The Fallacy of Retirement

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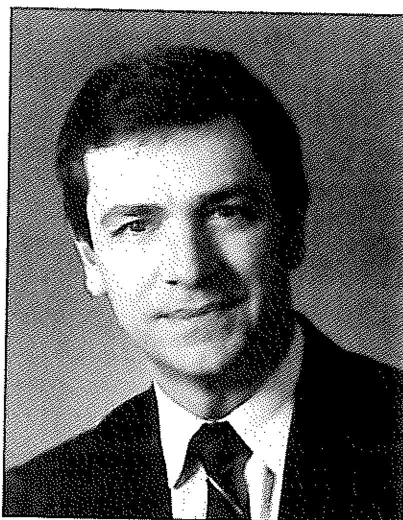
Retirement planning is the centerpiece of financial planning. It is the goal Americans most often give for why they save money, but it is also an area where study after study show Americans are falling short of this goal.

The perspective that supposedly distinguishes the Certified Financial Planner professional from "mere" money managers centers on the ability to lead clients toward good long-term decisions about their money, and nowhere could that be more important than in planning for life after the traditional retirement date. The ability to help clients will be much improved by approaching the topic with new insights derived from looking at the real world rather than the results of spreadsheet programs.

One of the most important things financial planners do is to help their clients think about the critical themes in their lives. If, in the expression of the day, clients "get it" when we lay out our vision, they can become motivated to take the steps they need to be successful. Planners have to be both realistic and visionary to do their jobs.

As a framework, planners may consider dividing the topic of retirement into three time frames, which we define as (1) accumulation planning, (2) transition to retirement, and (3) living in retirement and unretirement—working beyond the typical retirement age. *Accumulation planning* is the period up until about age 50 or 55, when the ultimate level of the client's available resources is still to be determined. *Transition to retirement* is the period when the client still is employed full time, but realizes that a change is beginning, and the level of post-retirement resources can be affected but not changed radically. *Living in retirement and unretirement* is the period after the end of a primary career, around age 60 to 65, when our clients either are living off their resources or will continue to earn money in some capacity. Here, the questions of liquidity, cash flow and qualified plan distribution strategies are the focus of much planning.



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Inaccuracies of Conventional Wisdom

Perhaps the best way to start this discussion is by looking at what can actually happen to people in the third stage, their retirement.

Conventionally, "retirement" means you work for a long time—40 hours a week for 40 years—and then suddenly you will never go to work again or ever earn another dollar. With the low savings rate in this country and lengthening life expectancies, this definition leads many observers to expect a retirement crisis when the Baby Boomers start turning 65, or before. Part of the anxiety that people feel when they see articles like, "Planning a Worry-Free Retirement," is the assumption that, if they don't follow the article's advice,

they will have a worry-*full* retirement. The methodology that we as financial planners use tells average Americans that they must build asset levels that may seem unobtainable for some.

Many readers may disagree with some of our suggested solutions. But here are some reasons why we believe the conventional idea of retirement is not appropriate for many people, and why a radically different approach to retirement planning needs to be taken.

1. Most of us define ourselves by what we do for a living. *What are you?...I'm an attorney...I'm an architect...I'm a financial planner.* How do we feel after 40 years when society says, "We're sorry, that's not what you are anymore because we are not going to let you work"?
2. Our daily life is structured by our jobs: we get up, we get dressed, we go to the office, we work, we eat lunch, we have a coffee break. For 40 years we follow that routine, until society says, "We're not going to let you structure your life that way anymore." We wonder what we are supposed to do all day.
3. The economic strength of our society is based in substantial part on the accumulated skills and wisdom of the workforce. Current employers have invested much more in educating and training workers than at any time in the past. It is foolish and wasteful to simply throw skills away when people reach their sixties.
4. The social part of our retirement funding has been based on current workers paying for retirees, in a kind of mortality-assisted pyramid scheme. It is common knowledge that the baby boom of the 1960s and 1970s and longer life expectancies for those born earlier combine to create some pretty unfavorable ratios of workers to retirees in the decades ahead.
5. The private part of the retirement funding model falls victim to the same mortality statistics. A generation or two ago, most people left schools and started working at a relatively young age and anticipated few years of retirement, so there might be four years of work for every year of retirement. Today the ratio may be less than two to one. The percentage of income that has to be saved today must be much higher if our lifestyle after age 65 is to be supported for several years without earned income.

It is interesting to note that the current generation of retirees—many of whom find themselves unable to live on their own savings and pensions—received many advantages that the next generation, the Baby Boomers, will not enjoy. They were beneficiaries of an enormous increase in residential real estate prices from the 1950s to the late 1980s, an increase their parents did not see, and one that is becoming only a dream to their children. There has been an enormous increase in stock market values, greater than the growth in prices or even of the economy in general, and this has helped fund retirements. It is debatable whether the stock market can continue to provide returns at twice the rate of general economic growth.

Further, Social Security taxes, for reasons both political and economic, were kept low in the decades after World War II. Medicare was created in 1965, early enough for today's retirees to enjoy it but late enough they did not have to pay for it throughout their careers. Experts project that current rules will allow people retiring now, 30 years later, to receive $100,000 more in Medicare benefits than they "paid for." Those still working are having to deal with a Social Security system that will be operated—somehow—on a more sound, but less generous, basis.

Finally, the last half-century saw the development and growth of a vast system of well-funded (and regulated) private pension plans for the first time, providing a safety net to millions of workers who did not have to save much on their own. Today's environment, in contrast, sees the decline of the defined benefit pension in favor of profit-sharing plans, 401(k) programs with modest matching funds, or "contract" work with no benefits at all.

Stage 1: Accumulation Planning

The lessons from this history, especially for people in the "accumulation planning" stage of their lives, are that they will have to do more for themselves than their parents and grandparents did, and that they have choices about their future. If they really want to prepare for many years of life without earned income, the balance between what they spend now and what they have to set aside now to spend later will have to change. If, however, they see the future as one in which they slow down but never really stop working, then their accumulation target can be lower. A realistic explanation of these trends and forces will help them decide on their goals and what trade-offs they are willing to make.

Despite a growing understanding of the concept of lifelong employment and "unretirement," many clients still turn to planners for advice on how to save enough money for a traditional retirement. They want to know how to get off the treadmill. But there are traps that lie ahead.

One way to see the traps is to imagine a financial planner working early in 1935, during the first term of Franklin D. Roosevelt's administration. A client comes asking for advice about how much to save for retirement. We get to review the notes from the meeting.

The notes reveal some of the information the planner and client might have used. The data would have shown a negative rate of return on the S&P 500 since its beginnings in 1926. The Consumer Price Index had gone down six of the prior nine years, and the rate of inflation over that period was a negative three-percent a year. If the client had invested in T-bills the prior year, he would have received one-sixth of one-percent interest. The client earned $2,500 a year, and he felt real good about that, because the country had had double-digit unemployment for the previous four years. There was discussion in the press about some form of government-sponsored universal retirement program, but nothing had been enacted yet. The client had neither a pension

nor health insurance.

Using today's techniques, the planner would have asked the client to project what his or her career future was going to look like; what inflation (or deflation) rates were going to be; what employer-sponsored retirement benefits might be available; when he or she planned to retire; life expectancy; expected rate of return on savings; what tax rates would be on ordinary income, capital gains and retirement plans (concepts that may not have even been invented by 1935); and what budget the client would need. However, it is doubtful that any specific projections would have been very accurate or useful.

The 700% Solution

We have developed a new tool to put the retirement planning process in a perspective that is useful, reasonable and motivational to our clients.[1] Clients need to think about wealth-building over time, developing a target rate of savings and a portfolio allocation. Clients in their 30s and 40s with children, thinking about a long-term budget and an appropriate replacement ratio for retirement income, should plan on living in retirement on about 40 percent (after-tax) of their pre-retirement income. That figure undoubtedly sounds extremely low to most planners. More commonly, 70 to 80 percent is cited, and even that is often seen as low. However, 40 percent reflects the need to spend money during pre-retirement years on children, retirement savings, work expenses, and paying off the mortgage, leaving about 40 percent for the parents/clients to actually spend on themselves (please refer to the *Fee Advisor* article for a more complete discussion of the math). We believe it is politically likely that some form of compulsory retirement program will be in place—either Social Security or its successor—so clients need to have personal resources, including employer plans, to replace about 28 percent of their pre-retirement income.

A diversified portfolio can provide a total return, after taxes and after inflation, of about two percent a year. We like to assume that clients will have 35 years in which to draw on their retirement funds. This may be longer than average life expectancy, but it is better to be a little conservative and build in a margin for a nursing home stay, a bad rate of return on investments, or leaving some money to grandchildren or charity. With a two-percent real rate of return, it takes $25 of initial capital to produce $1 of (inflation-adjusting) income for 35 years.

Therefore, the capital goal is $25 times 28 percent of income, or 700 percent of annual income in investment assets when it is time to retire. The dollar value of this target will adjust automatically as incomes, inflation rates, and tax rates change over time, but the relationship of the savings target to earnings should stay about the same.

Once the target is determined, a client's current accumulation also can be measured in units of income, and the necessary savings rate—again, as a percentage of income—can be calculated and communicated to the client. Those starting young can reach their target by saving 8 to 12 percent of income a year, while a 45-year-old with no assets will see a steep path, and come to a more accurate understanding of what will be and will not be possible in later years. Those expectations may well include the recognition that working past age 65 will be necessary.

Stage 2: Transition to Retirement

When clients are young, they can choose to save aggressively or not at all, and the impact of their decisions is far in the future. When clients reach their 50s and 60s, the miracle of compound interest is less available, and the choices are more narrow. Some people will reach their late 50s in good shape, perhaps having spent their lifetime in a government agency or large company with a generous pension plan. Others, however, will have little money built up. Some of them invested poorly, some educated several children through graduate school, faced illness, divided assets in a divorce, changed jobs and never accumulated retirement benefits, or simply chose to live well for the day instead of saving for the future. Whatever they did, they will find life after age 60 is a "come as you are" party.

Many organizations and planners devote a share of public education (and marketing) effort to this transition stage into retirement. The subjects covered include both financial and lifestyle concerns, and presenters hope to lift peoples' gaze and stretch their imagination. We will not attempt to repeat the advice others give, but the stage is important. Increasing the level of realism and the amount of time a client has will make the transition easier, both mechanically and psychologically. Many people act as though they believe they can continue to spend 100 percent of their "income," even after their incomes stop. They ask what they must do to maintain their standard of living, instead of asking what standard can be maintained on the resources they have.

A balance sheet is a concept that is widely understood by people in this age bracket. One author has proposed a Lifetime Balance Sheet as a framework for helping in this stage of planning.[2] In simple form, the Lifetime Balance Sheet adds to the asset side the present value of vested retirement benefits, the value of future earnings, and the value of any reliably-expected inheritances. These give the total value of all the resources a client will have under his or her control. On the *liability* side, we add to actual debts (like mortgages) any moral obligations (like college). The balance remaining is the amount the client has for living expenses for the rest of his or her lifetime. When lifestyle needs can be fully met from investments and vested pensions, the client is "financially independent." Until that time, the client will have to rely on, and therefore continue to generate, earned income.

As our clients begin the transition to retirement, those without adequate savings will have to reduce their standard of

living, continue to work, or both, unless there is an independent source of capital about to drop from the sky (which, if their parents were frugal or successful, could happen). The sooner the shift is made from spending to saving, the less dramatic it may have to be. This is a stage where reality therapy is necessary for many clients. However, a reality that includes continued employment may be a more attractive option than planners might assume.

Older adults may increasingly opt for *unretirement*—working either part-time or full-time, as employees or consultants, in paid or volunteer work. If Baby Boomers are not saving adequately for retirement, many in this generation will need to work beyond the current retirement age of 65. As a result, traditional means of saving and planning for retirement may not meet the needs of individuals seeking unretirement as a way of life.

Stage 3: Living in Retirement and Unretirement

Planners must also be prepared to help clients—as their trusted advisors—to remain in the world of work where appropriate. It is unfortunately true that clients wanting or needing to follow that path may not find it easy.

According to a survey conducted by Caroline Bird—author of *Second Careers*[1]—older adults tend to work for a number of reasons. While it is probably no surprise that financial considerations top the list of work motivators, older adults work to achieve a number of other goals: to be a part of the world and socialize with others, to help others, to avoid the "dangerous" aspects of retirement and for the enjoyment of work itself.

Employers are increasingly interested in employing older adults. The smaller number of workforce entrants represented by the "Baby Bust" generation has resulted in labor shortages in a number of industries and occupations, most notably in retail and hospitality (those industries whose occupations rely most heavily on young workforce entrants). Employers also cite benefits in hiring older adults, including the work ethic of older adults, their skills and life experiences, and customer focus.

Recareering for Second, Third and More Careers

Re-entering the job market later in life often means your clients must look for different occupations and industries from those they held as younger workers. The world of work is changing, and often those jobs held in years gone by are now either redesigned with new technology, obsolete or dramatically altered. Many areas of employment now rely heavily on technology to perform everyday tasks. Even working as a consultant in the same

field often entails taking on new skills, such as sales and marketing, finance and budgeting and administrative skills.

Often, to enter a new career, or to re-enter, individuals may need to look at lower, versus lateral, points of entry. It may not be possible to enter a new field or occupation at the same salary level, or with the same sets of expectations as when one can remain within their same field. Older adults may need to adjust their salary expectations, especially when making these kinds of recareering moves, and retirement planning will need to accommodate these changes.

According to Bird's study, most older workers said that they had to learn new skills for their current job. As Ken Dychtwald points out in his book, *Age Wave*,[4] learning isn't something that we only do in the first third of our lives as had been the pattern, but rather, the commitment to lifelong learning becomes the only way to remain active and engaged—not only on the job, but in life.

Older adults will need to update their skills, abilities, and knowledge through an ongoing commitment to learning. Whether it be through on-the-job training, off-site seminars, enrollment in college classes or in a computer software workshop, older adults will need to commit to training and retraining in order to unretire. Individuals not receiving education on the job will need to seek and pay for training on their own if they are to remain competitive in an increasingly complex labor market.

Barriers to Employment

Older adults, no matter how motivated to work, may find resistance from co-workers, supervisors, and even friends and family members, who may believe that they are not suited to employment. Unfortunately, there are many myths and commonly held misconceptions regarding older adults and their abilities in the workplace. Typical myths include the belief that older adults are slow, uninterested in continual employment, more accident-prone, and have increased absenteeism and tardiness

The Career Development Fund

Clients want us to tell them how they can retire. However, limiting the process to this approach overlooks a major opportunity. Planners can help promote change by challenging clients' ideas about earnings.

Clients have the opportunity to take control of their career development, and planners can help. Human resource experts tell us that everyone needs to plan for several careers and many employers during their lifetime. Many financial planners graduated from college years before the first CFP designation was awarded. College students are learning to be computer network managers, a field that didn't exist ten years ago, and when they are in their mid-40s, they will probably be in a job that doesn't exist today. Careers are changing: technology brings new jobs, other jobs are disappearing, and new skills become necessary. Everyone needs to continue to upgrade themselves to stay employed and employable. Further, the economy will continue to change dramatically. There is no reason to count on a slower rate of change a generation from now.

As a corollary, there is no reason to think that the skills that will be needed in another quarter century or half century can be predicted today. An expectation arose in the 1970s and 1980s that employers would take care of on-the-job training. Many companies are spending large amounts on retraining, but with employers downsizing, scaling back benefits, laying off tens of thousands of employees at a time, it is not realistic to think that the employers of our clients are going to pay all the bills for skill development. Individuals need to supplement what happens in their jobs to take care of their own long-term career growth.

Planners can assume an active role in helping clients earn more money and they can advise how much to hold back for the future. The *accumulation planning* period is about more than budgeting and investing.

Financing personal growth requires money. We have proposed that clients devote five to ten percent of their incomes to a *career development fund*. Just as a business must use a portion of revenue and earnings for marketing and research efforts to assure the long-term survival and growth of the enterprise, so must individuals set aside part of their income to promote their careers and earnings capacity. The money may be used to obtain advanced degrees, travel to professional meetings, support a sabbatical or parental leave, buy a computer (and training for the computer), get mid-life-crisis career counseling, or finance relocation to a new opportunity in a new city.

At a deeper level, a career development fund will reinforce in the client a sense of being responsible for his or her own life, and having the resources to carry out those responsibilities.

We have elsewhere suggested some new tools to help clients develop a more realistic understanding of where they stand in pursuing their career and retirement goals, and what additional steps are needed.* Each of these tools attempts to place in present-dollar perspective the resources available and called for. Those techniques involve both career development and savings and investment.

Whatever techniques we use, our job as financial planners is to help our clients understand both the uncertainty of the future and the necessity to take actions today to prepare for that unknowable time. The challenge to financial planners as counselors and motivators is great. It is tempting to return to the simple models that give 40-year projections to the penny. Unless we adopt a new approach, however, we will not serve our clients or our society well.

* Fyock and Vodra, "The End of Retirement," presentation to the 1995 ICFP National Retreat, San Diego, CA, June 16, 1995; Fyock, *UnRetirement*, Amacom, 1994.

rates. The reality, based upon research, is that older adults are just as productive as their younger counterparts, are interested in employment, have fewer on-the-job accidents than their younger counterparts and have less incidence of absenteeism and tardiness.

Typically, myths manifest themselves in the workplace in discriminatory behaviors that often become real barriers to the increased employment of older adults. Older adults find that there is resistance to their job-seeking efforts on the part of employers, and they are likely to hear such comments as, "We believe you're overqualified," and "We have someone (younger) in mind for this job." Older job seekers find that their rates of unemployment are higher than their younger counterparts (one study indicated as much as seven times greater unemployment rates for those over age 55 than for those people ages 16–54). Further, older adults generally have longer periods of unemployment. These barriers may eventually be lowered. However, in the meantime, older adults who want and need to work will need to take these barriers into consideration as they make financial plans for unretirement. Younger workers also should be strongly encouraged to save adequately, even if they plan on not retiring at normal retirement age, since they may not always be able to rely on employment being available.

Conclusion

Most Americans face a lifetime of employment and change. While the black-and-white concept of retirement will continue to fade for most Americans, it remains true that people who invest in their futures, both financially and professionally, will have the greatest amount of freedom and choice. Planners can serve clients well by helping them understand how the decisions they make today will expand or limit their options for the future. ■

Endnotes

1. Richard Vodra, "The 700% Solution," *Fee Advisor*, November-December 1995, p. 43.
2. Robert Veres, "The Retirement Plan of the Future," *Investment Advisor*, September 1995, p. 143. "The 700% Solution" and "Lifetime Balance Sheet" are trademarks owned by Richard Vodra.
3. Carolyn Bird, *Second Careers* (Little Brown & Co., 1992).
4. Ken Dychtwald and Joe Flower, *Age Wave* (Jeremy Tharcher, Inc., 1989).

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