Navigating retirement blind spots and decumulation fears

How to stop the mind from playing tricks that can erode financial confidence

There's evidence to challenge the popular assumption that most retirees have not accumulated enough assets to live comfortably throughout retirement—that they could be at high risk of running out of money. Although this certainly applies to some retirees, research shows many are actually spending less than they could from their retirement assets.

According to a recent study conducted by the Employee Benefit Research Institute (EBRI) among several different retiree profiles ages 62 to 75, three-quarters of respondents indicated their retirement savings had remained the same or even grown since retiring. And among the surveyed group of affluent retirees who had spent an average of 10 years in retirement, more than eight in 10 reported their assets had held steady or grown.[1] A prolonged bull market for the past several years has certainly buoyed many portfolios, but the research indicates there's more to the equation than equity returns.

A separate study conducted earlier by BlackRock Retirement Institute that mirrored EBRI's findings, described the results this way:

> **"Something unexpected has been the shared experience for our most recent generation of retirees. The vast majority haven't been spending their retirement savings—leaving nest eggs mostly untouched and living on ready sources of income instead."[2]**

—BlackRock Retirement Institute

[1] EBRI, "Retiree's Dilemma: Spend or Preserve?" May 6, 2021.

[2] BlackRock, "Spending retirement assets … or not?" 2017.

With such a dynamic pivot away from what industry experts had forecasted for decades to be retirees' greatest challenge—not saving enough money—it is essential to explore the factors influencing conservative spending habits in retirement.

Not only is this important so financial professionals can recognize these habits in relation to their clients' financial plans but also for retirees to understand how "saving one's savings" in retirement may not always be an optimal approach and could limit them from experiencing the joy and freedom this exciting stage of life can offer.

In this paper, we look at several key aspects of the retirement spending puzzle, including:

- Three behavioral biases that can influence retirees' decision-making capabilities, and how to counter the impacts of each.
- Evidence supporting the "savings obsession," and why many investors choose to protect their principal.
- Actionable strategies to convert assets to guaranteed sources of income that can liberate retirees to better enjoy retirement.

BEHAVIORAL BIASES

Over the past 50 years, the field of behavioral finance has evolved to a point where it is recognized today as an essential component of sound financial planning. Pioneered by behavioral psychologists Daniel Kahneman and Amos Tversky in the late 1970s and expanded by the work of economist Richard Thaler, the field of behavioral economics—as it is also known—offers valuable insights into the strong emotional biases that influence the ways investors think and behave.

These same biases certainly apply to attitudes and behaviors we see among retirees today, which can help explain the chasm between how experts believe retirees should spend their retirement savings, and how they actually are spending them.

Fundamentally, behavioral economics recognizes that we are human beings and, importantly, have brains optimized to make decisions quickly rather than accurately. Kahneman's work supports this and suggests that up to 98% of our thinking is done in an automatic, effortless fashion rather than through careful consideration.[3]

Unfortunately, planning for retirement and following a well-defined retirement plan require logical, rational, and conscious thinking. Kahneman's book, Thinking Fast and Slow, as paraphrased by the Digital Enterprise Show, explains that:

> **"The brain doesn't like logical, rational, conscious thinking—and will take any shortcut it can."[4]**

And it is these mental shortcuts that give rein to behavioral biases that often cause retirees to make financial choices and decisions that are not always in their best interest. We refer to these biases as behavioral blind spots and believe three, in particular, can have profound impacts on retirement planning and spending. Let's take a moment to briefly examine each.

[3] SUE Behavioral Design, Kahneman, "Fast and Slow Thinking Explained," 2022.

[4] Digital Enterprise Show, "Two Ways to Increase Engagement and Response Using Behavioral Science," July 18, 2019.

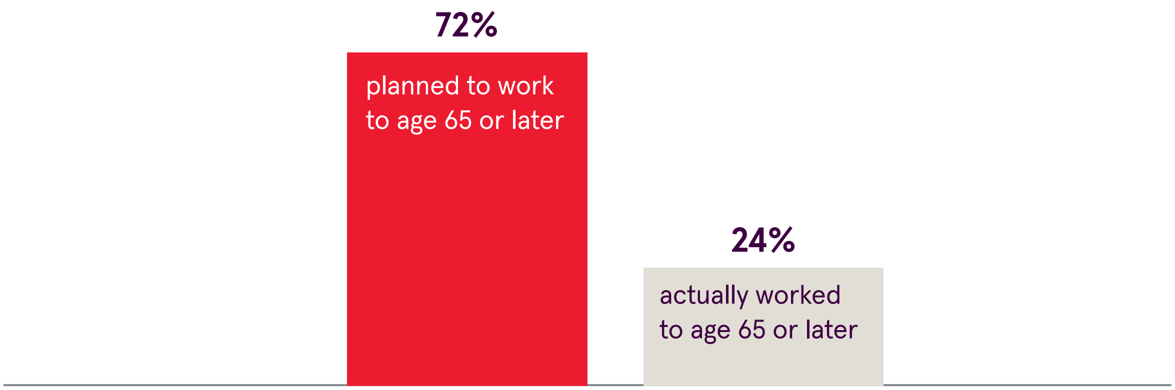
1. Planning fallacy

Planning fallacy is the behavioral bias that recognizes we often make plans based on limited, imperfect information. Specifically, we overestimate the likelihood of positive events occurring in the future and underestimate the chance of negative events.

An example of planning fallacy in retirement planning is how retirees drastically overestimate how long they will work. According to research conducted by Greenwald & Associates for the Society of Actuaries, 72% of people plan to work to age 65 or later, but in reality, only 24% actually work that long.[5]

People do not work as long as they plan

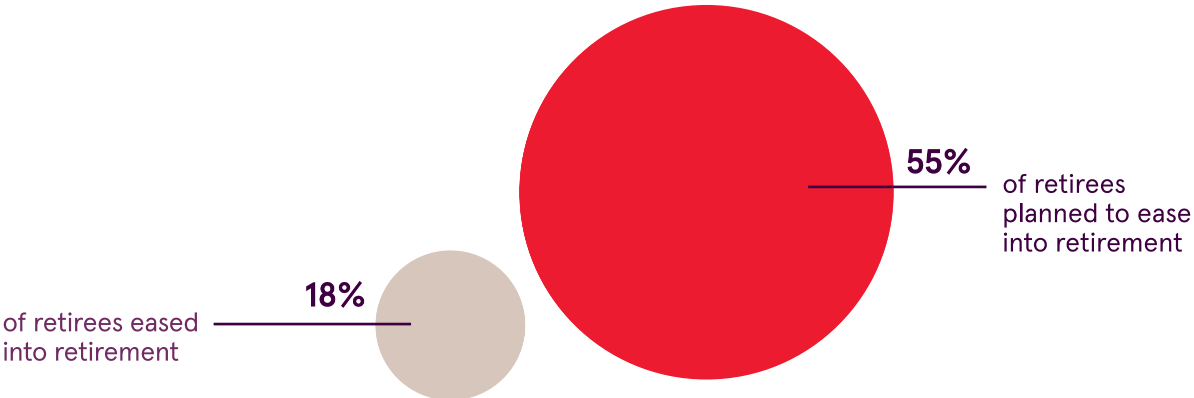
Planned vs. actual retirement age



Source: Society of Actuaries, 2019 Risks and Process of Retirement Survey, May 2020.

Another example of how retirees often get tripped up by planning fallacy relates to *how* they plan to retire. In the same study, 55% of respondents said they planned to ease into retirement, but only 18% actually did.[6]

Can't always ease into retirement



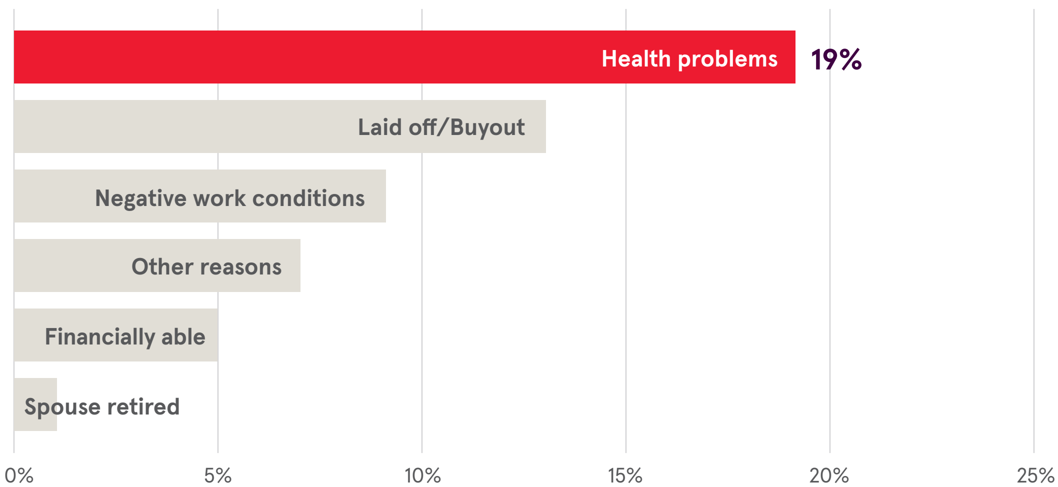
Source: Society of Actuaries, 2019 Risks and Process of Retirement Survey, May 2020.

[5] Society of Actuaries, "2019 Risks and Process of Retirement Survey," May 2020.
[6] Ibid.

Both of these scenarios are excellent examples of how planning fallacy can influence critical retirement decisions. The bias can trick many into making decisions and choices based on best-case scenarios that data clearly show are the exceptions rather than the norm. Retiring earlier than anticipated or not "easing into retirement" mean having less money upon leaving the workforce and a smaller nest egg to support additional years living without earning income from a job. In effect, planning fallacy can serve to derail someone's retirement dreams.

Because we tend to use our own limited experience and desired outcomes to make our plans, it's common for us to ignore negative events that have a high probability of affecting us. As reflected below, the most common reasons for retiring earlier than planned are usually out of the control of retirees.[7]

Health issues and layoffs force early retirement



Financial professionals can play a vital role helping investors counter the influences of planning fallacy by:

- **Using data from people in similar circumstances to help predict their future path.** Rather than asking, *"What is the right age to retire?,"* it might be better to ask, *"At what age have others in similar circumstances retired?"* Start with the average experience and adjust up or down based on individual circumstances.
- **Conducting a premortem.** Ask, *"What could take this plan off track?"* Help investors fight against their natural optimism that discounts threats that could disrupt their retirement plan. Some conversations may be uncomfortable, like: What happens if they suddenly find themselves in poor health? But helping investors consider how to address unforeseen issues is important.

2. Anchoring bias

Anchoring bias was discovered in the 1970s by behavioral psychologists Amos Tversky and Daniel Kahneman[8] and occurs when someone relies too much on preexisting information or the first information they encounter when making decisions. An example of this cognitive bias involves the critical decision retirees need to make concerning when they will claim Social Security benefits.

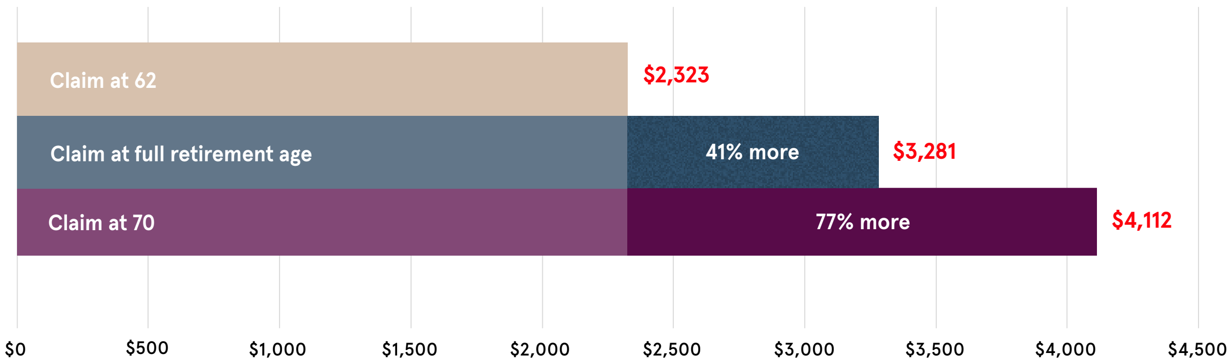
[7] Secure Retirement Institute, The Retirement Income Reference Book, Fourth Edition, 2018.

[8] The Decision Lab, "Why we tend to rely heavily upon the first piece of information we receive," 2022.

To illustrate this, consider that the most common age for claiming Social Security is 62. Why would the number 62 be prominent in the minds of many retirees? Chances are because it is often the first number they see when evaluating different Social Security claiming ages and also typically the number most people talk about first. In essence, 62 becomes the "anchor."

Claiming at 62 reduces monthly benefits

Social Security monthly benefit payouts at different claiming ages



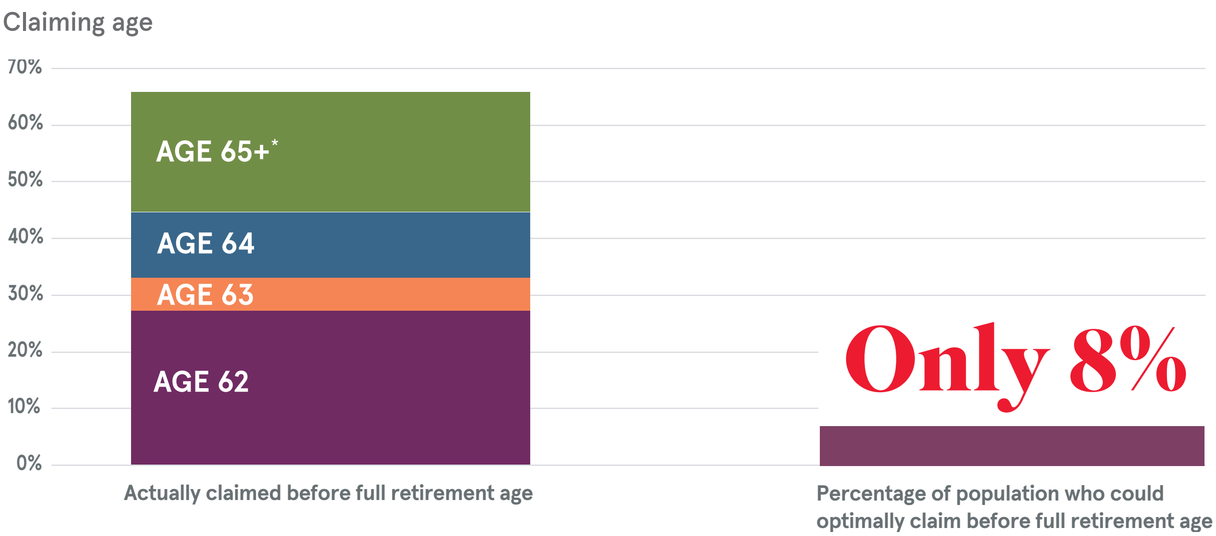
Assumes average earnings of maximum taxable amount, claiming at age 62 in 2021 (FRA 66 years, 10 months).

Sources: Social Security Comparison, Maximum Taxable Benefit Examples. SSA, "Effect of Early or Delayed Retirement on Retirement Benefits." SSA, "Workers with Maximum-Taxable Earnings."

And, although it is obvious to most people that there are significant financial advantages for retirees to claim benefits at full retirement age or later, data indicates a majority of those eligible claim them before their full retirement age.[9]

Even more unsettling than the number of retirees claiming Social Security early is the small percentage of those who would optimally benefit from doing so. When considering the actual mortality data, the portion of the population optimally served by claiming before their full retirement age is only 8%.[10]

More people claim Social Security earlier than they "should"



Source: National Bureau of Economic Research and United Income.

United Income, "The Retirement Solution Hiding in Plain Sight: How Much Retirees Would Gain by Improving Social Security Decisions," 2019.

* Until full Social Security claiming age.

9 National Bureau of Economic Research, "Social Security Claiming Decisions: Survey Evidence," August 2017.

10 United Income, "The Retirement Solution Hiding in Plain Sight: How Much Retirees Would Gain by Improving Social Security Decisions," 2019.

Though some retirees may claim benefits early simply out of financial need, it is evident that the anchoring effect is real and can be detrimental to the long-term financial plans of many who claim Social Security.

Another example of anchoring bias as it relates to retirement nest eggs occurs when employees invest the majority of their retirement savings in shares of the company where they work. This happens because employees feel they know their company better than competitors, and they perceive it as a safer investment. However, this "moral anchoring" can lead employees to take on too much risk, and they could lose their savings if something goes wrong with the company.

Financial professionals may be able to help investors overcome the influence of anchoring bias by:

- **Making clients aware of the bias** and how it works. When investors recognize the traps the mind can fall into, they can better anticipate and counter the effects.
- **Helping clients pause before making important financial decisions.** This can afford them the time necessary to conduct proper research, so their decisions are better informed.

3. Mental accounting

Behavioral economist and Nobel Prize winner Richard Thaler introduced the mental accounting bias in 1999. He explained the concept this way:

"Mental accounting is the set of cognitive operations used by individuals and households to organize, evaluate, and keep track of financial activities."[11]

In essence, people often make decisions to mentally place their assets in "buckets" for specific purposes, rather than just having one pile of money. For example, they may have buckets designed to hold money for:

- **Everyday expenses,** like a mortgage payment, groceries, and entertainment
- **Unforeseen expenses,** like a job change or high medical expenses
- **Future expenses,** like college or retirement

This is an example of how mental accounting can sometimes be a beneficial behavior. These buckets may live in different accounts or they may be purely mental constructs, such as when a person likes to keep a minimum balance in their checking account as a buffer against unforeseen expenses. After all, sound planning for meeting different financial needs is simply smart.

But mental accounting can also have a negative effect. Consider for instance people who dutifully contribute money every month to a low-interest-bearing savings account while at the same time racking up a large credit card balance and making monthly payments at a high interest rate. This can negatively affect financial security in retirement and is noteworthy because, of the three-fourths of retirees who carry debt, 67% have credit card debt.[12]

Rationally, having money in an account that earns a near 0% rate of return and continuing to carry high-interest debt on a credit card is an unsound proposition. However, the phenomenon—often attributable to mental accounting—is an all-too-common retirement blind spot.

The influence of mental accounting can also appear in how retirees view and use the money they have saved in their individual retirement accounts. After leaving the workforce, many investors use the same mental accounting schemes they used during their careers—one of which is spending income and preserving assets. Consequently, many retirees spend far less in retirement than their assets could reasonably support, which needlessly constrains their lifestyle.

[11] Wiley Online Library, "Behavioral Decision Making, Mental Accounting Matters," July 19, 1999.

[12] Clever, State of Retirement Finances: 2022 Edition, March 14, 2022.

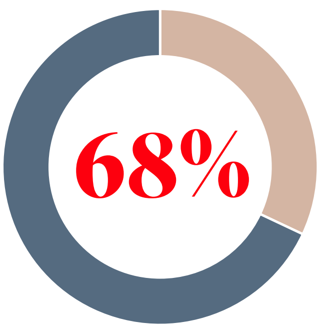
An IRA is an account clearly meant for use in retirement—its intended purpose is embedded in the name. And as discussed earlier, most people retire before the age of 73† when they must begin taking required minimum distributions. Interestingly though, less than one-quarter of IRA owners ages 71 or older were found to withdraw an amount from their traditional IRA in excess of their RMD.[13]

This is counter to the mindset behind most retirement plans created by financial professionals, who generally assume the retiree will be willing to make withdrawals from their retirement accounts. This doesn't seem to be happening in reality.

Sixty-eight percent of retirees take only the minimum amount required. Moreover, just 21% express confidence about drawing down the assets in their retirement plan.[14]

"Retirees may miss out on the full and rich life they dreamed of by not spending the money they worked hard to accumulate. A financial adviser can help retirees develop a strategy to withdraw their assets effectively so they don't outlive their money"[15]

—Marcy Keckler, Ameriprise Financial



68% of IRA owners take only their required minimum distributions

Source: Planadviser, "Most Retirees Only Withdrawing Required Minimum Distribution," June 21, 2018.

This propensity to preserve one's IRA money reveals how many retirees believe savings should be used. They have "bucketed" their IRA savings to be preserved, not spent; and that is mental accounting at work.

The underspending phenomenon extends to the very wealthy, as well. In fact, LIMRA research shows that 42% of retirees with $2 million or more in assets spend less than $100,000 per year.[16]

Broader industry research tells us that retirees relying solely on income puts big constraints on how they spend. And while most could spend more, they don't, as EBRI determined.

"People spend money that comes as regular income flow, such as pension or Social Security income, and try to preserve their assets for uncertainties or bequests."[17]

—Employee Benefits Research Institute

† The SECURE 2.0 Act changed the required beginning date for RMDs to age 73 for individuals attaining age 72 after December 31, 2022, and age 73 before January 1, 2033. Custodians are awaiting clarification, but SECURE 2.0 also appears to indicate that the required beginning date for RMD age is pushed back to 75 effective after December 31, 2032.

[13] EBRI, EBRI IRA Database: IRA Balances, Contributions, Rollovers, Withdrawals, and Asset Allocation, 2016 Update.

[14] PlanAdvisor, "Most Retirees Only Withdrawing Required Minimum Distribution," June 21, 2018.

[15] Ibid.

[16] Secure Retirement Institute, The Retirement Income Reference Book, Fourth Edition, 2018.

[17] EBRI, "Asset Decumulation or Asset Preservation? What Guides Retirement Spending?" April 3, 2018.

A closer look at the "uncertainties and bequests" that retirees identify as primary reasons for preserving assets may be ill-founded.

- A study conducted by BlackRock among people ages 68 to 80 with investible assets of at least $200,000 showed that only 18% consider it important to leave a bequest, and 73% say their bequest will be whatever remains at their time of death.[18]

- And, as for retiree concerns about preserving assets for uncertainties like acute and long-term medical care, the same study found that out-of-pocket medical expenses late in life—a reason many retirees retain assets—only affect a small portion of the population. The study notes that someone facing such an acute medical situation later in life would likely not be spending their income from Social Security, pensions, and investments on much else, lessening the need to dip deeply into retirement assets.[19]

The chart below shows the vast majority of retirees with assets of $120,000 could afford to set aside 40%—or $48,000—of their nest egg at retirement for emergencies or legacy planning and another 40% for living expenses. Even with an additional 20% pay raise—$24,000—they would have sufficient money to cover medical spending late in retirement. This assumes a conservative net return on the emergency fund of just 2% per year and is based on typical out-of-pocket medical expenses late in life.[20]

Out-of-pocket medical expenses late in life

Lifespan	Median	Extreme	Emergency fund
70-74	$323	$25,748	$52,996
75-79	$308	$25,528	$58,512
80-84	$308	$31,829	$64,602
85-89	$501	$55,045	$71,325
90-94	$746	$67,106	$78,749
95+	$433	$85,584	$86,945

Source: BlackRock, "Spending retirement assets ... or not?" 2017.
Emergency fund assumes 2% net rate of return annualized on $48,000.
Financial Planning Association, "Spending in Retirement: Determining the Consumption Gap," February 2016.

Although mental accounting is ingrained in our spending decisions, financial professionals can help investors mitigate its negative aspects.

- **Helping clients assign accounts a new name.** By categorizing retirement dollars by purpose rather than lumping them together in a catch-all retirement bucket, it may make it easier for clients to spend the money. For example, a 401(k) may be categorized for spending on groceries and utilities after age 65. Similarly, a Roth IRA might be reserved for "housing expenses after downsizing primary residence." These types of labels make it easier for money to flow from the future-income bucket to the current-income bucket.

- **Build portfolios that automate income and cash flow** rather than just accumulate assets. This will likely lead to different investment choices and perhaps even incorporating insurance products specifically created to produce predictable income that can't be outlived. This is addressed in more detail below.

[18] BlackRock, "Spending retirement assets ... or not?" 2017.

[19] Ibid.

[20] Financial Planning Association, "Spending in Retirement: Determining the Consumption Gap," February 2016.

BEATING THE BIASES

Simply recognizing how mental obstacles influence perspectives on the use of money in retirement is an important starting point for financial professionals to help investors view savings in a different light.

Let's briefly review the three biases we covered and their potential negative impacts.

- **Planning fallacy** may cause investors to make overly optimistic plans that are hard to adapt to when events don't occur as anticipated.
- **Anchoring bias** can lock retirees into a picture of retirement that isn't necessarily one that creates long-lasting fulfillment.
- **Mental accounting** locks our money away in accounts when it could be put to better use by spending in a manner that brings us real joy and fulfillment.

Biases like these can represent a sizeable mountain to summit. The good news is financial professionals already have a playbook for how to navigate many of these obstacles, and it begins with automation.

SOLUTIONS FOR EFFECTIVE RETIREMENT SPENDING

The power of automation

Investors have long enjoyed the benefits of automation to help them save more efficiently and systematically for retirement. Many 401(k) plans reflect the best thinking of leading behavioral economists and automate much of the saving process. Just consider:

- Employees are often automatically enrolled in their workplace retirement savings plans, and then their contributions are usually automatically increased a certain percentage each year.
- Once enrolled, participants generally select from prebuilt investment models that automate the process of allocating their assets.

Despite automation's proven benefits on the retirement-saving side, when it comes to how retirees spend in retirement, it is almost nonexistent.

Automation in saving years (401k)
Automatic enrollment
Automatically escalated contributions
Default investment options

Automation in retirement years
?

At the same time, fewer retirees today enjoy the automated income of a pension, and for many affluent retirees, Social Security payments replace only a small fraction of the income they enjoyed in their working years.

The dearth of automated programs in retirement is understandable when considering how challenging it is for retirees—or anyone for that matter—to forecast the future. In the words of economist Richard Thaler, who won the Nobel Prize in economic sciences for his contributions to the field of behavior economics:

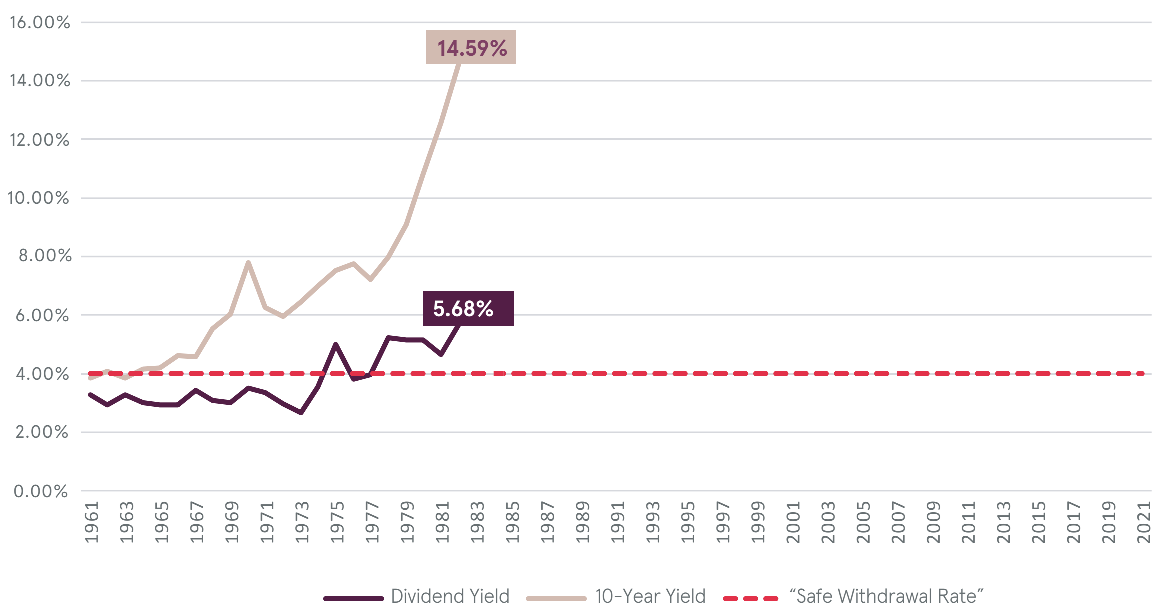
"You don't know how long you're going to live. You don't know how long your spouse is going to live. You don't know what the markets are going to do. For the mathematicians, this is ... a problem that is pretty hard. And it is ridiculous to think that any human can solve that. What [retirees] want is to be on an allowance."[21]

In other words, retirees want a regularly scheduled, reliable program that makes it simpler to spend their savings without worry. They want to be on autopilot while ensuring their wants and needs are met. Once upon a time, this was a fairly easy request.

In the early '80s, when many retirees had pensions, the landscape for retirement income was completely different. Those who relied on their own savings could comfortably plan to live off the income produced by their assets since 10-year bonds issued by the U.S. government were yielding roughly 14% and the dividend yield on the S&P 500 was more than 5%. Retirees could leave their principal intact and rely on income from their savings to produce a cash flow robust enough to fund a comfortable lifestyle.

Building an income portfolio is harder now

Stock and bond yields 1961–1982



Source: Adapted from Robert Shiller, Princeton University, Irrational Exuberance, U.S. Stock Markets 1871-Present and CAPE Ratio.

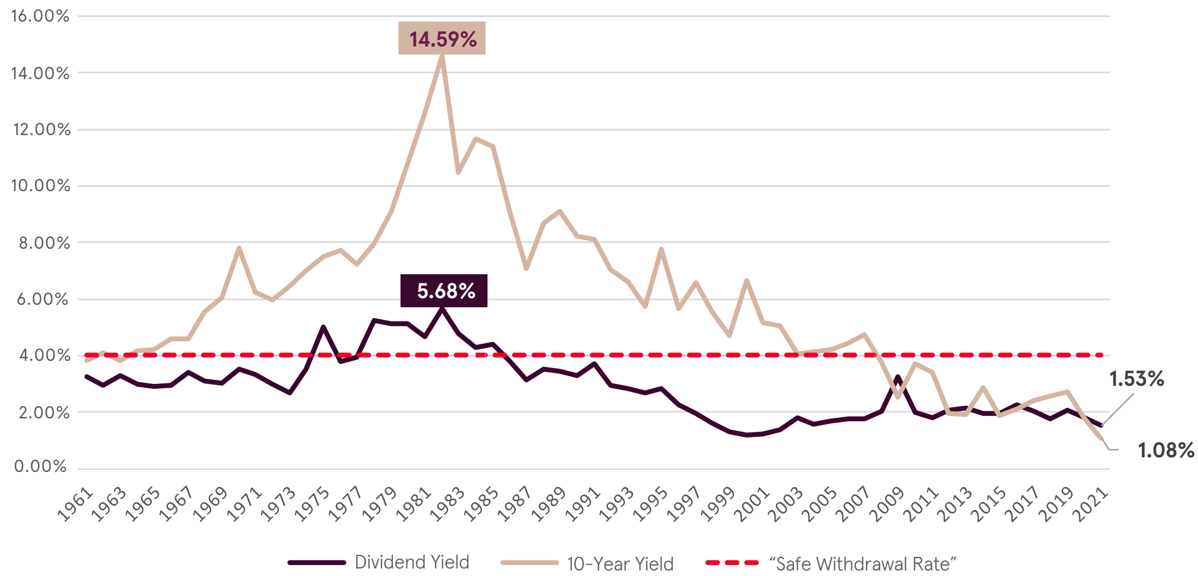
But things have changed.

Traditional sources of investment income—dividends from equity investments and interest from bond investments—have remained at the lowest levels we have seen in 60 years. Ultimately, mental accounting influences retirees to live off income, but that income doesn't generally create enough cash flow to meaningfully impact their retirement budget if they rely on traditional investments under current market conditions.

[21] Video "Behavioral Insights: Addressing Retirement Challenges," January 29, 2020.

Building an income portfolio is harder now

Stock and bond yields 1961–2021



Source: Adapted from Robert Shiller, Princeton University, Irrational Exuberance, U.S. Stock Markets 1871-Present and CAPE Ratio.

INCOME SOLUTIONS

Broad research confirms retirees are committed to living off their income and not their savings. This defies the fundamental belief that retirees should "spend down" their retirement savings and do so in a manner where they will have enough money to live comfortably throughout retirement. Instead, retirees continue to overzealously guard their savings.

Financial professionals have a unique opportunity to help retirees invest effectively to support reliable income and provide new strategies that can help ensure this income remains consistent. Social Security is obviously one source that helps accomplish this, and retirees who have a pension are fortunate to have two sources.

Annuities, which may include products designed to provide guaranteed* income for life, can serve as the third leg of the stool in helping meet the needs of retirees. Not only can the right annuity provide a sense of protection and a guaranteed* source of lifetime income, but it can also help address the decumulation challenges that affect the majority of the most recent generation of retirees.[22] It's interesting to note that recent research by Athene found that among those saving for retirement, 75% of annuity owners feel they are on track to reach their retirement savings goals, which marks a 26% increase over the larger population of Americans saving for retirement.[23]

What are annuities?

Annuities are long-term, tax-deferred vehicles designed for retirement. Variable annuities involve investment risks and may lose value. Earnings are taxable as ordinary income when distributed. Individuals may be subject to a 10% additional tax for withdrawals before age 59½ unless an exception to the tax is met.

Add-on benefits that provide income for the length of the designated life and/or lives may be available for an additional charge.

* Guarantees are backed by the claims-paying ability of the issuing insurance company.

[22] BlackRock, "Decumulation challenges and potential solutions," 2022.

[23] Yahoo, "Annuity Ownership Drives Retirement Savings Confidence, Athene Finds," June 6, 2022.

AVOIDING THE BLIND SPOTS

For decades, investors have been encouraged to invest strategically with a long-term perspective and a goal of saving adequately for retirement. One could say they were programmed to follow a universal concept focused on saving.

However, little guidance was provided over their earning years on how they should plan to spend their savings once they retired. So, it shouldn't be surprising that a savings mindset developed over a lifetime of work would be difficult to shed in retirement. After all, for most investors, saving is all they have been taught.

As trusted financial professionals armed with the expertise to help clients avoid their retirement blind spots and the resources to support their evolving needs for retirement income, financial professionals can provide their clients with the guidance they need to address their retirement concerns and achieve favorable retirement outcomes.

Financial professionals, your Jackson team can provide you with more information on how to help your clients discover their retirement blind spots.

For investors, talk to your financial professional about how to identify and address your retirement blind spots.

Before investing, investors should carefully consider the investment objectives, risks, charges, and expenses of the variable product and its underlying investment options. The current contract prospectus and underlying fund prospectuses provide this and other important information. Please contact your financial professional to obtain the prospectuses. Please read the prospectuses carefully before investing or sending money.

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