

Taking a Consumer Approach to Retirement Savings

by Dennis R. Ackley

What are the most expensive things you'll ever buy? A house, car, your kid's education? Unfortunately, most employees are unaware of their most expensive purchase – retirement.

The price of a house – what most people think is their most expensive purchase – is often two to four years of the buyer's annual income. Yet, people retiring at age 60 and living to 85 will need roughly 25 years of their annual income.

Why is retirement overlooked? The answer is simple: *Retirement is not considered a consumer item.* Few people think retirement is something they must buy.

Retirement illiteracy is rampant. Most people have no idea how much their retirement will cost or how to go about buying it.

Test of Basic Retirement Savvy

Americans are smart shoppers. We know how to buy things based on price, quality, and value – except when it comes to retirement. If we were savvy *retirement income consumers*, this test would be easy.

#1. A couple accustomed to \$50,000 a year in “spendable income” wants to retire at age 65. If they expect to live to 85 and keep their current lifestyle, their retirement will likely cost (in today's dollars):

- A. \$250,000 C. \$750,000
B. \$500,000 D. \$1,000,000

#2. An employee who expects to retire at age 60 and live to 85 and who currently has \$100,000 in a 401(k), (assuming inflation and investment rates are the same), should view that money as:

- A. Taxable income
B. Help with medical and long-term care expenses
C. \$4,000 worth of income a year
D. All of the above

#3. At age 65, a typical retiree who wants the most value should choose:

- A. \$100,000 lump sum
B. \$1,500 a month for life
C. Both are the same value

#4. At age 65, a typical retiree who has \$100,000 and wants a monthly income that will last a lifetime should expect – **by buying a lifetime annuity** – to receive about:

- A. \$400 C. \$1,600
B. \$800 D. \$3,200

#5. At age 65, a typical retiree who has \$100,000 and wants a monthly income that will last a lifetime should expect – **by withdrawing the same dollar amount each month from an account invested in large company stocks and U.S. government bonds** – to receive about:

- A. \$400 C. \$1,600
B. \$800 D. \$3,200

Retirement for Sale

Retirement illiteracy is rampant. Most people have no idea how much their retirement will cost or how to go about buying it.

Because employees don't consider retirement something they must buy, they ignore most retirement-related messages. According to surveys, a great majority of workers say they've heard "start saving early" and "you'll need 60% to 80% of your pay in retirement." But the messages are having too little impact. Nearly a third of eligible employees don't save regularly for retirement. And about two-thirds of the baby boomers – roughly 50 million people who are only a few years away from retirement – have no idea how much money they'll need or have. By these measures alone, our country's retirement education efforts are failures.

Even the government does not view retirement as a consumer item. If it did, it would probably require the disclosure of much more "retirement product information." The government requires that even candy bars must have a label that explains how that "food" will help meet your daily nutritional requirements. How many savings, pension, or Social Security booklets have labels showing how well those plans will meet the employees' lifelong retirement requirements?

Reinventing Retirement Education

Isn't time to create new messages and new educational techniques? Clearly, continuing to send the same messages to people who have already heard them – and who have not changed their behavior – is a waste of time.

New, high-impact retirement messages are needed – messages that will break

through to employees and cause them to change their retirement savings and investment behaviors. The new messages must be vivid, easy to understand, and in dollars and cents (not percentages). They must be personal, simple, and in consumer-oriented terms that describe the "purchase of retirement income."

Here is a simple, high-impact technique: A couple looking forward to 20 years of retirement and accustomed to living on \$50,000 of spendable pay a year will need about \$50,000 worth of income a year for 20 years. That's $20 \times \$50,000 = \$1,000,000$. It's that simple. That's the "retail price" of their retirement.

It's a bigger amount if they retire earlier, live longer, or if inflation outpaces their investment gains. It's not as much if they are willing to accept a lower standard of living or keep working.

Informing the Uninformed

As a first step in becoming informed retirement income consumers, employees need to know three things:

1. The retail price of their retirement
2. How far the money they've already saved and the pensions they've earned will go toward paying the retail price.
3. How much more they need to save.

Here's some good news. Employees don't need to pay the full retail price – or pay it all at once. They'll have help from Social Security, their employers' savings and pension plans, their personal savings, and the power of compound earnings.

However, if employees have not come up with the amount they owe by the time they need it, they'll get only the part that they've paid for. (See the three-step estimator on page 4.)

High Cost of Ineffective Retirement Education

Ineffective retirement education will not change how much money employees need to retire; only how much they have. The sad truth is that employees who want to retire, but cannot afford to, have only two not-very-good choices:

- *Continue to work.* This is a critical issue for employers. Picture an organization with an aging work force that wants to retire but cannot afford it. Is this what's ahead for your organization?
- *Reduce financial expectations.* Some people who cannot afford to retire will likely blame someone else for their fate. Whose fault could it be that employees have too little money to retire? Who has deep pockets? If lawsuits are brought over spilled coffee that is too hot, you can bet some people will try to sue their former employers over too little retirement income.

Most employers are working hard to educate their employees by using "best practices." Unfortunately, when it comes to retirement education, there are too few best practices. In fact, plan sponsors who say they have excellent retirement communication do not believe their employees will be better prepared for retirement than employees at other organizations.

Employers are not to blame for the failure of retirement education. It should have been taught in schools or homes. But it wasn't – and still isn't. Employers are no more responsible for teaching about retirement than they are for explaining how to finance a house, whether to buy or lease a car, or how to manage credit card debt. Yet the reality is, if employers do not educate employees about retirement, who

will? And organizations that choose to make the effort should use techniques that achieve the intended results.

Consumer Approach Is Only the Beginning

Only when employees have a clear idea of the retail price of their retirement will they begin making consumer-like comparisons.

For example, some baby boomers are deservedly proud they've built their retirement savings to \$100,000 or more. Yet they need to compare that to the retail price of their retirement. If they did, they would see \$100,000 as \$4,000 worth of income each year for 25 years (\$100,000 divided by 25 is \$4,000, under \$400 a month – assuming inflation and investment rates are the same). Naturally, if their investments do better than inflation, the \$4,000 will increase in value.

As employees become savvy retirement consumers, they will be motivated to learn the answers to:

- How can I get a more precise estimate of how much money I'll need?
- How much will Social Security pay?
- Will I owe taxes on my retirement income, and at what rate?
- Will I need to work longer than I planned?
- What about health care and nursing care expenses?
- Will I need to sell my home?
- What about future inflation rates and investment performance?
- What types of investments are best to meet my savings target?
- How can I set a budget today to save more money for retirement?

At best, the consumer-oriented approach is a starting point for the millions

Taking a Consumer Approach to Retirement Planning

of people who don't know the answer to:
"What is the price of your retirement?"

Until we begin explaining retirement in consumer terms, for most employees retirement simply isn't going to work.

Three-Step Retirement Planning Estimator

Step 1: RETAIL PRICE OF RETIREMENT

\$ _____ Amount you expect to spend each year during retirement multiplied by
X _____ Number of years you expect your retirement to last ... equals
[A] \$ _____ Estimated retail price of your retirement.

Step 2: DISCOUNTS – AMOUNTS TO BE PAID FROM OTHER SOURCES

From Pensions and Social Security

\$ _____ Annual retirement benefits payable for your lifetime from your employers' pensions (contact the benefits department), Social Security (800-772-1213), and other sources... multiplied by

X _____ Number of years you expect your retirement to last...equals

\$ _____ Total estimated lifetime value of your pensions and Social Security income
... plus

+\$ _____ Current 401(k) and other savings account balances ... plus

From your future part-time income

+\$ _____ Total take-home pay you expect to earn during your entire retirement ...

[B] \$ _____ Estimated discounts

Step 3: LAYAWAY PAYMENT

[A] \$ _____ Estimated retail price of retirement (from line [A]) ... minus

[B]- \$ _____ Estimated discounts (from line [B]) ... equals

\$ _____ Estimated additional amount you need to accumulate to afford the retirement income you want. You can spread the "layaway payments" for this amount over the rest of your working career.

Clearly, this formula lacks precision and it does not address every issue. But it gives people a general target. And research shows that people who at least have tried to figure out how much they'll need for retirement have saved about five times more than other employees. And as employees become smarter retirement income consumers, they will be motivated to obtain a more elaborate projection and more detailed information. That is exactly what retirement educators want – motivated learners. Libraries, newspapers, and the Internet are full of information employees can use to better understand how to shop for and buy their retirement.

Answers #1-D, #2-D, #3-B (actuarially, the lifetime income is more valuable), #4-B (a life only, single premium annuity from major insurance company), #5-A (this is “dollar-cost averaging” in reverse ... see www.scottburns.com and click on ‘The Spenders Portfolio’).



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Dennis Ackley is a nationally recognized leader in benefit communication and retirement education. His innovative, award-winning communication programs have reached more than three million employees on topics such as retirement planning, investing, health care, benefit choices, pay, and incentive plans. Dennis has created communication campaigns for hundreds of the country’s largest employers. He has written more than four dozen articles for such publications as *HR Magazine*, *Benefits Quarterly*, *Employee Benefits News*, and *Communication World*. He is a featured speaker at scores of conferences including the International Foundation of Employee Benefit Plans, Profit Sharing/401(k) Council, the PBGC, The Conference Board, Pensions & Investments, and Benefits Management Forum and Expo.

For more articles about how to improve employee communication and retirement education, search the Internet for “Dennis Ackley communication.”