Why Traditional Retirement Is Out of Reach for Most Baby Boomers . . . And What We Should Do About It

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The prevailing model for happiness and fulfillment for a person who's in their 60s or older is "traditional" retirement, which is defined as "not working." The traditional solution to enable "not working" is to accumulate sufficient financial resources through a combination of personal saving, employer-sponsored benefits and Social Security. These three resources have been called the "three-legged stool" that supports retirement. However, all three legs of the stool are under stress in today's environment and may not be sufficient to support the traditional retirement for many people. Here's why:

- Personal saving is at an all-time low.
- Employers have been reducing or eliminating traditional defined benefit and retiree medical plans.
- Social Security has long-term financial difficulties, and some experts predict that benefit cutbacks are likely.

A considerable amount of research points to two disturbing trends:

- Currently available financial resources will not be sufficient to support a traditional retirement for large numbers of baby boomers. And this was the situation before the recent financial meltdown; it's even worse now.
- Many people have misperceptions about the amount of money that's needed for a traditional retirement and how to manage financial resources to last a lifetime.

Financial Resources and Benefits Are Inadequate

It doesn't really matter which survey you read, which demographic grouping is used, or whether you look at average or median account balances: They all report account balances that are far below the amounts necessary to generate sufficient retirement incomes. Let's take a brief look at some numbers which support this conclusion.

The 2008 Retirement Confidence Survey, produced by the Employee Benefits Research Institute (EBRI), surveyed 1,000 individuals age 25 and over. Respondents age 55 and over reported the following amounts of retirement savings:

Table 1. Reported Retirement Savings

Prevalence	Retirement Savings
28%	Less than $10,000
23%	$10,000 to $99,000
18%	$100,000 to $249,999
23%	$250,000 and over

The amounts in Table 1 are self-reported but are consistent with other surveys. For example, EBRI Issue Brief No. 308 reports the following average 401(k) balances in 2006 from a database of 20 million 401(k) participants:

Table 2. Average 401(k) Balances in 2006 by Age and Tenure

Age Group	Tenure (years)					
	<2	**2-5**	**5-10**	**10-20**	**20-30**	**30+**
50s	$17,854	$32,532	$54,491	$99,794	$174,272	$167,806
60s	$20,076	$31,914	$51,268	$93,636	$157,069	$190,593

The average balances reported in this study understate the problem, since average balances are more than twice the median balances (50% of participants have balances below the median, 50% above).

Married couples tend to have the best statistics, followed by single men, with single women dominating the bottom of the results. Single and widowed women need particular help, as large percentages of them face poverty in their retirement years.

The above amounts don't include home equity or retirement income earned under traditional defined benefit plans. But this shouldn't give us much hope: According to EBRI, only 37% of private sector American workers participate in defined benefit plans, a significant drop from 1979, when 82% of such workers participated in these plans. But it gets worse: Far fewer of these participants stay at their jobs for the 15 to 30 years needed to generate significant lifetime pensions. And recent declines in housing values point to the danger of relying on home equity for funding retirement.

So how much lifetime annual retirement income can be generated by the amounts of retirement savings shown in Table 1? Analyses by financial planners and actuaries suggest that you withdraw just 4% or 5% of your retirement savings each year, if you want an income that lasts for the rest of your life and increases for inflation. Let's revisit Table 1 on retirement savings and apply 5%, to see estimates of the resulting annual retirement income.

Table 3. Estimated Annual Income Generated by Retirement Savings

Prevalence	Retirement Savings	Resulting Annual Income with 5% Drawdown
28%	Less than $10,000	Less than $500
23%	$10,000 to $99,999	$500 to $4,999
18%	$100,000 to $249,999	$5,000 to $12,499
23%	$250,000 and over	$12,500 and over

Ouch! These amounts won't exactly fund the "golden years."

Many Americans Lack Financial Management Skills

But will Americans be prudent in drawing down their retirement savings? The evidence points to "no." Let's take a look.

The 2008 MetLife Retirement Income IQ Test surveyed 1,216 people age 56 to 65 on the safe withdrawal percentage, with the following results:

- 31% say withdrawing 4% of retirement savings per year is safe
- 26% say 7% is safe
- 29% say 10% is safe
- 14% say 15% is safe

How safe are these strategies? If we apply "Monte Carlo" techniques to the above withdrawal percentages to determine the odds of ruin (actuarialeze for "You're broke but not yet dead"), you'll find that only a 4% withdrawal rate has acceptable odds. But less than one-third of the MetLife survey respondents plan to use this rate. With a 7% withdrawal rate, the odds of outliving your money are a little worse than 1 out of 2, which is equal to or worse than a flip of a coin. Those are pretty bad odds for such an unpleasant outcome. Almost half of the MetLife respondents plan to use a withdrawal rate of 10% or more--with this rate, the odds of outliving your money are very high, ranging from 4 out of 5 to virtual certainty. And all of these odds get much worse for retirement ages below 65 or if you consistently receive poor investment returns.

But what are current retirees actually doing? According to the Fourth Annual Retirement Survey from Wachovia Bank, 28% of current retirees are withdrawing 10% or more from their retirement savings every year. Most likely, these retirees will run out of money in their mid-seventies, at a time when it could be tough to go back to work.

So what's happening here? According to the EBRI study, fewer than half of all workers do any retirement needs' calculations. Such an analysis would produce a realistic estimate of lifetime retirement income that could be generated by retirement accounts. This helps determine if an employee has sufficient financial resources to retire.

Instead, it appears that most retirees are just "winging it." The amount they have in retirement savings seems like a lot of money, and when they look around, they see their friends and relatives retiring, so retirement seems like a good idea. Their "withdrawal strategy" consists of withdrawing from their retirement savings the amounts they need to live on. They don't learn about safe withdrawal percentages; they just hope the money will last. Well, hope is not a good strategy!

What About Social Security?

Even when you add Social Security income to the money that can be generated by existing retirement savings, the result falls well short of the income that could support a full-time retirement for most Americans. And the evidence shows that many Americans aren't making the wisest choices for their Social Security benefits.

Social Security's website reports that the estimated average annual income for men retiring in 2008 is $17,000; the comparable amount for women is about $10,800. Our government has never intended for Social Security to be sufficient to fund a comfortable retirement, as evidenced by these numbers.

For many people, Social Security may be their only source of guaranteed lifetime retirement income. And fortunately, it has some unique features. For instance, it's indexed for inflation, and for many people, it's not subject to income taxes. Since many people will have trouble managing retirement investments to last the rest of their lives, you'd think they would want to make their Social Security income as big as possible. This happens when you delay commencement of benefits. Age 62 is the earliest possible age at which benefits can start. Delaying commencement until age 66 increases the annual income by approximately 35% over commencement at age 62, while delaying commencement until age 70 increases the annual income by approximately 80%.

However, the majority of Social Security recipients don't follow this strategy; almost three-fourths start benefits before age 66, the "Full Retirement Age" for most baby boomers, and a little more than half elect commencement at age 62 with the smallest amount of income. Again, it appears that Americans aren't planning ahead; instead, they're grabbing some money now and hoping that things turn out OK down the road.

The Health Time Bomb

We're not done yet with the disturbing trends. According to a 2008 study conducted by Fidelity Investments, a 65 year-old couple will need approximately $225,000 in the bank today to cover medical costs throughout their retirement years. And that doesn't include costs for most dental services and long-term care--including them makes matters worse.

Note that the $225,000 amount is bigger than most people's *entire* retirement savings; presumably these balances are supposed to fund *all* living expenses in retirement, not just medical expenses. When you dig down into the numbers, about $67,500 of the $225,000 will be spent for premiums, while the rest--$157,500--will be spent when they get sick, on deductibles, coinsurance, etc. Avoiding spending over $150,000 is a powerful financial incentive to stay healthy!

One way to protect against the risk of these high expenses is through medical insurance. Unfortunately, it's likely that retirees will need to buy this insurance on their own, since fewer than 13% of private sector employers offer health insurance to their retirees according to surveys by EBRI. However, many retirees won't have access to individually purchased medical insurance, either due to high premiums or preexisting conditions. The inevitable conclusion for many: continue working to maintain essential medical insurance coverage.

But will we be healthy in our retirement years? About one-third of all Americans are overweight, and another one-third are obese. This fact, combined with a lack of exercise, could result in substantial increases in all of the expensive, debilitating illnesses that afflict older Americans, including heart disease, cancer, diabetes, Alzheimer's, dementia and osteoporosis. This result is not sustainable: *Current* medical costs are spiraling out of control in America. What's the future going to look like?

We will pay a dear price for our unhealthy lifestyle--a serious threat to our prosperity for the rest of our lives. The good news? We don't need to pay this price! Research suggests that if all Americans adopted healthy lifestyles regarding nutrition and exercise, and if all smokers quit smoking, our nation's medical bills could drop by 50%! While a drop of this magnitude is unrealistic, we'll have terrific results if we achieve just a fraction of this savings.

What We Should Do About It

Instead of a traditional retirement, it may be more realistic for baby boomers to strive for new goals: life fulfillment, health and financial security. If they have insufficient financial resources for a traditional retirement, then the inevitable solution will be some combination of:

- Working in retirement years to make ends meet
- Postponing retirement
- Reducing living expenses before retirement to enable higher saving for retirement
- Reducing living expenses during retirement

Any of the above solutions may be viewed as unpleasant or undesirable, but they should be assessed against the new goals espoused here. Will they jeopardize life fulfillment, health and financial security? It's highly possible that the answer could be 'no!'

Keep an eye out for future issues of my newsletter, which will explore creative and realistic solutions to existing retirement challenges. I'll describe solutions that rely on analysis and facts, not myths, misconceptions and sales pitches. These solutions will help all of us plan for a happy, healthy, secure *rest-of-life*. It's not too late to begin planning, saving and taking care of our health!