Consumer Approach to Retirement Planning

By Dennis Ackley

No one would ever take a new job without first knowing what it paid. And yet surveys show that millions of people are headed toward a new career — called retirement — and are clueless about their retirement income and the price of their retirement.

Do your employees know the estimated price of their retirement? It's probably the most important — and expensive — purchase they'll ever make. Their answers will offer a revealing look at the current state of your retirement education program and the extent to which critical messages need to be retooled

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Lifestyle x time = price

Two factors that greatly influence the estimated price of retirement are:

Lifestyle. A couple accustomed to spending $40,000 a year will need about that much each year to maintain their lifestyle.

Time. People who intend to retire at age 60, for example, will likely need 20 to 25 years of income (to age 80 or 85) during their retirement.

The estimated price of retirement is found by multiplying lifestyle by time. In this example, $40,000 a year times 25 years is $1 million.

It's a larger amount if they retire earlier, live longer, have bigger bills or if inflation outpaces their investment gains. It's even larger yet if they want to improve their lifestyle -- traveling or living in a more expensive area. It's not as much if they're willing to accept a lower standard of living, keep working or if their investments do well while they're retired.

Of course, this estimate isn't precise. It may be off by 10% to 20% or more. But it is far more accurate than the "Gee, I don't know" answer most employees give when they're asked, "What's the estimated price of your retirement?"

Retirement as a consumer item

Too many employees don't know the price because retirement is not considered a consumer item — not like a house, car or TV. That's why the government doesn't require the kind of consumer information it does for other products.

Yet, if your employees make a "bad retirement purchase" — by not saving enough or not investing wisely — they may end up with 20 or 30 years of inadequate income.

Unfortunately, too many employees don't know how much to save or how to invest for retirement because they don't know how much they need. Interestingly, studies show that employees who have at least tried to determine "how much" have much larger 401(k) account balances than everyone else.

Discounts and layaways

Good news: Retirement income is available at discount prices. The discount comes because part of the full price will be reduced by employers' retirement plans, the power of compound earnings, a part-time job during "retirement" and any Social Security benefits.

More good news: The discount price doesn't have to be paid all at once. It can be paid off like a layaway purchase during the employees' working careers. The earlier they start, the smaller their "payments" (how much they save) need to be.

However, if the amount they owe isn't paid by the time retirement arrives, employees will get only the part that's been paid for. And after retirement starts, inflation will eat away at the value of the retirement account.

By helping employees gain a better idea of the full price and layaway price of retirement, you'll put them on track to becoming "retirement income consumers" — able to make consumer-like decisions and comparisons.

For example, some baby boomers can be proud that they've built their retirement savings to $100,000 or more. And, some organizations have introduced retirement plans that feature even larger single sums at retirement. This sounds like a lot of money for retirement. But if employees have a retirement income consumer's view, they'll see $100,000 as roughly $4,000 worth of income each year for 25 years ($100,000 divided by 25 years is $4,000 a year — assuming future inflation and investment rates are the same). It's worth more if investments outperform inflation — less if they don't.

Motivated consumers

As they become retirement income consumers — like all consumers — employees will want answers to questions about how to make the best purchase. They will want to know about future Social Security benefits, taxes on retirement income, health care and nursing care expenses during retirement, future housing needs and the impact of inflation. Naturally, they will also want to get a more precise estimate of how much income they'll need. And, of course, they'll want advice about how to save and invest to reach their target and how to do that on their budget.

Who will teach?

Most employers don't teach employees how to buy houses, cars or TVs. And if retirement were considered a consumer item, retirement education would be taught in schools. But the reality is today, if employers don't teach employees how to buy retirement, who will?

Studies show that most employers are taking on this task and have been increasing the educational efforts. But perhaps the tools and concepts they are using are not working as well as they should. Employees seem to be learning — but it may be too little. Just 2% of all self-described "retirement investors" from the general public correctly answered all 10 questions in a recent 401(k) quiz sponsored by J.P. Morgan/ American Century Retirement Plan Services.

Perhaps it's time to reinvent retirement education. Because educational techniques that don't work well will not change how much retirement income employees need — only how much they'll have. And in far too many cases, that's probably too little.

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A version of this article appeared in the September 2000 issue of ***Employee Benefit News***

Dennis Ackley

For 20 years Dennis Ackley has been an advocate for clarity and accountability in retirement education – helping workers gain the knowledge to achieve the financial future they want. His award-winning communication programs on retirement, investing, and health care have reached three million employees at hundreds of employers. For more articles and more information, visit ***www.DennisAckley.com***.