

# AMERICA'S RETIREMENT CRISIS

## FACING THREATS TO RETIREMENT PROSPERITY

America is facing a serious retirement crisis: many Americans are not confident that they will be able to enjoy a comfortable retirement, and many retirees face longevity risk, or the danger of outliving their life savings. The 2008–2009 economic downturn drastically changed the financial landscape and caused profound shifts in the way that many Americans view their retirements. Despite being the largest, wealthiest, and most influential generation of Americans, baby boomers are facing one of the most serious retirement challenges in history. A combination of declining income, increased longevity, and high costs means that an increasing number of Americans face the possibility of outliving their assets.

One economic study found that approximately 46 percent of Americans die with less than \$10,000 in assets, many of them lacking even home equity and relying largely on Social Security benefits to meet their expenses.<sup>1</sup> Most shockingly, many of the households surveyed in the study entered retirement in good financial health; factors such as unexpected health expenses, market losses, and increased lifestyle expenses combined to erode their financial security.

The purpose of this report is to explore a critical issue facing American retirees today and highlight some strategies that might help you avoid outliving your assets.



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## UNDERSTANDING THE PROBLEM

### THE EFFECTS OF THE FINANCIAL CRISIS

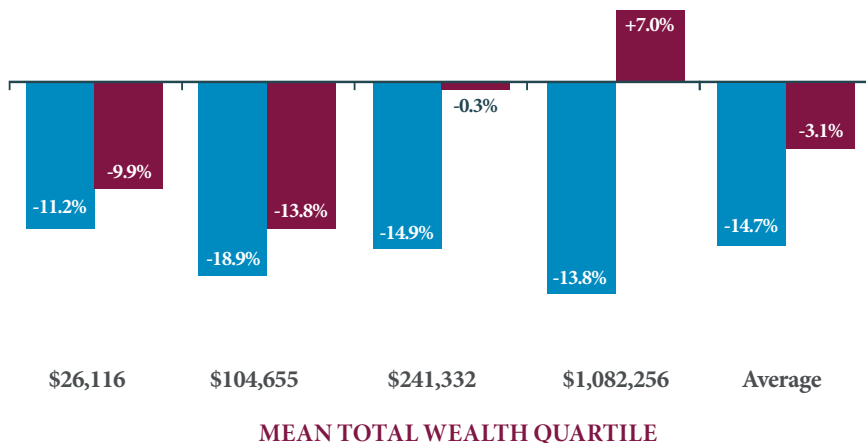
The economic downturn drastically changed the financial circumstances of many seniors. According to a study presented at the 2013 Financial Security Summit, Americans aged seventy-five and older lost one-third of their financial assets and one-sixth of their total net worth between 2007 and 2010.<sup>2</sup> While many household balance sheets have recovered in the years since, retirees and preretirees have much less time to make up lost ground when markets decline. Evidence in the study also suggested that many older retirees are struggling to make ends meet.

Although most Americans have been able to sharply pay down credit card debt since 2007, credit card debt among elderly retirees has actually risen. An AARP study found that between 2007 and 2010, the percentage of Americans seventy-five and older with credit card debt rose, while the percentage decreased in every other age group. The same study found that by 2012, while younger Americans had reduced their credit card balances by 37 percent, Americans aged fifty and up saw their balances decline by just 16 percent.<sup>3</sup> Living so close to the financial edge can have devastating consequences; seniors who find themselves in this position might not be able to withstand financial shocks, such as expensive medical treatments not covered by Medicare or Medicaid, or other unexpected events, such as the need to replace a car or a household appliance.

### MANY RETIREES UNDERESTIMATE FUTURE LIVING EXPENSES

An accurate estimate of your postretirement living expenses is critical to credibly projecting how large your nest egg needs to be to ensure a comfortable retirement.

#### EXPECTED VS. ACTUAL EXPENSE REDUCTION



Source: Michael Hurd and Susann Rohwedder. "The Retirement Consumption Puzzle: Actual Spending Change in Panel Data" NBER Working Paper 13929. April 2008. Survey of 385 retirees, ages fifty to seventy. Average anticipated and actual change in spending at retirement. Mean total wealth, including housing.



Unfortunately, accurately estimating these expenses can be challenging, and retirees who depend too much on optimistic estimates of their future expenses might find themselves facing shortfalls. Many retirement expense calculators confidently predict that retirees will spend as much as 20 percent less in retirement than they do before retiring. However, changes in spending do not always happen the way people expect.

A landmark 2008 study found that, on average, most retirees did not significantly reduce their expenses after retirement. Retirees having a mean total net worth of about \$100,000 (including their houses) were able to reduce their expenses by the greatest amount, 13.8 percent; however, those in the wealthiest quartile (having a mean net worth of approximately \$1 million) actually increased their postretirement spending by 7 percent.<sup>4</sup> While it's possible to reduce retirement expenses by adapting your lifestyle to your circumstances, it's always best when those changes come by choice, not by lack of options.

Health-care costs are one of the major contributors to increased living expenses after retirement. The rapid increase in medical costs over recent years has caused considerable angst for retirees since, as people age, their health-care expenses tend to rise. Just 14 percent of respondents to the 2015 Retirement Confidence Survey felt "very confident" that they will have enough money in retirement to cover healthcare needs, such as nursing home care. In contrast, 32 percent were "not at all confident" about their ability to afford care.<sup>5</sup> Another 2015 study found that the rising cost of health care

caused 27 percent of respondents to delay retirement.<sup>6</sup> American retirees have good reason to worry about rising health-care costs during retirement. According to data collected by the Kaiser Family Foundation in the chart below, inflation increased by approximately 3 percent each year during the period of 1999 to 2015, cumulatively eroding purchasing power. During the same period, workers' earnings increased by 56 percent. However, health-care insurance premiums increased by a staggering 203 percent, far outstripping wage increases over time. If health-care inflation continues to grow at similar rates in the future, retirees might struggle to cover rising medical costs.<sup>7</sup>

### LIVING LONGER IN RETIREMENT

Life expectancies for both men and women have steadily increased over time. In 1950, a sixty-five-year-old man lived to an average age of 77.8, while a woman lived to an average age of eighty. In 2016, a sixty-five-year-old man's average life expectancy has increased to 84.3, while a woman's has reached 86.6.<sup>8</sup>

In fact, actuarial tables show that there's a fifty-fifty chance an average American will live beyond his or her life expectancy. A healthy, nonsmoking person who engages in moderate exercise dramatically increases the odds of living longer than the average life expectancy.<sup>9</sup> According to the Social Security Administration, one out of every four sixty-five-year-olds will live past the age of 90 and one out of 10 will live past the age of

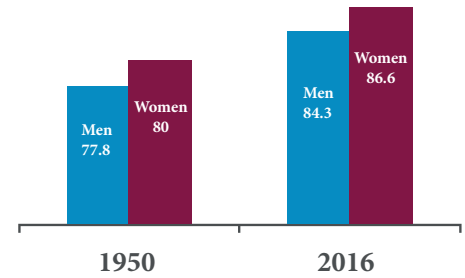
95.<sup>10</sup> Many retirement plans were not designed with the possibility of living more than two decades in retirement in mind, and a retirement plan structured that way might not provide enough income to last the investor's lifetime. Couples also need to consider joint life expectancies and the probability that one spouse might long outlive the other.

Longer life-spans may also increase the effect that health-care costs have on living expenses, and many retirees face the issue of paying for assisted living facilities or retirement communities when independent living is no longer possible.

### STRATEGIES TO MITIGATE LONGEVITY RISK

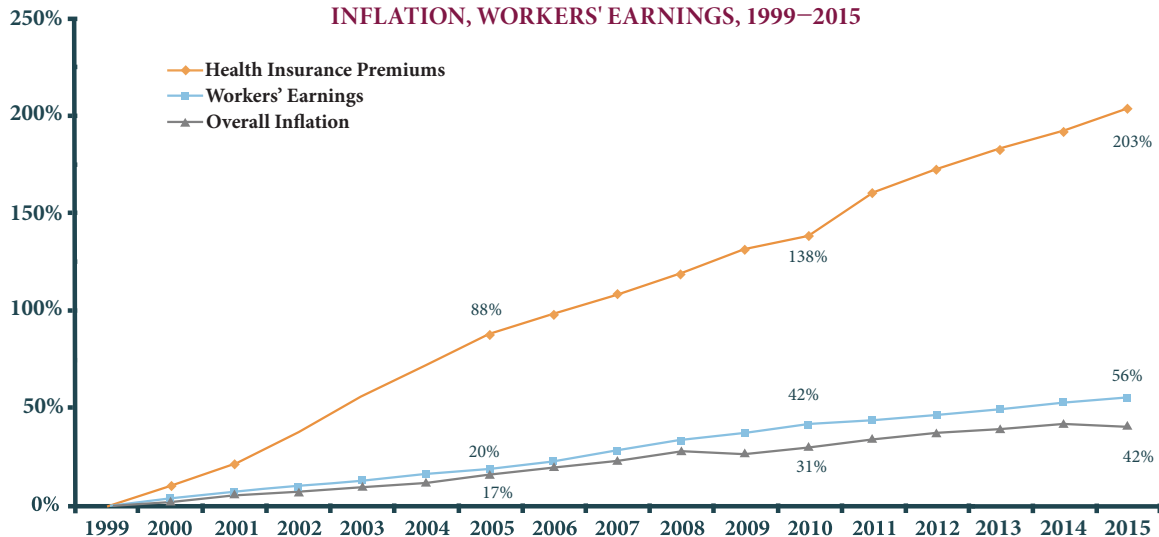
There's no doubt that Americans are facing a retirement crisis; now that we've covered some of the factors that are contributing to this nationwide issue, let's discuss some strategies that can help protect your retirement lifestyle and might help ensure that your assets last as long as you need them to.

### AVERAGE LIFE EXPECTANCY IS INCREASING



Source: CDC and SSA

### CUMULATIVE INCREASES IN HEALTH INSURANCE PREMIUMS, INFLATION, WORKERS' EARNINGS, 1999–2015



Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999–2015. Bureau of Labor Statistics, Consumer Price Index, US City Average of Annual Inflation (April to April), 1999–2015; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1999–2015 (April to April).

A framed painting of a family consisting of a man, a woman, a young girl, and a young boy. The faces are replaced by circular cutouts. The man is in a suit, the woman is in a striped shirt, the girl is in a pink tutu, and the boy is holding a basketball. The painting is on a wooden floor against a light-colored wall.

## CLARIFY YOUR RETIREMENT NEEDS:

1. *Do you know how much income you will need each month during retirement?*
2. *What sources of guaranteed income do you already have?*
3. *How much do you already have saved for retirement?*
4. *How long could you afford to live in retirement if your investments grow 4 percent annually? 5 percent? 6 percent?*
5. *Have you discussed your concerns with a financial professional?*

### CONSIDER DELAYING RETIREMENT OR STARTING A SECOND CAREER

An increasing number of Americans are postponing retirement. Many choose to extend their working lives for a number of reasons, including allowing their investments to pursue additional growth, increasing their retirement savings, taking advantage of health insurance coverage, or waiting for a spouse to retire. Some simply aren't ready to give up fulfilling careers. Research supports this view, showing that 82 percent of Americans in their sixties expect to continue working past age sixty-five or don't plan to retire at all. Just 18 percent expect to stop working entirely and fully retire.<sup>11</sup>

Some Americans who are ready to retire from their primary professions choose to take on part-time work or begin second careers. While financial considerations can make part-time work look attractive, many retirees enjoy the camaraderie or want to stay active and productive while still having plenty of time for family, hobbies, or travel.

According to a survey by the MetLife Foundation, about 9 million Americans between the ages of forty-four and seventy have already launched "encore careers," or jobs that combine income with passion or social impact. As many as 31 million more are interested in making the transition to more meaningful work. On the whole, those in encore careers find their work fulfilling and worth doing. More than 80 percent of respondents said that they get either a "tremendous amount" or "quite a bit" of satisfaction from their encore careers.<sup>12</sup>

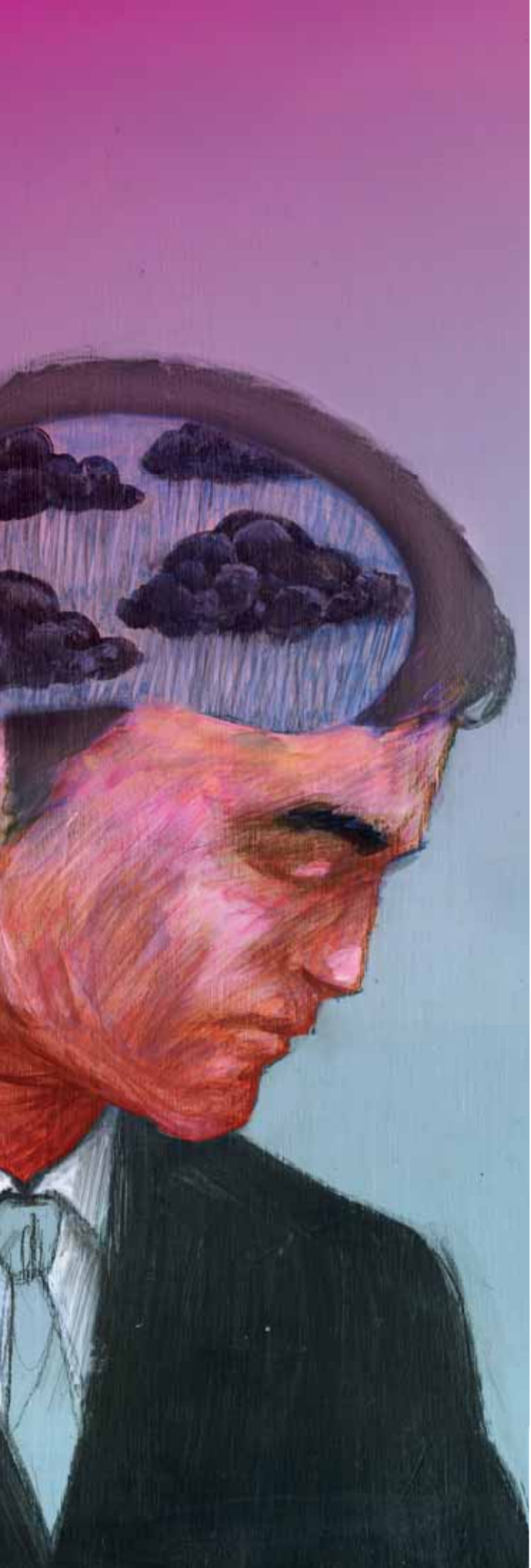
An increasing body of research suggests that Americans are reinventing retirement and viewing it more as a phase of rejuvenation and recreation than as a period of complete rest.

### DELAY TAKING SOCIAL SECURITY BENEFITS

One of the most important decisions facing a retiring worker is when to start taking Social Security benefits. While the dependable income can relieve the anxiety of losing a steady paycheck, there are some valuable arguments in favor of delaying benefits. Full retirement age (FRA) is the age at which you're eligible to receive your full Social Security benefits. It used to be sixty-five for everyone, but current laws mean that for those born after 1938, normal retirement age is somewhere between sixty-five and sixty-seven.

While the right age to start taking benefits depends on a retiree's individual circumstances, in general, delaying benefits is usually a better choice for most people for the following reasons:

- **Delaying Social Security means you get increased benefits each year, reducing your risk of running out of money later in life.** If you begin taking Social Security retirement benefits as soon as you become eligible at age sixty-two, you permanently give up a significant chunk of monthly income. By claiming benefits at your FRA, you'd be eligible for 100 percent of your full benefits; however, by delaying longer, you qualify for an annual increase (8 percent for most retirees). Monthly benefits claimed at age seventy are



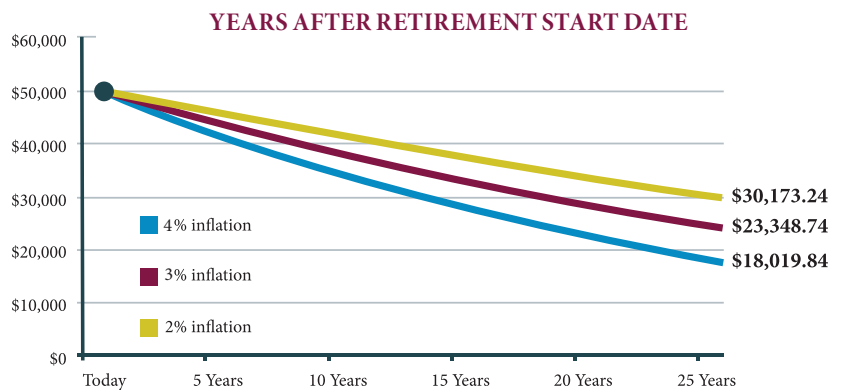
76 percent higher than those claimed at age sixty-two for a retiree whose FRA is sixty-six.<sup>13</sup> Social Security regulations changed significantly in 2015, making it critical for married couples to carefully coordinate their claiming strategies to maximize income. We strongly recommend that you work with a professional who understands your personal financial circumstances before making decisions about when to take Social Security.

- **Each future cost of living adjustment (COLA) might be bigger.** Social Security benefits increase each year to keep up with inflation. Your COLA typically could increase by a percentage of the current payout each year, meaning that delaying your benefits might give each adjustment a higher dollar value.

Between life expectancies, delayed retirement credits, and income considerations, Social Security claiming strategies can be very complex. Before making any decisions, be sure to consult with a tax planner or other financial professional who can help you make the right decision for your needs. Please feel free to contact us if you would like assistance with determining what is best for your situation.

#### FIGHT THE EFFECTS OF INFLATION

Inflation is insidious and can eat away at the purchasing power of your money over time. Retirees are disproportionately affected by the effects of rising prices because they are paying higher prices for food, housing, and other expenses while often living on fixed incomes. Medical bills are also typically higher in retirement due to increased health needs and higher insurance premiums. Even relatively low inflation can significantly impact a retiree's purchasing power over time.



This is a hypothetical example calculated using assumed rates of inflation of 2 percent, 3 percent, and 4 percent to illustrate the effects of inflation on purchasing power over time. The US long-term average annual inflation rate is 3.22 percent, according to the US Bureau of Labor Statistics. Actual inflation might be more or less and will vary. This example does not include the effects of taxes, fees, or potential portfolio growth and should only be used for illustrative purposes.

The hypothetical example on the previous page shows that \$50,000 would be worth just over \$30,000 in twenty-five years, even assuming a very low inflation rate of 2 percent. Historically, the average annual inflation rate in the United States has been 3.22 percent, though it jumped as high as 18 percent in 1918 and fell into negative digits during several periods in the last century.<sup>14</sup>

Having a portfolio that's positioned to help fight inflation is critical. Traditionally, as workers have neared retirement age, they have gradually reduced their exposure to risk and favored more conservative investments that prioritize income and wealth preservation over growth. However, a too-conservative investment strategy can be as dangerous as a too-aggressive one since it exposes your portfolio to the corrosive effects of inflation and might limit your retirement assets' ability to grow over time, thus increasing the risk that you'll outlive your assets. A well-diversified portfolio that includes an appropriate mix of stocks, bonds, and other investment types according to your personal needs and goals may help you seek the growth you need in a way that lets you sleep better at night.<sup>15</sup> Diversification helps you spread risk throughout your portfolio, so investments that do poorly might be balanced by others that do relatively better. However, please note that diversification cannot ensure a profit or protect against a loss.

Before making any investment decisions, it's important to understand how factors such as your own personal financial circumstances, risk tolerance, and time horizon affect your choices. A financial professional can work with you to develop an investing strategy that's right for your needs, goals, and financial situation.

## PLAN FOR RISING HEALTH-CARE COSTS

Longer life-spans, rising medical costs, declining medical coverage, and funding shortfalls for Medicare and Medicaid mean retirees face a serious challenge in managing their health-care costs in retirement. According to a Fidelity report, a sixty-five-year-old couple retiring in 2015 will need an estimated \$245,000 in savings just to cover health-care costs during their retirement.<sup>16</sup> Some estimates put health-care inflation at over 6 percent a year, and if future trends continue, health care could be retirees' second-largest expense after housing.<sup>17</sup>

In order to understand and plan for your health-care expenses in retirement, consider the following strategies:

- **Earmark a portion of your retirement savings specifically for health-care expenses.** Take advantage of tax-favored vehicles, such as health savings accounts.
- **Understand your health insurance options after retirement.** While most retiring workers will lose their employer-sponsored coverage, some firms still offer retirement health-care coverage.
- **Understand how Medicare fits into your health coverage.**
- **Be a smart health-care shopper.** When visiting a health-care provider, be prepared with information about existing conditions and any symptoms you are experiencing. Ask questions about a diagnosis and prescribed medications to be sure you understand all alternatives and outcomes. Know what you're paying for so that you fully understand your out-of-pocket costs for any treatment plans.



## CONCLUSIONS & NEXT STEPS

The average sixty-five-year-old can expect to live twenty years or more in retirement. It is critical to prepare so you can maintain a comfortable retirement lifestyle. Living a long life has its considerable benefits, but it can create uncertainty and stress around how much money retirees will need to live comfortably for the rest of their lives. Out of fear of financial ruin, many retirees unnecessarily adopt frugal lifestyles that cause them to miss out on the best parts of retirement. Others miscalculate the true cost of retirement and overspend, depleting their savings too soon.

Many retirees have been taught the rule of thumb that retirement assets can be made to last thirty years if investors withdraw 4 to 4.5 percent of the original value each year. Unfortunately, this old adage was developed in the 1990s, and that withdrawal rate might not work when inflation-adjusted interest rates are close to zero for long periods of time. So, if you can't safely withdraw at least 4 percent a year from your portfolio, what can you do? There are a number of alternative approaches that a retirement specialist can explore with you that might help ensure that your money lasts as long as you do.

The issues we've presented in this report are complex, and it's critical to make the right decisions before and during retirement. While every investor's circumstances are different and there are no guarantees of success, we aim to help our clients take some of the uncertainty out of retirement planning and work with them to develop suitable financial strategies for their unique retirement circumstances.

### Footnotes, disclosures, and sources:

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<sup>1</sup> "Were They Prepared for Retirement?" NBER. <http://www.nber.org/papers/w17824.pdf>. [Accessed 20 May 2016]

<sup>2</sup> "A crisis for the very old: They're outliving their assets." LA Times. <http://www.jsonline.com/news/opinion/a-crisis-for-the-very-old- theyre-outliving-their-assets-b9957225z1-216189001.html> [Accessed 20 May 2016]

<sup>3</sup> "In the Red: Older Americans and Credit Card Debt." AARP. [http://www.aarp.org/content/dam/aarp/research/public\\_policy\\_institute/security/2013/older-americans-and-credit-card-debt-AARP-ppi-sec.pdf](http://www.aarp.org/content/dam/aarp/research/public_policy_institute/security/2013/older-americans-and-credit-card-debt-AARP-ppi-sec.pdf) [Accessed May 20, 2016]

<sup>4</sup> "The Retirement Consumption Puzzle: Actual Spending Change in Panel Data" NBER Working Paper 13929. <http://www.nber.org/papers/w13929.pdf> [Accessed May 20, 2016]

<sup>5</sup> "The 2015 Retirement Confidence Survey." EBRI. [http://www.ebri.org/pdf/surveys/rcs/2015/EBRI\\_IB\\_413\\_Apr15\\_RCS-2015.pdf](http://www.ebri.org/pdf/surveys/rcs/2015/EBRI_IB_413_Apr15_RCS-2015.pdf) [Accessed May 20, 2016]

<sup>6</sup> "2015 EBRI/Greenwald & Associates Health and Voluntary Workplace Benefits Survey." [http://www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_09\\_Sept15\\_WBS-IRAs.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_09_Sept15_WBS-IRAs.pdf) [Accessed May 20, 2016]

<sup>7</sup> "Employer Health Benefit Survey 2015." Kaiser Family Foundation and HRET. <https://kaiserfamilyfoundation.files.wordpress.com/2015/08/8775-employer-health-benefit-survey-2015-chartpack.pdf> [Accessed May 20, 2016]

<sup>8</sup> "Table 22. Life expectancy at age 65." CDC. <http://www.cdc.gov/nchs/data/hsr/2011/022.pdf> [Accessed May 20, 2016]

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<sup>9</sup> "Planning to Your Average Life Expectancy: A Bad Mistake." CBS News. <http://www.cbsnews.com/news/planning-to-your-average-life-expectancy-a-bad-mistake/> [Accessed May 20, 2016]

<sup>10</sup> "Social Security Calculators: Life Expectancy." SSA. <https://www.ssa.gov/planners/lifeexpectancy.html> [Accessed May 20, 2016]

<sup>11</sup> "American Workers Are Changing the U.S. Retirement Landscape." Transamerica Center for Retirement Studies\*. [http://www.transamericacenter.org/docs/default-source/resources/center-research/16th-annual/tcrs2015\\_pr\\_retirement\\_throughout\\_the\\_ages.pdf](http://www.transamericacenter.org/docs/default-source/resources/center-research/16th-annual/tcrs2015_pr_retirement_throughout_the_ages.pdf) [Accessed May 20, 2016]

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<sup>14</sup> "Historical Inflation Rates: 1914-2016." US Inflation Calculator. <http://www.usinflationcalculator.com/inflation/historical-inflation-rates/> [Accessed May 20, 2016]

<sup>15</sup> Diversification does not guarantee profit nor is it guaranteed to protect assets during periods of declining markets. [Accessed May 20, 2016]

<sup>16</sup> "Fidelity's Retiree Health Care Cost Estimate Rises To \$245,000 A Couple." Forbes. <http://www.forbes.com/sites/ashleaebeling/2015/10/07/fidelitys-retiree-health-care-cost-estimate-rises-to-245000-a-couple/> [Accessed May 20, 2016]

<sup>17</sup> "2015 Retirement Health Care Costs Data Report." Healthview Services. [https://www.hvsfinancial.com/PublicFiles/Data\\_Release.pdf](https://www.hvsfinancial.com/PublicFiles/Data_Release.pdf) [Accessed May 20, 2016]



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