T - 130

Statement for the

ERISA Advisory Council

Working Group on Preparing For Retirement

by

Dallas L. Salisbury
President and CEO,
Employee Benefit Research Institute
Washington, DC

April 9, 2001

Chairman McMahon and members of the workgroup:

I am Dallas Salisbury, President and CEO of the Employee Benefit Research Institute. EBRI has worked with the Department of Labor and the ERISA Advisory Council since its founding in 1978, and I had the honor of serving as a member of the Council in the 1980's. Related directly to this work group, EBRI began working with PWBA in 1994 on issues related to savings and retirement planning education. That early work led to the 1995 initiation of the Department of Labor campaign now known as "Saving Matters", and to the creation of new programs within the EBRI Education and Research Fund to work with partners across the nation on these important topics. First, we joined with many partners to form the American Savings Education Council (ASEC) program (www.asec.org), of which I serve as Chairman and CEO. Second, we joined with those and other partners to start the "Choose to Save®" media public service announcement and web based education program (www.choosetosave.org).

EBRI and ASEC responded to congressional requests in 1996 and 1997 for ideas on how to increase both public and private sector attention to these issues with suggestions for what became the SAVER Act and the National Summits on Retirement Savings. EBRI and its program units worked with the Department of Labor, other executive branch agencies, the Congress, and the American Society of Pension Actuaries to design and organize the 1998 Summit, and have been working with all of them again on the 2001 Summit.

The fact that there will be a 2001 National Summit on Retirement Savings makes the work on "preparing for retirement" especially relevant. The Employee Benefit Research Institute (EBRI) is pleased that the ERISA Advisory Council has convened a working group on preparing for retirement.

Today I have been asked to focus my comments on what information individuals should possess prior to making the decision to retire. I will seek to do that by providing some "steps", leaving time for discussion. I have placed these steps in a different order than many others would based upon our research and what it suggests individuals most readily know and don't know. For example, most people have a poor idea of how long they can expect to live, so I always start with that question. Without an individualized target for life expectancy it is difficult to figure out what you will need in retirement.

One: Assess how long you might live. This can be done today with many tools, with the easiest one available on the internet at www.northwesternmutual.com : the longevity game. I completed the game last week and was told that I should expect to live to 93. My rule of thumb for people is to add 10 years to that number, so I assume 103 in my retirement and savings decisions. Subtract this predicted life expectancy (plus ten), from the age at which you think you want to retire to determine how long you will need to support yourself without working for pay. This provides a necessary life expectancy number for working with retirement planning and savings adequacy calculators, as most as for an age of planned retirement and an age at which you expect to die.

This is an assessment that can be made – a game that can be played – at a very early age, and then every few years, to provide an ongoing input for calculating savings adequacy.

Two: Create or update your annual income and spending budget to what you expect you will have as income and will need to spend during the last year of planned work. Then, taking into consideration your life expectancy, and assuming annual inflation of about four percent (if you think the economists are correct about likely futures), grow your expense budget through your years of expected retirement. Can you grow your income expectations as well? What are your expected income sources? For example, a Federal employee hired in 1980 who is part of the "old" CSRS pension system can expect an annuity for life that is indexed for inflation. It will grow. Should that worker have a spouse working in the private sector who will have a Social Security annuity, also indexed each year for inflation, they will have two income sources that grow. They might purchase an inflation-indexed annuity, or plan to take more money each year out of savings. The tools I will mention provide what people need to do all this work, but it is work, and it will take a lot of time.

Our surveys suggest that for the majority of Americans this will actually be a tremendous amount of work, as most have never done a budget or documented annual income flows and spending. There are many tools on the internet to aid in this process, including many at http://www.choosetosave.org/tools/fincalcs.htm .

I also recommend that everyone begin at the earliest age possible to do all their finances with a tool like Microsoft money or Quicken so that it is easy to know where your finances are on a daily basis. For retirement planning this allows you to look at years worth of income and spending patterns as you seek to determine what you will need as a budget during retirement.

Three: Steps one and two combined will cause most people to take a long pause. The vast majority, if they have been realistic, will see a projected budget that says that expected retirement income is not going to cover desired retirement expenses. What are some of the points of realism based upon the advice of conservative financial planners?

1. Include more money for health expenses than you were spending while working. Most retirees will not have employer-facilitated health insurance. Purchase on the open market is expensive. Medicare only pays an average of 54 percent of retiree medical expenses and, contrary to public opinion, does not pay for long-term care. So even for the minority that think they will have enough income for retirement, they should re-check their health spending figures. The internet has good information on this available in many places, but www.aarp.org also can show you what they charge for the retiree health and long-term care insurance policies that they sell.
2. Assume no more than a 3 percent real return on your total investment portfolio (that is, above inflation) and don't forget that even that may be subject to income taxes. Many investment firm sites provide information on this, as well as the financial planning sites of experts like Ric Edelman and Jonathan Pond.
3. Plan to spend no more than 3 percent to 4 percent of your total pool of savings each year if you want a high probability of having it last as long as you do. There are excellent studies and tools on this topic at sites like www.troweprice.com and www.vanguard.com, and articles at www.aaii.org .
4. Realize that you will have a great deal of free time in retirement and that you are likely to spend more not less on entertainment and eating out than

when working, unless following a detailed and careful budget and spending plan.

5. Adjust your spending budget down to match your income, beginning with your first year of retirement. Need to move to a smaller home? Need to sell a second home? Need to remain in the work force longer in order to build savings to a point that they will match with the spending budget? Whatever it takes, don't sign retirement papers until you have a financial plan that looks like it will work.
6. Don't quit permanent full time or part time employment on the assumption that you can find employment elsewhere if continued earned income is essentially to affording full or part time retirement. For better or worse we are still an economy that frequently pays based upon firm specific seniority, so the next position might be equal at a much reduced salary.
7. When working on your financial plan, think about your wealth, not your net worth. Your wealth is tied to income. For example, is your home an asset or liability? I think about assets as things that either produce current income or that I am willing and able to sell. My home does not produce current income. In fact, it produces expenses that can have wide fluctuation, even if I own the home without debt. Just look at what homeowners are now facing with gas and electricity bills. When my bride and I do our financial planning we do not count the house as an asset or a liability, it is carried at zero because we do not want to sell it. But, the remaining mortgage is carried as a liability because we must make a

monthly payment. And, clearly, all the monthly and yearly expenses create an absolute requirement for current income. Most retirees responding to our annual Retirement Confidence Survey say they do not plan to sell their primary pre-retirement residence during retirement. Therefore, most should not count it as an asset as they consider their ability to retire. They should count all the expenses of staying in that home.

Four: Have an estate plan in place, prior to retirement, in case you die a lot sooner than your projected life expectancy. Pretend that you will have to serve as the executor of your own estate. Get everything organized and in order so that your job would be easy, so that the real executor doesn't wish they had said no to your request that they agree to be named in your will. Don't have a will? That makes you normal, but doesn't make it desirable.

Five: Visit a bookstore. Their shelves are full of books that will assist you in all of the areas listed above. Don't just read one book. Many will make the same points I have made here, some will disagree with them, others will add many new ideas. The "Dummy" series now has books. Insight can be gained from bestsellers like "Rich Dad:Poor Dad". Specialized books like "Living on Your Nest Egg: How to Save, Invest and Spend for Your Retirement" provide a set of planning tools. A book now at the printers that I have co-authored with Marc Robinson, "Managing Money in Retirement" starts with the assumption that you have already retired, but may not have done it having completed steps like those noted above. We included the following sections:

- What Will It Take to Retire?

- What Lifestyle Do You Want?
- Charting Your Financial Future
- Legal Preparations
- Understanding Risks
- Design a Strategy
- Protecting What You Have
- Trusts
- Discounts
- Cutting Back on Expenses
- Long-Term Care Insurance
- Generating Income
- Working
- Retirement Plan Withdrawals
- Income From Employer Plans
- Some Tax Issues
- Types of Fixed Income Investments
- Bond Mutual Funds
- Annuities
- Home Equity
- Growing What You Have
- Managing Your Money
- Who Can Help?

I greatly appreciate the opportunity to discuss this important topic with you today. Most retirees continue to have Social Security as their primary source of income. For a large percentage of retirees it is their only source of income. It was not designed to provide an adequate income, and it does not. Yet, for a majority of today's workers it will play the same dominant role unless they take action and change their behavior. Your work can only help.

What you are working on, and what I have discussed, serve to underline the importance of the SAVER Act, the Saving Matters campaign, the ChoosetoSave® campaign, the American Savings Education Council partnership, and all other activity aimed at increasing financial literacy. I commend you for your attention to this vital matter.

I would be pleased to take any questions.