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Baby Boomers' Retirement:

Bold Action Needed Now

by Steve Vernon

A comfortable retirement appears out of reach for a majority of baby boomers. Companies and plan sponsors need to make substantial efforts to help employees understand the issues surrounding retirement, increase their financial skills and begin to make lifestyle changes. This article sets forth the challenges and some of the possible solutions. The author also takes a look at the advisability of resurrecting defined benefit plans and of employees forgoing a traditional retirement in favor of new goals: life fulfillment, health and financial security.

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Baby Boomers' Retirement: Bold Action Needed Now

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It's time to face the facts: Traditional retirement will be out of reach for most baby boomers in the United States. While many dream of retiring full time from the workplace and spending the rest of their lives playing golf, taking cruises and spending time with grandchildren, the money and benefits just aren't there for most to support such a lifestyle. To make matters worse, most don't have the financial skills needed to manage their inadequate resources to last the rest of their lives.

For employers and plan sponsors, these are issues that just can't be ignored. In the next decade or two, U.S. businesses could be stuck with millions of older, unhealthy employees who are demoralized by having to work much longer than they'd hoped, causing major productivity problems.

For employees and plan participants, what's at stake is the quality of the rest of their lives. Will they be impoverished in old age, or will they have enough money to live a comfortable life? Will they be unhealthy or healthy? Will they be miserable or happy? The planning they do now will have a direct impact on the answers to all these questions.

It's going to take a substantial effort for companies and plan sponsors to help their employees and participants understand the issues surrounding retirement and take effective action steps. And employees and participants will need to make significant changes in their lifestyles in order to effectively meet the challenges of their retirement years.

The Challenges Facing Employers and Plan Sponsors

Briefly, here are those challenges:

- The retirement savings of most persons aged 55 and older are far less than the amounts needed to generate a comfortable retirement, even when expected Social Security benefits are included. This was the situation before the recent financial meltdown; it's even worse now. Most people's retirement savings have taken a significant hit.
- These same people aren't saving enough money to make up the shortfall before they reach retirement age.
- Almost half of all those approaching retirement don't analyze how much they need to generate a lifetime retirement income. Instead, they just "wing it" when it comes to drawing down their retirement savings. Evidence shows they're withdrawing their savings too quickly. The probable result: They'll outlive their money and be without funds at a time when it's difficult to return to work.
- About half of all U.S. citizens draw Social Security as early as possible (age 62), resulting in the smallest amount of annual retirement income possible.
- Given current trends regarding the cost of medical care and the health of baby boomers, older people's meager retirement savings could easily be depleted by high medical bills and long-term care expenses.

People who work for a full career with an employer that still sponsors a defined benefit pension plan and/or retiree medical plan have a good chance for a traditional retirement. This doesn't describe many people today, given the decline of these types of plans.

For numbers that go into detail on these challenges, see the accompanying article titled "Statistical Analysis: Why Traditional Retirement Is Out of Reach for Most Baby Boomers."

These challenges needn't be a source of despair for employers and their employees. We can create a positive future by taking bold steps now. This article briefly summarizes just what those steps are.

What Can Employers and Plan Sponsors Do?

One inevitable conclusion is to be prepared for more older workers working longer. To accommodate these older workers, here are some steps to consider:

- Employers can make work more attractive and feasible by adopting

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Retirement—Additional Resources

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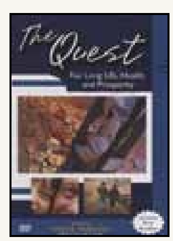

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Statistical Analysis:

Why Traditional Retirement Is Out of Reach for Most Baby Boomers

The prevailing model for happiness and fulfillment for a person in his or her 60s or older is "traditional" retirement, 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. Today, all three legs of the stool are under stress and may not be sufficient to support a traditional retirement for many people.

Let's take a look at two disturbing trends that are supported by a substantial amount of research. First, currently available financial resources are not sufficient to support a traditional retirement for large numbers of baby boomers. This was the situation before the recent financial meltdown; it's even worse now. Second, many people have misperceptions about the amount of money that's needed for a traditional retirement and how to manage their financial resources to last a lifetime.

Financial Resources and Benefits Are Inadequate

It doesn't really matter which survey is read, which demographic grouping is used, or whether average or median account balances are used: They all report account balances far below the amounts necessary to generate sufficient retirement incomes.

The 2008 Retirement Confidence Survey, produced by the Employee Benefits Research Institute (EBRI), surveyed 1,000 individuals aged 25 and over. Respondents aged 55 and over reported retirement savings shown in Table I. These figures are self-reported but consistent with other surveys. For example, EBRI Issue Brief No. 308 reports the average 401(k) balances in 2006 from a database of 20 million 401(k) participants, shown in Table II.

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 much hope: According to EBRI, only 37% of private sector 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 I? Analyses by financial planners and actuaries suggest withdrawal rates of just 4% or 5% each year to generate a retirement income that lasts for life and increases for inflation. Let's revisit Table I and apply a 5% withdrawal rate to see estimates of the resulting annual retirement income. 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."

The 2008 MetLife Retirement Income IQ Test surveyed 1,216 people aged 56 to 65 on what they perceived a safe withdrawal percentage.

- 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.

"Monte Carlo" techniques were applied to the above percentages to determine the odds of ruin (actuarialeze for "You're broke but not yet dead"). Only a 4% withdrawal rate has acceptable odds. Yet less than one-third of the MetLife survey respondents plan to use this rate. With a 7% withdrawal rate, the odds of outliving retirement assets are a little worse than one out of two—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 retirement assets are very high, ranging from four out of five to virtual certainty. All of these odds get much worse for retirement before age 65 or if retirement savings earn consistently 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-70s, at a time when it could be tough to go back to work.

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 would help determine whether an employee has sufficient financial resources to retire.

It appears that most retirees are just "winging it." The amount they have in retirement savings seems like a lot of money. 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 amount they need to live on. They don't

TABLE I 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

TABLE II Average 401(k) Balances in 2006 by Age and Tenure (Years in Plan)

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

learn about safe withdrawal percentages; they just hope the money will last. Hope is not a good strategy!

What About Social Security?

Even when Social Security income is added to the money that can be generated from existing retirement savings, the result falls well short of the income that could support a full-time retirement for most people.

Social Security's Web site 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 never intended for Social Security to be sufficient to fund a comfortable retirement, as evidenced by these numbers.

For many, Social Security may be their only source of guaranteed lifetime retirement income. Fortunately, it has some unique features. 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 age at which benefits can start. Delaying commencement of Social Security benefits until the age of 66 increases the annual income by approximately 35% over commencement at the age of 62, while delaying commencement until the age of 70 increases the annual income by approximately 80%.

The majority of Social Security recipients don't follow this strategy; almost three-fourths start benefits before the age of 66, the "full retirement age" for most baby boomers. A little more than half elect commencement at the age of 62. It appears that people aren't planning ahead; they're grabbing some money now and hoping that things turn out OK down the road.

The Health Time Bomb

Let's look at one more disturbing trend. According to a 2008 Fidelity Investments study, a 65-year-old couple will need approximately $225,000 in the bank today to cover medical costs throughout their retirement years. That doesn't include most dental services and long-term care.

Note that $225,000 is more than most people's *entire* retirement savings. Presumably these balances are supposed to fund *all* living expenses in retirement, not just medical expenses. Digging 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 medical expenses is through insurance. Unfortunately, it's likely that retirees will need to buy this insurance on their own. Fewer than 13% of private sector employers offer health insurance to their retirees, according to EBRI surveys. 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 employees and plan participants be healthy in their retirement years? About one-third of persons in the United States are overweight; 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 persons, including heart disease, cancer, diabetes, Alzheimer's, dementia and osteoporosis. Current medical costs are spiraling out of control in the United States. What's the future going to look like?

An unhealthy lifestyle is a serious threat to prosperity in retirement years. The good news? This price doesn't need to be paid! Research suggests that if all people adopted healthy lifestyles regarding nutrition and exercise, and if all smokers quit smoking, the nation's medical bills could drop by 50%! Think of the results if just a fraction of this savings is realized.

Wishing and hoping that these challenges go away won't work. Employers and plan sponsors can create a positive future by adopting workplace and benefit plan changes to accommodate the realities of today's economy. They can also encourage employees and plan participants to take charge of their future, by planning, saving and taking care of their health. While these steps aren't easy, there are no better alternatives. •

The Most Important Questions Facing Employees and Participants

In order to plan for a happy, healthy, financially secure retirement, employees and plan participants will need to ask—and find the answers to—the following questions:

1. How long might I live, given my lifestyle and family history?
2. How much retirement savings do I need to generate a sufficient retirement income to last the rest of my life? Answering this will help answer the question, "When can I retire?"
3. What is the role of part-time or full-time work in my retirement years?
4. What are strategies for balancing income and expenses in my retirement years?
5. If I participate in a defined benefit plan, what are the most effective payout options? If I'm offered a lump sum in lieu of a monthly pension, what are the advantages and disadvantages?
6. When should I draw Social Security benefits?
7. What are the best strategies for drawing down my retirement assets to generate a lifetime retirement income that increases for inflation?
8. How can I protect against the threat of large bills for medical and nursing home expenses?
9. How can I work most effectively with financial advisors, brokers and salespeople?
10. What are the most important considerations for selecting financial products and services?

more flexible work schedules and policies. It's a myth that older workers are more expensive, can't be trained or are inflexible. In fact, they bring a lifetime of experience and stability that can be an invaluable asset for most companies.

- Employers can also examine why they want their older workers to retire. Are skills out of date? Maybe training is in order. Are they too expensive due to wage structures based on seniority and longevity? Then maybe the pay scale needs to be reexamined if older workers want to work longer.
- Employers can optimize retirement and health insurance plans for their older workers. Examples include offering participation in these plans to part-time workers, providing "bridge" medical coverage until they reach eligibility for Medicare at the age of 65 and/or enhancing retirement plans. In a "back to the future" move, some may take the lead to sponsor an affordable defined benefit pension plan, which is much more efficient at generating retirement income than a 401(k) plan (see the section that follows for elaboration on this idea). Employers can be strategic in budgeting for these benefits; many people in their retirement years may be willing to forgo wage increases or accept lower wages in exchange for essential medical coverage and enhanced retirement benefits, as long as this "deal" is explained to them.
- Get serious about maintaining the health of older workers so they can continue to work.
- Employers can sponsor comprehensive retirement education campaigns to help their employees plan for the future. The costs can be low, with a big payoff in years to come.

Can Defined Benefit Plans Be Resurrected or Saved?

The shift from defined benefit to defined contribution plans has been well documented, along with the various reasons. The recent stock market decline has exposed serious problems with exclusive reliance on defined contribution plans for retirement security. Market declines can be devastating to recent retirees, and employees close to retirement may postpone their retirement date indefinitely.

Let's revisit key advantages of defined benefit plans:

- Compared to defined contribution plans, defined benefit plans provide roughly 50% more retirement income than defined contribution plans for a given dollar expenditure by the plan sponsor. The reasons: a longer investment time horizon, professional asset management, less leakage for vested terminated employees and, most importantly, the ability to manage toward the average life expectancy of the covered group.
- Defined benefit plans protect participants against outliving their assets and poor financial decisions. This last point becomes more important as retirees age and become less able to manage their resources.

In the move away from defined benefit plans, employers and plan sponsors may have thrown out the baby with the bath water. Prior plans were too generous, and plan sponsors exposed themselves to too much risk through significant stock market investments and shaving funding to bare minimums. However, eliminating these plans may not be the best response. A modest defined benefit plan, conservatively managed and funded, will still make a tremendous difference in older workers' ability to retire.

An employer considering implementing a new defined benefit plan can adopt these strategies to manage the risk:

- Instead of expensive final pay plans, consider career average plans or plans with fixed dollar multipliers.
- Start pensions at the age of 65 and

- consider them as longevity insurance. If employees leave before the age of 65, there will be a good pension waiting for them at the age of 65. If they need income before the age of 65, they can get a bridge job that tides them over until the age of 65, or rely on retirement savings.
- Funding and investment policies can be managed to deliver stable funding and expense amounts, through increased investment in bonds and conservative selection of actuarial methods and assumptions.

These actions may seem undesirable when compared to defined benefit plans of the past, but a defined benefit plan managed as described above is much better than no plan at all.

Why Should Employers Sponsor a Retirement Education Program?

Retirement education has several positive outcomes:

- It helps retain and motivate valuable older workers—those who can analyze, plan ahead and take responsibility.
- It helps prevent having demoralized older employees who are working far longer than they'd hoped.
- It reinforces existing wellness initiatives.
- Employers are being socially responsible by helping their employees with important life planning.
- Employees appreciate that their employer cares enough about them to give them the "straight story" so they can effectively plan ahead. This appreciation can result in more loyal employees, which studies show helps the bottom line.

The goal of an effective retirement education campaign is to provide employees with insights and strategies that help them make decisions that positively impact their retirement years. Employers need to find the line between providing good information and strategies, which is recommended, versus providing advice, which they should avoid. The insert—*The Most Important Questions Facing Employees and Participants*—offers a list of the most critical questions to address with older workers.

There are established precedents for the success of extensive public education campaigns. Just look at past efforts on the dangers of smoking and drunk driving. And positive results are emerging today from current campaigns on employee wellness. While success didn't happen overnight—substantial time and effort was involved—the results are definitely worth it.

What Can Employees and Participants Do?

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.

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 is "no!"

Individuals should also examine what is wrong with their work that makes them want to retire. Possible reasons include boredom, poor health, unsafe working conditions and so on. Some of these are fixable, some aren't. If they can't afford a traditional retirement, continuing to work in some way is the only realistic option.

Employers and plan sponsors can reinforce these ideas through communications with participants. It may not be in their best interests to encourage expectations for a traditional retirement, relying exclusively on inadequate financial resources for periods of 20, 30 or 40 years.

One thing is certain: Employers and plan sponsors can't afford to wait much longer. Taking bold action steps now will result in a better future for all parties: employers, plan sponsors, employees and plan participants. **B&C**

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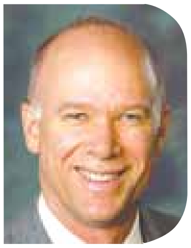

Steve Vernon, FSA, is president of Rest-of-Life Communications, where he delivers retirement education in a variety of formats, including keynote presentations, workshops, e-mail and print newsletters, DVDs and traditional books and articles. He is an executive faculty member and research fellow with the California Institute for Finance at California Lutheran University. Vernon recently retired as vice president and consulting actuary with Watson Wyatt Worldwide.