Center for Financial Security Family Financial Security Webinar Series

April 25, 2012

Retirement Rules of Thumb

This webinar is part of MoneySmart Week® Wisconsin

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DEPARTMENT OF
Economics
UNIVERSITY OF WISCONSIN–MADISON

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CFS Webinar, April 25, 2012

Economics matters

A fundamental challenge that people face is to figure out the right amount to save for retirement. This is not an easy question, since it depends on…

- How long will you live?
- How much will you spend?
- What rate of return will you receive on your assets?
- How much will prices rise?
- What is the trajectory of future health and associated health expenses?

While determining the right amount of retirement wealth is a fundamentally difficult question, many are convinced that Americans are doing an awful job with it.

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Current Practice: Rules and Tools

Most people turn, I think, to rules of thumb or on-line calculators.

- A workhorse concept for both approaches is the "replacement rate."
- A common idea is that households should be able to "replace" 75 to 90 percent of pre-retirement income in retirement to be comfortable.

There are a number of on-line financial tools, including ones from Fidelity, AARP, CNN Money and many others.

- The saving goals will naturally be affected by pre-retirement income, and income from Social Security and pensions.
- The calculators will also make additional implicit assumptions and seek additional external information.

The results can nevertheless leave people scratching their heads.

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Consider “Melissa” and Her On-Line Experience

Here’s a little bit about Melissa (her circumstances are simple)

- She is single and 53 in 2012, with an annual income of $55,000.
- She plans to retire at age 65 and has a planning horizon to 87.
- Melissa is thorough, so she uses two calculators

Calculator	Target RR	Goal (in 2024$)
Fidelity	Default: 85%	$881,000
CNN Money	Default: 70%	$420,094
CNN Money	85%	$610,260

- **This is darn confusing.**

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Are Rules of Thumb More Promising?

There are plenty of rules of thumb

- Net Worth should equal your age times pre-tax income divided by 10.
- Savings goal = (expected spending in your 1st retirement year) * 25.
- Save 20 times your gross annual income.
- Save 10% (or pre-tax income) for basics, 15% for comfort, 20% to escape.
- Save half of all raises in your life.

I can say two nice things about these: they are simple, and they get people thinking about saving (as do the retirement calculators).

- There is little solid conceptual grounding for these rules of thumb, however.

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The Underpinnings of a Better Way

The life-cycle model (accounting for uncertain earnings, lifespan, and health) provides a natural benchmark.

- The jargon: to maximize one's lifetime well-being given available resources, households should equate the discounted marginal utility of consumption each period.

- The intuition: smooth the satisfaction you get from your last bit of consumption each period.

Given lifetime resources and preferences, the lifecycle model's consumption choices will maximize appropriately discounted lifetime well-being.

We examine the implications of the life-cycle model, household-by-household, using data from the Health and Retirement Study, linked to data from the Social Security Administration on lifetime earnings.

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More on Our Approach

We model the tax, transfer, and social security systems, people get married and have children as they do in practice, and they face uncertain earnings, health and longevity.

We calculate optimal consumption rules for households. We then observe the earnings that households actually receive, based on their SS records.

- We then compare their actual wealth (observed in the data) with their optimal wealth, as determined by the model.

We can be agnostic about whether people actually make the dynamic programming calculations that underlie our model solutions.

- The model provides a *normative* ideal. Put differently, if our modeling assumptions are correct, we know precisely how much each household should save and consume each period to maximize their lifetime well-being, given their incomes, marriage and fertility profiles.

- In short, we create sophisticated financial planning software for HRS households that allows us to ask: is the household on track for maintaining their living standards in retirement?

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Preliminary Results for 2008

An earlier paper of ours examines households with an adult born between 1931-41.

- We found 84 percent of households had accumulated more than their optimal wealth target in 1992.

- Of those who saved less than their optimal target, the median shortfall was only $5,300.

An important question is whether the earlier results apply to other cohorts.

- We now study a set of households representative of all Americans born before 1954 (and we have made many other improvements to our approach).

Our preliminary results paint a somewhat less optimistic picture, but nevertheless are in contrast to the conventional wisdom that most Americans are doing a poor job preparing for retirement.

Our 2008 Results: Tabular Version

Optimal and Actual Net Worth (excluding social security and DB pensions) and Percentage Failing to Meet Their Optimal Targets by Cohort						
Cohort	Median Optimal Wealth Target	Median Actual Wealth	Mean Optimal Wealth Target	Mean Actual Wealth	Percentage Below Optimal Target	Median Conditional Deficit
AHEAD (n=1,773)	$54,416	$144,915	$212,083	$400,636	34.7	$18,828
CODA (1,719)	86,008	227,299	302,123	580,852	32.2	24,160
HRS (4,240)	79,264	199,115	301,479	596,816	33.8	22,053
War Babies (1.323)	89,903	211,799	299,908	629,944	33.5	34,744
Early Boomers (1,743)	64,156	139,076	230,544	404,265	37.1	24,307
Full (10,798)	75,095	186,744	275,095	535,040	34.2	23,642

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The Numerical Results Are Consistent With Qualitative Responses

Subjective Views of Retirement Well-Being, HRS Cohorts, 2008

	How satisfying is retirement?			Retirement years compared to before?		
	Very	**Moderately**	**Not at all**	**Better**	**Same**	**Worse**
AHEAD (avg. age 92)	59 percent	37 percent	4 percent	32 percent	55 percent	13 percent
CODA (81)	55	40	5	36	45	19
HRS (72)	54	38	8	45	39	16
War Babies (64)	54	36	10	57	29	13
Early Boomers (58)	32	43	25	53	18	29
Overall (75)	54	38	8	47	36	17

Note: 8,230 respondents answered the “how satisfying” question, 1,808 answered the other.

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Where Do We Go From Here?

Most Americans are on track for financially secure retirements.

- There are nevertheless trouble spots, particularly among the economically disadvantaged.

- We continue to refine our model, most recently modeling health and health investments.

Our longer-run objective is to develop rules of thumb that more closely mirror optimal behavior for households in specific circumstances.

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What Do I Tell People Now?

You likely are in better shape than you think.

- Many calculators give inappropriately high levels of target wealth. They typically fail to account sensibly for children.

How much do you need?

- Track expenses to determine how much you need to live comfortably.
- Put yourself on a budget.
- Test yourself – live on the budget for several months.
- How much wealth needed to support this budget over your expected lifetime (with life tables, this is a straightforward present value calculation).

For those damaged by financial market mishaps (or a late start): there are no easy solutions.

- Work longer?
- Spend less in retirement?
- Save more if still in the labor market?

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Thank You!

- Nicole Truog for her work with CFS and the webinars
- My friends and colleagues at the Center for Financial Security
- Other panel participants, and
- My frequent collaborator and friend, Ananth Seshadri.
- **And all those participating in the Webinar.**

Discussant

Brian Bullock

AARP Financial Security Team

Helping People 50+ Make the Most of Their Lives…

Financial Security – Education & Outreach
April, 2012

Advancing Social Impact

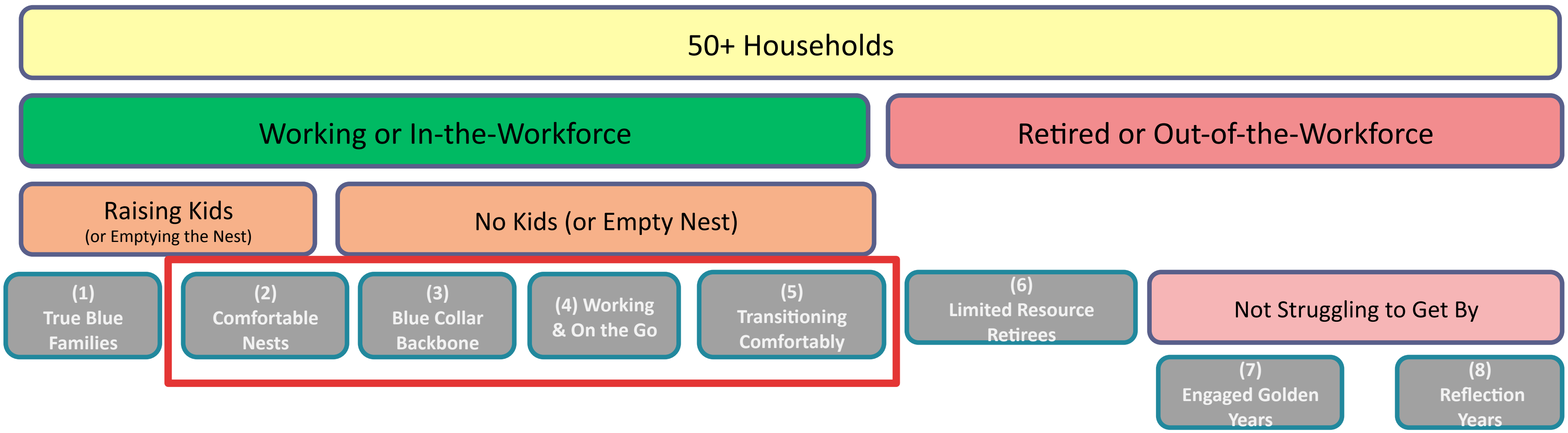
- Driving **behavioral change** by providing consumers and professional audiences information and guidance for informed decision-making and **self-advocacy**
- Developing **culturally appropriate** strategies and messaging that reflects key needs and interests
- Leading the Association with **best-in-class outreach and educational resources**
- Personalizing campaign issues by encouraging our members and others to **tell their stories**

Our Challenge

How does AARP increase impact (behavior change) and relevance among 50+ consumers through financial education and engagement?

1. Define Target Audience

Life Stage Segments



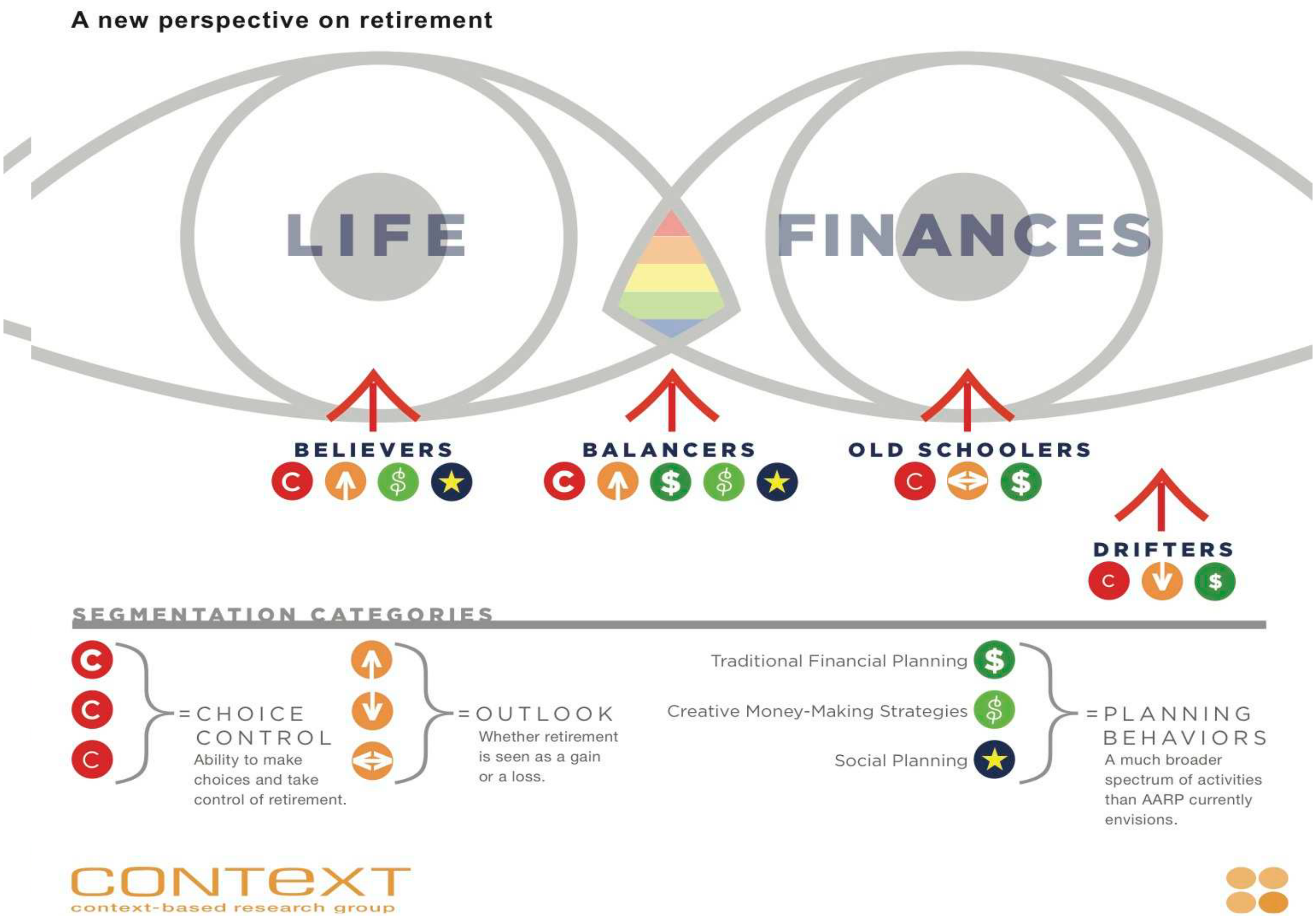
2. Narrowing the Scope

- Commissioned academic research to define the critical financial decision in retirement
- Tony Webb of Boston College (Center for Retirement Research) uncovered three key financial decisions in retirement:
  - When should consumers claim Social Security?
  - How should consumers produce income from retirement assets? (e.g., annuitizing assets, optimal asset allocation, appropriate withdrawal rates)
  - Should consumers repay any outstanding mortgage debt or take a reverse mortgage?

3. Know Your Target

- E&O (in collaboration with RSA) engaged Context-based Research Group to conduct ethnographic research that informs the positioning of our financial educational resources with middle-income consumers approaching retirement (58-62).
- 29 Participants: Miami/Fort Lauderdale, Baltimore, Denver
- Send-ahead Storybook Exercises
- Ethnographic Field Visit
    - 3 Hours per Participant, Video and Photo Documented
    - Debrief of Send-Ahead Exercises
    - One-on-One Interview
    - Retirement Inventory
    - Online Inventory and AARP website Tour

3. Know Your Target



4. Develop Program & Products

READY

FOR RETIREMENT?

Tools to Achieve Peace of Mind

4. Develop Program & Products

4. Develop Program & Products

AARP SOCIAL SECURITY BENEFITS CALCULATOR

This calculator can help estimate your Social Security benefits and show you when is the best time to claim Social Security.

Bookmark | Share | Email | Recommend (0) | Tweet 0 Like

Overview | Personalize | When to claim

powered by LifeTuner

It pays to wait

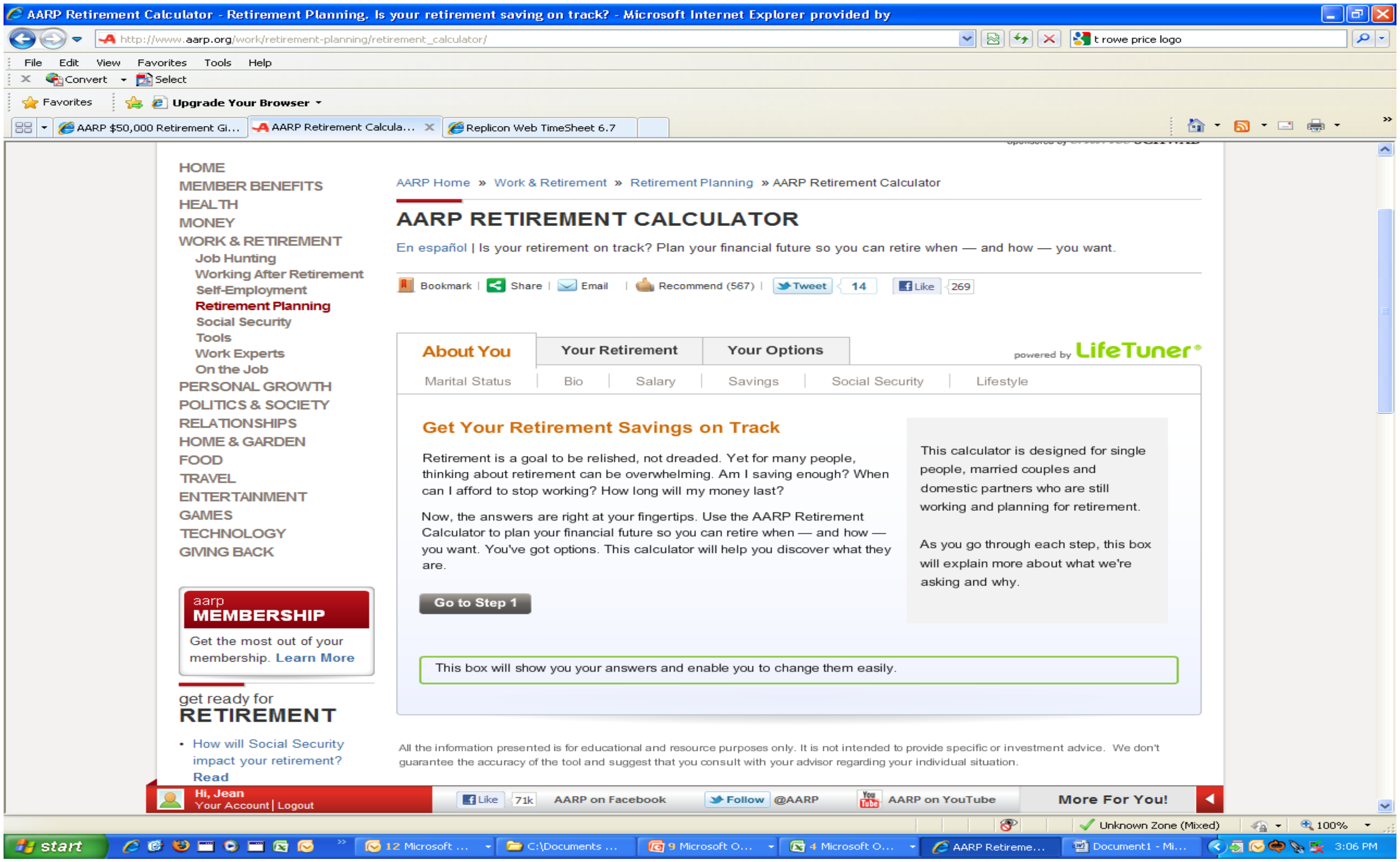
After you claim Social Security, you will receive a monthly check for the rest of your life. But how big that check is depends on how much you've paid into the system and when you start taking it.

The longer you are able to wait, the higher your monthly benefits will be. This guide will show you why most people should wait as long as possible to claim Social Security — and why a few people should claim earlier.

Tell us some basic information about your situation, and we'll tailor this guide for you.

Personalize this guide

4. Develop Program & Products



5. Define Target Metrics

The key measure of success for this outcome is the number of engagements with targeted AARP personal retirement resources.

- 3.4 million engagements with targeted AARP personal retirement tools, including 60,000 engagements targeted uniquely to 50+ African Americans/Blacks and Hispanics/Latinos.

6. Coordinate Promotion

Outcome 6a Campaign Tactical Work Plan (by channel)

Channel	Tactic	Owner	Contrib	Budget	Proj Qty	Actual Qty	Segment(s)	Proj RR	Act RR	Projected Engagements	Actual Engagements	Actual MME Engagements	Balance
EMAIL	Ready for Retirement: Retirement Calculator	E&O	MEM	$3,850	3,000,000	2,352,149	2,3,4,5	1.0%	12.2%	30,000	252,094	33,829	255,923
	Ready for Retirement: SS + Couples Webinar Invitation/SS Benefits Calculator (webinar week of 10/3)	E&O	MEM	$1,925	1,500,000	1,389,542	2,3,4,5 60+			6,000	8,248	653	2,901
	Financial Freedom Webinar Invitation AA/HL (Sept 14 webinar)	E&O	MEM	$1,100	300,000	281,958	1-5 AA, HL	1.0%	0.7%	3,000	0	2,054	(946)
	Ready for Retirement: Cut Costs Boost Savings Webinar (Oct 25)	E&O	MEM	$3,850	3,000,000		2,3,4,5			2,000	4,411	215	2,626
	Ready for Retirement: 401(k) Fee Calc/401(k) Fee Savings Calc	E&O	MEM	$3,850	2,000,000		2,3,4,5	2.0%		40,000			
	Ready for Retirement: E&O Retirement Sweeps	E&O	MEM	$3,130	2,400,000		2,4,5	2.0%		48,000			
	Ready for Retirement: 10 Steps to Retirement	E&O	MEM	$3,850	3,000,000		2,3,4,5	2.0%		60,000			
	SUBTOTAL			***$21,555***	***15,200,000***					***189,000***	***264,753***	***36,751***	***112,504***
WEBINARS	Social Security FAQ Webinar (Feb 2011)	E&O	MEM		2,000,000						1,974		
	Ten Steps to Retirement Webinar (Feb 2011)	E&O	MEM		2,000,000						2,218		
	Cost Savings Webinar (March 2011)	E&O	MEM		1,000,000						2,127		
	Social Security FAQ Family Webinar (March 2011)	E&O	MEM		1,000,000						3,928		
	Social Security FAQ Webinar (April 2011)	E&O	MEM		1,000,000						4,756		
	Ten Steps to Retirement Webinar (May 2011)	E&O	MEM		500,000						808		
	Cost Savings Webinar (June 2011)	E&O	MEM		1,500,000						623		
	Q2 SS and Couples Webinar--June (registrations + eng)	E&O	MEM		2,000,000		2,3,4,5			6,000	8,873		2,873
	SS Decision to Claim/Benefit Calc Webinar (regist + eng)	E&O	MEM				2,3,4,5			6,000	12,777		6,777
	Financial Freedom Webinar (Additional Engagements: add'l eng	E&O	MEM				1,3			450			
	SS and Couples Webinar (Additional Engagements: add'l eng)	E&O	MEM				2,3,4,5			4,000			
	Cost Savings Webinar (tie in to Savings Challenge) (add'l eng)	E&O	MEM				2,3,4,5			600			
	SUBTOTAL			***$0***	***11,000,000***					***17,050***	***38,084***	***0***	***21,034***
ONLINE	AARP Tips (Retire Calc, Benefits Calc, 401(k) Fee Calc, 10 Steps)	E&O	DSO				ALL			2,000	1,070		
	Webletter (SS Benefits Calc/Webinar + Sweeps)	E&O	DSO		11,400,000		subscrip	4.5%	0.2%	513,000	22,074		
	Financial Freedom Banner Ads (External Sites)	E&O	Brand	$73,859	10,721,000			0.1%		41,586		70,000	
	Ready for Retirement Banner Ads (External Sites)	E&O	Brand	$245,500						140,000	25,817		
	Paid Search (All Tools)	E&O	DSO		8,100,000		N/A	1.3%		109,000			
	Banner Ads (DSO)	E&O	DSO	$75,000						75,000			
	Money Newsletter (Retire Calc, Sweeps, 10 Steps, etc)	E&O	DSO		540,000		subscrip	10.0%		54,000	4,123		
	E&O Retirement Sweeps (Registrations, Add'l Clicks/Tool Usage)	E&O	DSO							75,000			
	SUBTOTAL			***$394,359***	***30,799,000***					***1,017,186***	***53,084***	***70,000***	***(894,102)***
EARNED MEDIA	Social Security Benefits Calculator Press Release	IC	E&O	$750	10,000,000		ALL	0.1%					
	Social Security Benefits Calculator Press Release (Spanish)	IC	E&O	$750	3,000,000		ALL	0.1%					
	Yahoo Story on Social Security (Benefits Calculator)												
	SUBTOTAL			***$1,500***	***13,000,000***					***0***	***0***		
SOCIAL MEDIA	Facebook (Tied to PR, Webinars, Sweeps/Challenges)	E&O	DSO				ALL			300	105		
	Twitter (Tied to PR, Webinars, Sweeps/Challenges)	E&O	DSO				ALL			50	366		
	Online Community (Tied to PR, Webinars, Sweeps/Challenges)	E&O	DSO				ALL			5			
	SUBTOTAL			***0***	***0***					***355***	***471***		***116***
MEMBERSHIP	Life@50+ Digital Experience	E&O	Events							1,000			
	Member Benefit Channel .org (tied to Retirement Sweeps)	E&O	MEM							1,000			
	New Member Welcome Email	MEM											
	Preference Webletter	MEM	E&O							100			
	SUBTOTAL			***0***	***0***					***2,100***			
MEM COMM	SS Response Program: Member Communication (Email)	E&O	MEM							5,000			
	SS Response Program: Member Communication (Phone)	E&O	Call Ctr							5,000			
	SUBTOTAL			***$0***	***0***					***10,000***	***0***		
OTHER	Link to Tools in Pubs Editorial (where applicable)	Pubs	E&O		23,500,000		ALL	0.02%		4,700			
	DSO Retirement Sweep Emails	DSO	MEM		4,000,000			1.50%		60,000			
	Direct Mail Promoting Sweeps, RC, SSBC	E&O	MEM		400,000			1.00%		4,000			
	State Outreach (various channels and vehicles--some MME eng)	States	E&O				2,3,4,5			30,000			
	Q3-Q4 PROJECTED			**$417,414**	**97,499,000**					**698,636**			
	YTD TOTALS (includes PVs and clicks/calls, webinars, etc)									**1,294,777**	**356,392**	**106,751**	**1,757,920**
	TOTAL YTD + PROJECTED									**2,456,556**			
	Email creative: design, copy, coding			$25,000									
	DM creative costs			$16,000									
	Agency banner ad production costs			$8,000									
	Total Agency Costs			***$49,000***									
	GRAND TOTAL			**$466,414**	**97,499,000**					**2,456,556**	**1,757,920**		**(698,636)**

Tactic	3rd Quarter: 11-Jul	18-Jul	25-Jul	1-Aug	8-Aug	15-Aug	22-Aug	29-Aug	5-Sep	12-Sep	19-Sep	26-Sep	4th Quarter: 3-Oct	10-Oct	17-Oct	24-Oct	31-Oct	7-Nov	14-Nov	21-Nov	5-Dec	12-Dec
AARP Tips (Retire Calc, Benefits Calc, 401(k) Fee Calc, 10 Steps)								R Calc				SSBC						401k fee			10 Steps	
Webletter (SS Benefits Calc/Webinar + Sweeps)												SSBC			Advisor					Sweeps		
Money Newsletter (Retire Calc, Sweeps, 10 Steps, etc)					10 Steps					R Calc				Advisor				Sweeps				10 Steps
Facebook (Tied to PR, Webinars, Sweeps/Challenges)												SS web			Costs			sweep				
Twitter (Tied to PR, Webinars, Sweeps/Challenges)												SS web						sweep				
Online Community (Tied to PR, Webinars, Sweeps/Challenges)																		sweep				

7. Track Results

	2011 Results
Retirement Calculator	812,412
Social Security Benefits Calculator	679,386
Ready for Retirement	202,782
Retirement Sweepstakes	260,000
Webinar Engagements	41,028
Multicultural Engagements	207,333
	2,202,941

**Excludes state engagements, promotional engagements and page views

Discussant

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Senior Vice President – Client Services

Francis Investment Counsel LLC

Center for Financial Security Webinar Series: Retirement Rules of Thumb

Retirement Readiness: Perspectives from the Trenches

April 25, 2012

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Retirement Readiness:
Perspectives from the Trenches

1. **People want to retire sooner rather than later**

2. **Rules of thumb serve as planning tools, but….**

3. **Workers ultimately retire when they want to, not when they achieve some planning benchmark**

4. **How can we help them?**

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1 People Want to Retire Sooner Rather Than Later

- Most commonly stated retirement goal?

"I want to retire when I'm eligible for Social Security."

- Despite some research, workers yearn for "life after work"
- Workers often indicate willingness to work part-time…. although some state they've regretted it!
- What stops them? It's all about health care, not recent market declines.

2 Rules of Thumb Serve as Helpful Tools But…

Wage replacement ratios:

- Many think they can live on less than standard rule of 70-80% of income

"Look at all these expenses that go away in retirement!"

- Most workers are not on track to achieve this level of wage replacement, families that are pension eligible are generally in better shape

- Clearly, a better WRR is needed

- Workplace retirement plans are beginning to quantify plan success with this metric

2 Rules of Thumb Serve as Helpful Tools But…

Withdrawal rates:

- At a 4% withdrawal, your money lasts 30 years
- At a 5% withdrawal, your money lasts 25 years

"No way I'm living until I am 95!"

- These rules allow for an annual increase in income to keep pace with inflation – is that reasonable?

- Perhaps a two-tiered income approach would be better: "active" and "quiet" retirement years

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3 Workers Retire When The Math Works

- In the end, it’s all about the retirement budget

- Math gets easier if:
  - Worker waits to take Social Security
  - Worker is eligible for Medicare
  - Retiree health insurance is available
  - The house is paid off

“As long as I can get Medicare I can make ends meet.”

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4 So How We Can Help Workers Prepare?

- **Policymakers: understand that Medicare eligibility is key driver for**
- **Industry: provide workers meaningful advice**
  - **Advice vs. education**
  - **Online vs. face-to-face**

Does Advice Help?

- According to several Francis Investment Counsel studies advised participants enjoyed over a 2% greater annualized rate of return over the time period studied

- According to a recent study by Aon (Hewitt) referenced in the Wall Street Journal, advised participants earned 2.9% greater return over five years ending 12/31/10.

Aon study referenced by Anne Tergensen (Encore Blog, SmartMoney.com) in the October 2, 2011 edition of the Wall Street Journal

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Q&A

May Webinar

Tuesday, May 8th
1pm – 2pm CDT / 2pm – 3pm EDT

Wisconsin Poverty Measure

Timothy Smeeding
Director, Institute for Research on Poverty
University of Wisconsin-Madison

For more information on the
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