expectancies for women, this is a common occurrence. Federal poverty thresholds indicate that a widow needs, on average, 79% of a couple's income to maintain her standard of living after the death of her husband. Yet in a study of married women expected to enter retirement over the next quarter century, half are projected to have only 62% of the couple's income, or less, when widowed.²

Surviving spouses also may be more at risk in retirement if they were part of a two-income household, another phenomenon that continues to become increasingly common.³ Dual-income households typically spend more on fixed expenses (e.g., larger mortgages, auto payments, etc.) while both spouses are working, since two incomes allow them to “afford” more. Having built a lifestyle dependent on two incomes, though, the untimely death of a spouse can create challenges in retirement since household income can then go down more than household expenses.

In summary, future retired couples cannot look to the experience of previous generations, when more financial safeguards were in place, and assume their own retirement will work out as well financially. As a consequence, they may wish to consult with a financial advisor, who can help them save more for retirement, manage their retirement risks, and ensure that a surviving spouse is protected against outliving their retirement income. A financial advisor can help establish realistic retirement expectations and recommend products and solutions, such as life insurance or annuities, to address various retirement risks.

Let's take a closer look at the factors challenging the retirement outlook for today's married couples, and for surviving spouses, and the steps they can take to help improve their long-term financial outlook.

Federal poverty thresholds indicate that a widow needs 79% of a couple's income to maintain her standard of living; however, only half of married women surveyed are projected to have 62% of the couple's income, or less, when widowed.

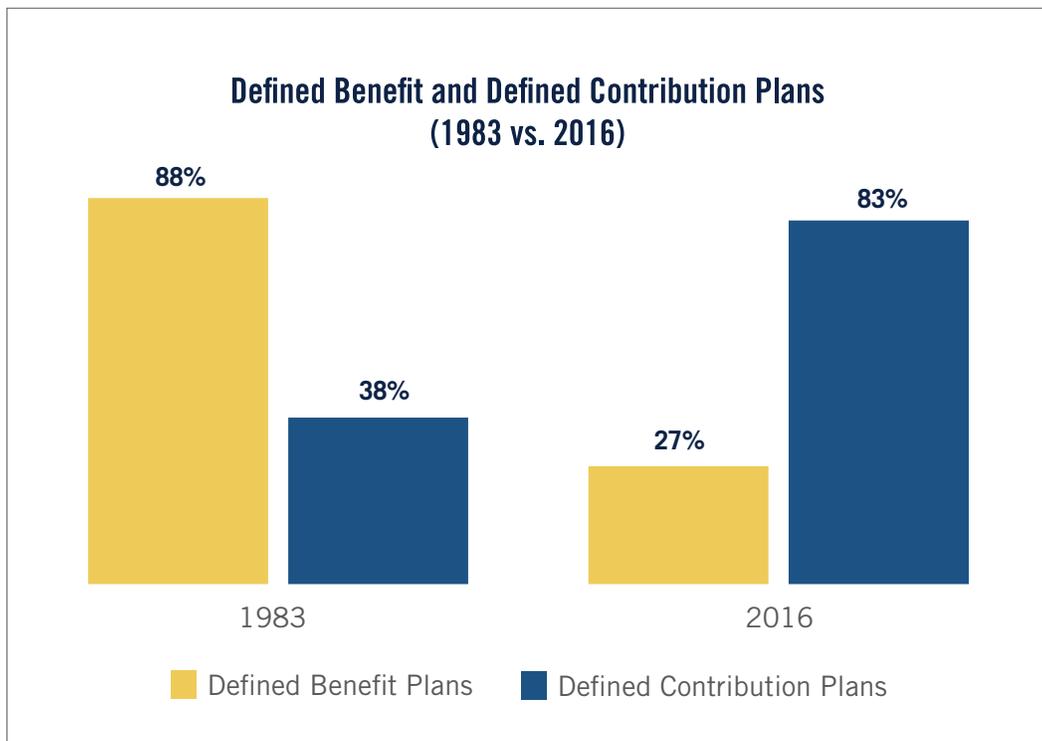
² Center for Retirement Research at Boston College, “Will the Financial Fragility of Retirees Increase?” February 2018.

³ Kitces.com, “Why Two Incomes Aren't Always Better Than One,” December 2017.

The Demise of Defined Benefit Pension Plans

In the past, many working-age households could rely on traditional, employer-funded, defined benefit pension plans to provide them with guaranteed income in retirement. Defined benefit plans generally provide a steady stream of payments over the life of the retiree, and the plan bears all the attendant longevity and investment risks associated with guaranteeing that benefit. Importantly, defined benefit plans also typically include a survivor benefit as a default distribution option. With this option, a surviving spouse continues to receive pension benefits after the retired worker's death. Recently published research indicates that 65% of retiree households were receiving income from a defined benefit plan in 2012.⁴

The prevalence of employer-funded defined benefit plans has declined substantially over the past few decades, however, especially in the private sector. They have largely been replaced by defined contribution plans—401(k) plans are the most common example—in which employees may save part of their paychecks in tax-deferred accounts, typically supplemented by employer contributions. Of all employees that had access to a workplace retirement plan in 2016, only 27% had access to a defined benefit plan, down from 88% in 1983. Conversely, the percentage with access to a defined contribution plan during that period jumped to 83% from 38%.⁵



Source: Munnell, Alicia H., Center for Retirement Research at Boston College, "401(k)/IRA Holdings in 2016: An Update from the SCF," 2017.

Defined contribution plans place the risk of saving for retirement and generating retirement income on employees rather than employers. This leaves workers with several responsibilities: accumulating sufficient savings, investing carefully, resisting

⁴ Bee, Adam, and Joshua Mitchell, "Do Older Americans Have More Income Than We Think?" p. 22, July 2017.

⁵ Munnell, Alicia H., Center for Retirement Research at Boston College, "401(k)/IRA Holdings in 2016: An Update from the SCF," 2017.

the temptation to withdraw money from their accounts before they retire, and, perhaps most challenging, using their savings in retirement to generate income as long as it is needed. Because there is no way to know how long they might live, participants in defined contribution plans must worry about either spending too quickly and outliving their resources after they retire, or spending too conservatively and depriving themselves of things and experiences they could otherwise be enjoying.

These are not abstract concerns. The shift from defined benefit to defined contribution plans has contributed to a dramatic worsening of retirement readiness over the past 30 years. In 1986, only 31% of working-age households were at risk of not being able to maintain their standard of living in retirement, according to the Center for Retirement Research at Boston College.⁶ Now, according to its latest research, that figure has jumped to 50%.⁷ One reason for this disturbing outlook is that only about half of households have saved any money for retirement in an employer-sponsored defined contribution plan such as a 401(k), or privately in an Individual Retirement Account. The average 401(k)/IRA balance for Americans ages 55 to 65 is only \$135,000, which equates to about \$600 per month in lifetime income.⁸

The shift from defined benefit to defined contribution plans has not only impacted individuals' retirement readiness, but it has also reduced retirement security for the spouses of retiring workers. With traditional defined benefit pension plans, married retirees generally had a choice from several payout options, such as:

- **A single life annuity**, which provided regular payments to the pension recipient until his or her death, but provided no income thereafter to a surviving spouse.
- **A qualified joint and survivor annuity (QJSA)**, which generally provided lower monthly benefits, but continued to pay them to the surviving spouse after the death of the pension plan participant.

A qualified plan, like a defined benefit pension plan, must offer a QJSA to married participants, unless the participant and spouse consent, in writing, to another form of payment. This likely helps to improve the overall economic viability of widows and widowers and offers a level of protection for a worker's spouse.

On the other hand, defined contribution plans may be exempt from having to provide a QJSA, and, therefore, surviving spouses may be vulnerable to the risk of outliving their assets in retirement. This is especially true given current life expectancies. Assuming a retirement age of 65, the average male can expect to live another 21 years in retirement, up from 15 years in the 1980s. An average female who retires at age 65 can expect to live 23 years, up from 19 years since the 1980s.⁹ Accordingly, individuals are faced with trying to ensure that their retirement savings last through their lifetimes. Life insurance and annuities can help address this longevity risk by providing proceeds that can be used to help generate income for a surviving spouse in retirement.

50%
of Americans are projected to be unable to maintain their standard of living in retirement.

⁶ The National Retirement Risk Index was launched in June 2006. In October 2012, the CRR published an NRRRI calculation based on 1986 Survey of Consumer Finances data. Munnell, Alicia, Anthony Webb, and Francesca Golub-Sass, "The National Retirement Risk Index: An Update," p. 3, October 2012.

⁷ Prudential, "Planning for Retirement: A Generational Perspective," January 2018.

⁸ Center for Retirement Research at Boston College, "401(k)/IRA Holdings in 2016: An Update from the SCF," October 2017.

⁹ Prudential calculations based on GAM 71 mortality table and RP-2014 mortality table with MP-2016 projection scale. Years reflect rounding, while the increase reflects a calculation based on actual results.

Changes to Social Security Claiming Strategies

Maximizing Social Security benefits and developing an appropriate claiming strategy has become a critical component of retirement planning as married couples have taken on more of the risk of saving for retirement and generating enough income in retirement to cover expenses. Some popular claiming strategies have disappeared, however, as a result of the Bipartisan Budget Act of 2015. Specifically, the Act eliminated, beginning in 2016, the “file and suspend” and “restricted application” strategies primarily used by married couples.¹⁰ These strategies allowed a higher-earning spouse to postpone Social Security benefits and earn Delayed Retirement Credits, which ultimately boost survivor benefits, while at the same time generating spousal benefits. For couples, delaying the higher earner’s retirement benefit until age 70 also provided a larger survivor benefit if the higher earner died first.

Under the new rules, married couples can no longer receive a spousal Social Security benefit for one individual while simultaneously accumulating a bonus for the other spouse by delaying the latter’s retirement benefit. Couples are also prevented from having one spouse choose to take a spousal benefit while also delaying his or her own worker benefit to earn Delayed Retirement Credits. These restrictions not only impact the total amount of Social Security benefits a couple could receive in retirement—they could lose up to \$60,000 or more in expected lifetime benefits¹¹—it also makes it less attractive for a higher-earning spouse to delay benefits to age 70. The new rules also may encourage people to file earlier and not take advantage of Delayed Retirement Credits, ultimately reducing, potentially, future survivor benefits for widows and widowers.

In addition to these changes to claiming strategies, the Social Security Administration has been gradually raising the Full Retirement Age, with individuals born in 1960 or later now eligible to receive 100% of their Social Security benefit only when they reach the age of 67. Older retirees—those born in 1937 or earlier—were eligible to collect 100% of their benefit at age 65. Relative to previous generations, this change will result in reduced Social Security benefits for individuals retiring at any given age, including age 65.¹² In fact, the Social Security replacement rate—the percentage of pre-retirement income replaced by Social Security benefits—was 39% in 2015, but is now expected to gradually decrease to 36% by 2035.¹³

The legislative changes to Social Security claiming strategies and the increases in the Full Retirement Age place more responsibility on couples to ensure that they have adequate retirement savings in place to supplement Social Security benefits in the future. Life insurance and annuities can help provide a supplemental source of income for a surviving spouse in retirement.

The Social Security replacement rate is expected to decrease to
36%
in 2035 from 39% in 2015.

¹⁰ The “restricted application” strategy is currently only available to individuals who were born prior to January 2, 1954, and are, therefore, deemed to have turned age 62 in 2015 or earlier.

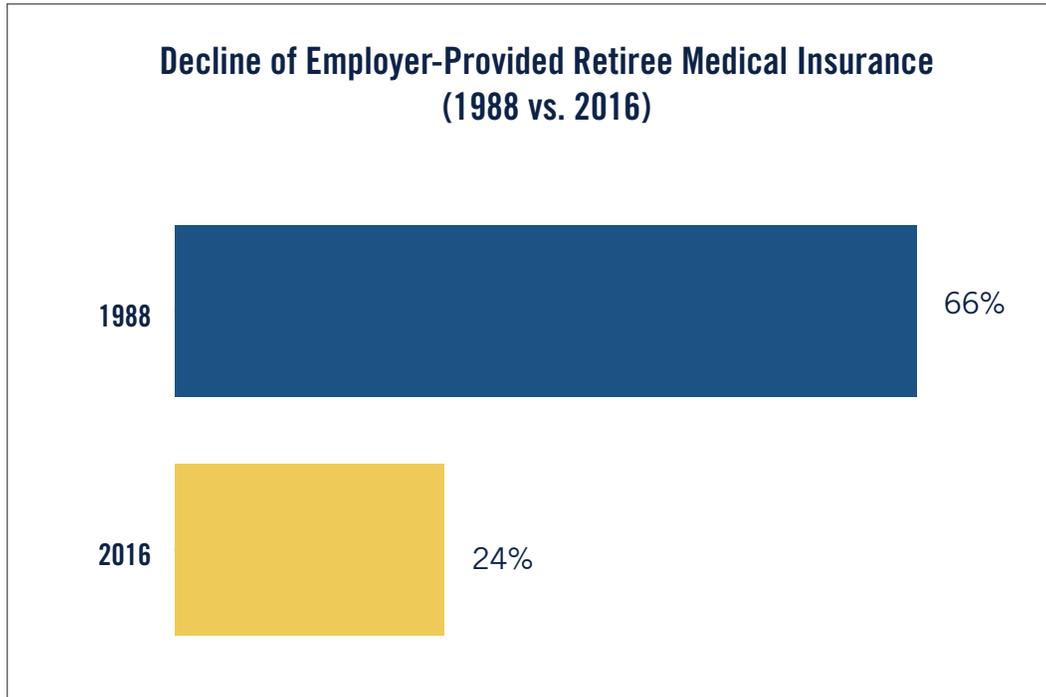
¹¹ Bernard, Tara Siegel, “The End of Social Security Loopholes: What Now?” *The New York Times*, December 4, 2015.

¹² Prudential, “Planning for Retirement: A Generational Perspective,” 2018.

¹³ Center for Retirement Research at Boston College, “Social Security’s Financial Outlook: The 2016 Update in Perspective,” June 2016.

The Decline of Employer-Provided Retiree Medical Insurance

In addition to shifting from defined benefit retirement plans to defined contribution plans, employers have been reducing the availability of employer-provided retiree medical insurance, largely in response to accounting changes and the rising cost of healthcare. The percentage of large employers (200 or more workers) paying for their retirees' medical coverage dropped by nearly two-thirds between 1988 and 2016, to 24% from 66%.¹⁴ Many, if not most, of the plans that remain have been modified to limit employers' future costs.



Sources: Kaiser Family Foundation, "Retiree Health Benefits at the Crossroads," p. 1, 2014, and "Employer Health Benefits: 2016 Summary of Findings," p. 7, 2016.

The loss of these plans is a sharp blow to retirees; historically, the plans played a key role in contributing to retirees' retirement security. They helped fill financial gaps in Medicare coverage, frequently covering some or all of Medicare's cost-sharing requirements and deductibles, and often included a cap on out-of-pocket spending by retired workers. Today, most retirees are fully responsible for funding any healthcare expenses in retirement that aren't covered by Medicare.

Relying solely on traditional Medicare coverage, meanwhile, can impose high costs on retirees, since the program has no limits on out-of-pocket spending. By one calculation, a 65-year-old couple with Medicare retiring in 2016 will need an estimated \$275,000 to cover health and medical expenses throughout retirement, not counting any expenses they may incur for nursing home stays or long-term care.¹⁵ Chronic illness care also can add significantly to out-of-pocket healthcare costs, and, with one of every two Americans currently turning 65 expected to suffer from a chronic illness, these expenses will become even more common going forward.¹⁶

¹⁴ Kaiser Family Foundation, "Retiree Health Benefits at the Crossroads," p. 1, 2014, and "Employer Health Benefits: 2016 Summary of Findings," p. 7, 2016.

¹⁵ Carrns, Ann, "The Benefits (and the Catch) of Health Savings Accounts," *The New York Times*, October 13, 2017.

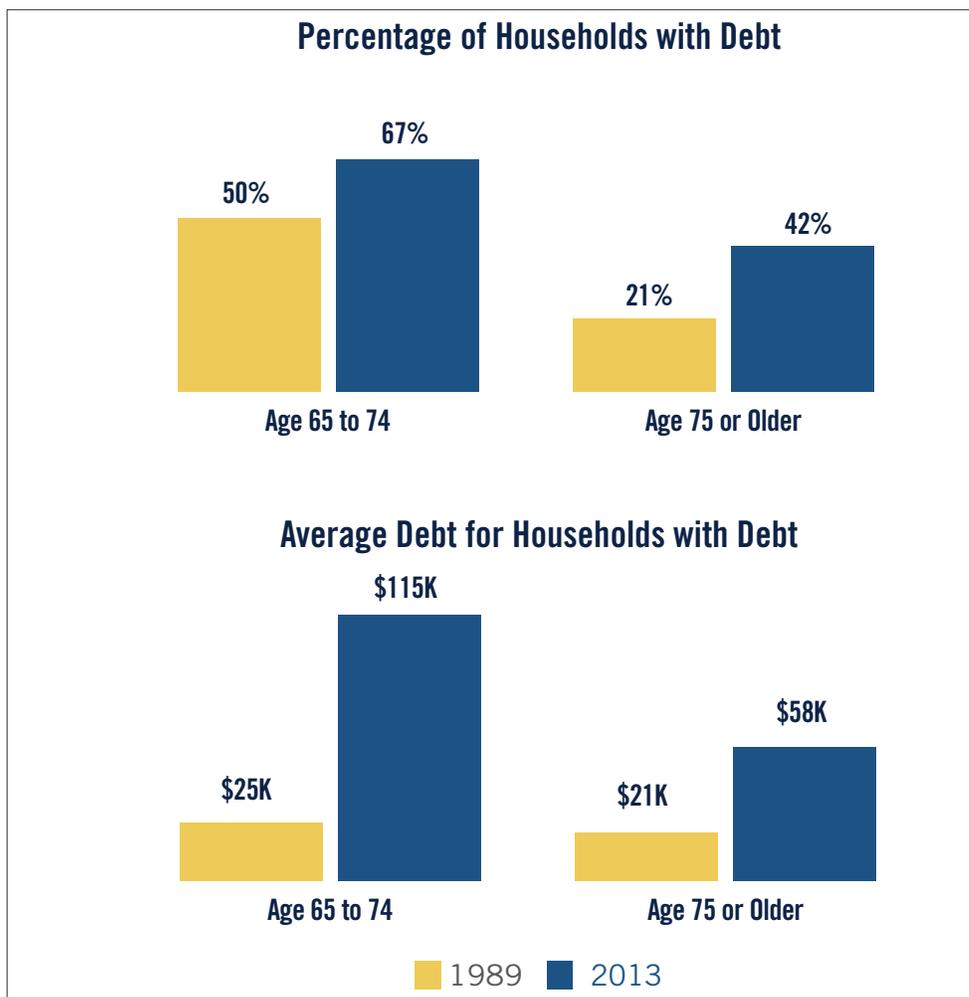
¹⁶ Favreault, Melissa, and Judith Dey, "Long-term Services and Supports for Older Americans: Risks and Financing," ASPE Issue Brief, Department of Health and Human Services, pp. 3 and 9, 2015.

Already, four in 10 retirees find themselves spending more than expected on healthcare and long-term care.¹⁷ Underestimating healthcare costs can significantly impact a retired couple's quality of life, and have severe consequences in the long run for surviving spouses if healthcare costs have depleted a couple's retirement savings. Some life insurance policies have special features or riders that can help reduce this risk. The policy rider allows individuals who become chronically or terminally ill to accelerate, or make available, the death benefit while still alive. A life insurance policy's death benefit can also be used to pay for chronic illness expenses or other healthcare costs occurring at the end of life.

4 in 10 retirees encounter higher-than-expected healthcare and long-term care costs in retirement.

Increasing Debt in Retirement

Retirees are carrying much higher levels of debt into retirement than in the past, as measured both by the percentage of households that have debt and by the volume of that debt. Since 1989, the number of households headed by Americans age 75 or older carrying debt has doubled to 42% from 21%; while the average amount of debt for this group increased almost threefold to \$58,000 from \$21,000. For households headed by someone between the ages of 65 and 74, the number of households carrying debt increased to 67% from 50%, while the average amount of debt for this group increased more than 4.5 times to \$115,000 from \$25,000.¹⁸



Source: LIMRA, "The Retirement Income Reference Book," 2015.

¹⁷ LIMRA, "Sources of Retirement Income Study," 2018.

¹⁸ LIMRA, "The Retirement Income Reference Book," 2015.

Household debt levels are rising as a majority of pre-retirees (defined for this report as those ages 55 and up) are carrying their mortgage, credit card balances, and even student loan debt into retirement.¹⁹ Although credit card balances are not usually large, the high interest rates and partial payment options characteristic of credit card accounts may increase a cardholder's balance over time. Meanwhile, student loan debt is forecasted to be an issue for an increasing number of retirees in the future. As of 2017, more than 3.4 million individuals over age 60 had student loan debt, marking a 385% increase since 2005. Many retirees either have remnants of their own student loans or have cosigned loans for children or grandchildren.²⁰

Surprisingly, borrowers age 65 and over are already defaulting on their debt twice as often as their younger counterparts, and this rate is likely to grow as the Federal Reserve raises interest rates.²¹ Specifically, individuals age 50 to 80 have seen their debt rise by 60% between 2003 and 2015, whereas debt for younger borrowers has declined over the same period. Higher interest rates may come as a shock to the older borrowers who hold significantly more debt than in the past, especially adjustable-rate debt. Moreover, more than a quarter of people age 56 to 66 are already financially fragile, meaning they say they are unable to come up with \$2,000 within a month of an unexpected emergency.²²

That's a worrisome statistic on its own, but it becomes even more frightening considering that 72% of retirees report they have encountered at least one financial shock or unexpected expense in retirement. The unanticipated expenses were associated with, among other things, the death of a spouse, divorce, major home repairs, family emergencies, and medical and dental expenses. Approximately 13% of retirees have encountered three shocks or unexpected expenses, and 19% have encountered four or more. For surviving spouses, the numbers are even worse. About a quarter of retired widows (24%) have encountered four or more financial shocks.²³

Carrying a large amount of debt in retirement means a higher percentage of a retiree's cash must be allocated to fixed expenses, such as mortgage payments and credit cards bills, and less to variable expenses such as travel and entertainment. In cases where debt continues to grow as retirees age, it means they have to devote even more of their retirement income to servicing that debt, leaving fewer financial resources to meet routine living expenses and unexpected bills. All this creates particular challenges for a surviving spouse in the event of a retiree's death, as debt payments must be continued even though household income may be significantly reduced. Life insurance and annuities can help a surviving spouse pay off any remaining debts and maintain their preferred lifestyle in retirement.

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¹⁹ Ibid.

²⁰ AARP, "Student Loan Debt Rising Among Older Borrowers," August 2017.

²¹ Mitchell, Olivia, "Why Higher Interest Rates Are Going to Really Hurt Today's Elderly," *The Wall Street Journal*, September 24, 2017.

²² Ibid.

²³ Society of Actuaries, "2015 Risks and Process of Retirement Survey," January 2016.

Older Adults Are Working Longer

To supplement retirement income, many older adults are postponing retirement and working longer. According to the Pew Research Center, approximately 13% of individuals age 65 and older reported being employed full-time or part-time in 2000. By May 2016, that figure had jumped to about 19%, representing nearly nine million individuals. Over the next five years, that number is expected to increase to 32%.²⁴

In comparison to recent retirees, pre-retirees are up to four times more likely to expect to work and receive wage income in retirement.²⁵ Pre-retirees may prefer to postpone full retirement so they can continue to build their retirement assets, supplement retirement income, or take advantage of employer-provided health benefits. They also likely recognize that working longer increases lifetime earnings and accumulates Delayed Retirement Credits within the Social Security program, which boosts Social Security benefits. Working longer also reduces the retirement period, so that savings do not have to last as long.

The rise of gig work, in which workers act as independent contractors rather than employees, is making it somewhat easier for pre-retirees to continue working while gradually transitioning to full retirement, and for retirees to supplement their retirement income. Approximately 8% of the U.S. gig force consists of individuals 65 and older.²⁶

Retirees who plan to continue working in retirement, even part-time, will want to develop appropriate plans to replace that income after their death if their surviving spouse would need it. Life insurance and annuities can help replace the loss of a worker's income, in the event a surviving spouse was relying on that income to supplement retirement savings.

*In 2016,
19%
of individuals
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By 2021, that
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²⁴ Hanc, John, "Workers Are Working Longer — and Better," *The New York Times*, March 2, 2017.

²⁵ Vanguard, "Retirement Transitions in Four Countries," January 2017.

²⁶ McKinsey & Company, "Independent Work: Choice, Necessity, and the Gig Economy," October 2016.

Conclusion

Societal trends and fundamental changes to the U.S. retirement system have made it increasingly difficult for married couples to effectively plan for and manage retirement. As employer-sponsored defined benefit pension plans and retiree medical plans become less prevalent, couples are burdened with funding a greater share of their everyday living expenses and healthcare costs after they stop working. Meanwhile, legislative changes to Social Security claiming strategies, along with the increases in the Full Retirement Age, have made it difficult for couples to get as much value out of the Social Security program as they might have in the past. At the same time, average life expectancies continue to rise, and couples are bringing much higher levels of debt into retirement than was common years ago. Finally, since many individuals have accumulated insufficient retirement savings, they are planning to work longer to supplement retirement income—assuming their health and their job circumstances allow for it.

The net result is that retirement income is shrinking while retirement liabilities are increasing—making achieving a secure retirement increasingly challenging for future retirees. Future widows and widowers are particularly vulnerable to outliving retirement income. Couples need to ensure that appropriate financial resources are in place for a surviving spouse to maintain their lifestyle and avoid running out of money. With lower projected survivor income from defined benefit pension plans and Social Security to rely on, couples may want to consider solutions such as life insurance and annuities to secure a guaranteed source of income in retirement and help improve future financial security.

Financial advisors can help. They can work with married couples to develop strategies that allow them to save more for retirement and help manage their retirement risks. Advisors also can help couples ensure that a surviving spouse is protected against outliving his or her retirement savings and is able to manage unexpected financial setbacks.

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