

The Potential for Better Asset Management in Retirement to Increase Financial Security



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Presented to:

Employee Benefit Research Institute

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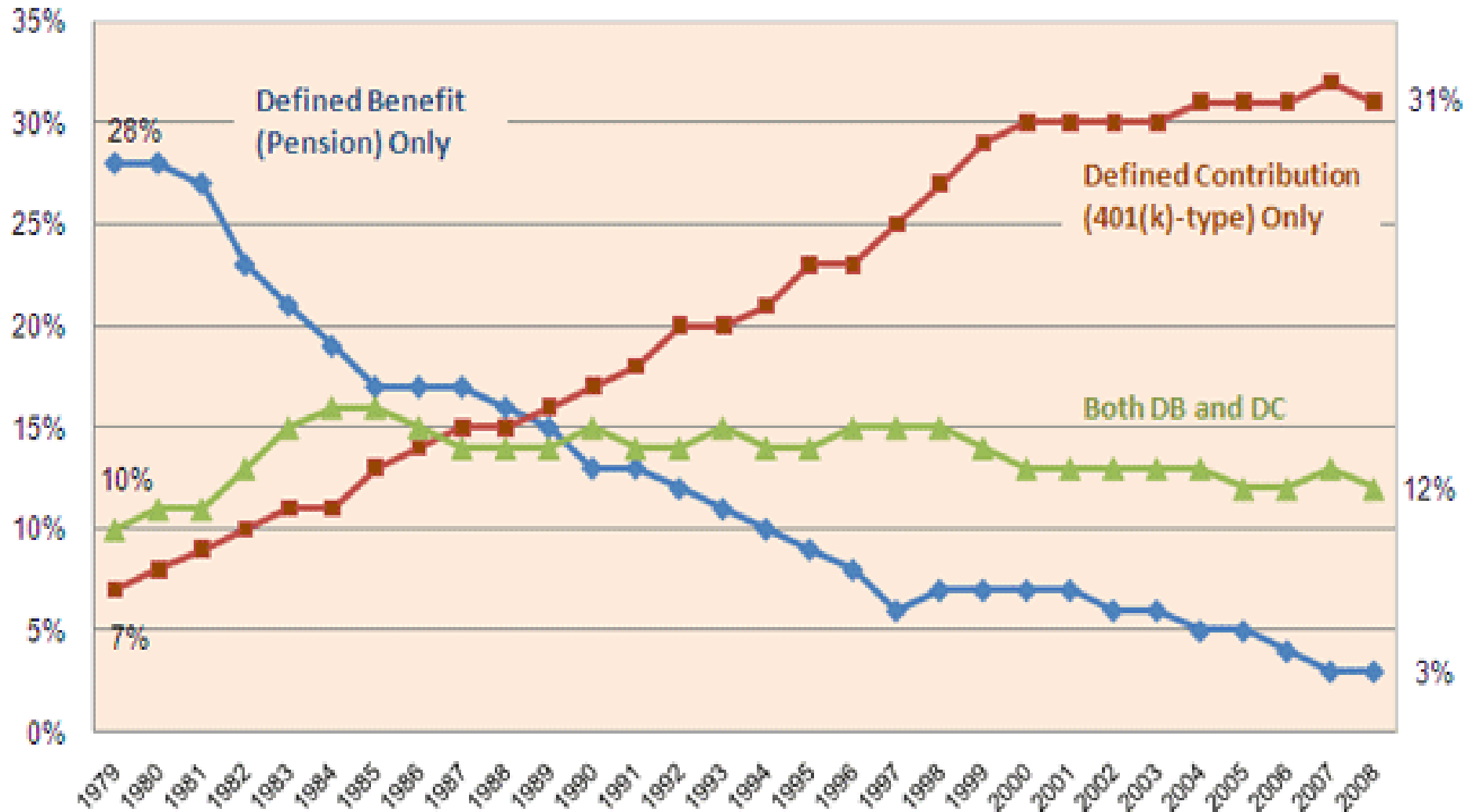
The Challenge

The Huge Baby Boom Generation Faces an Incredibly Expensive Retirement, Which They Have Not Adequately Prepared For

- **Reduction of Guaranteed Lifetime Income**
 - **Falling entitlement programs**
 - **Less defined benefit plans**
- **Higher Health Care Costs**
- **Longer Life**
- **Higher lifestyle needs**



Figure 1
Private-Sector Workers Participating in an Employment-Based Retirement Plan, by Plan Type, 1979–2008
(Among all workers)



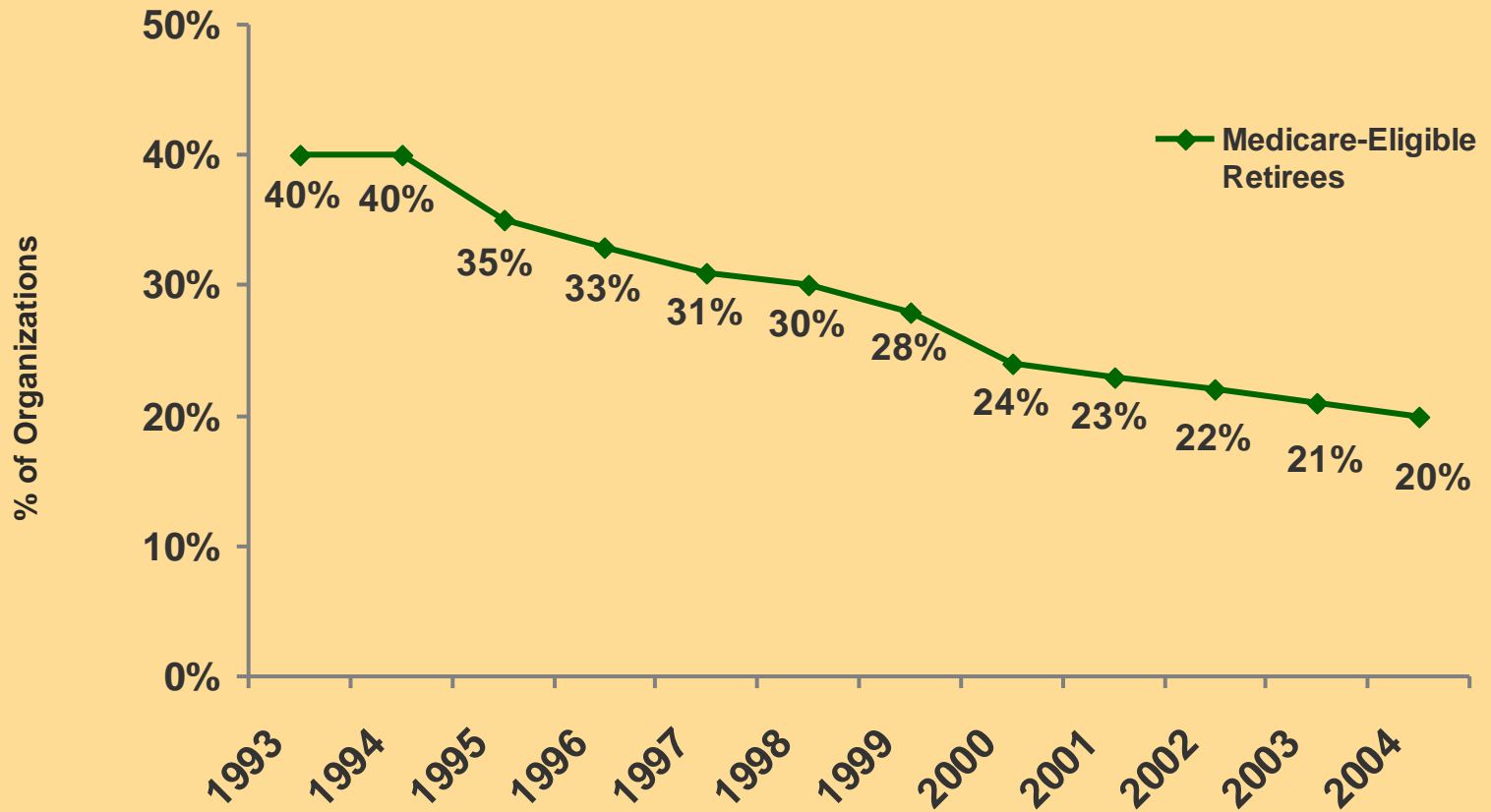
Source: U.S. Department of Labor Form 5500 Summaries for 1979–1996; PBGC, Current Population Survey data for 1999–2006; Employee Benefit Research Institute estimates for 1999–2006.

The Decline in Social Security Replacement Rate for the Average Worker Retiring at Age 65

	%
In 2004	39
In 2030, After Extension of Normal Retirement Age to 67	36
After Medicare Part B Premium Deduction	32
After Personal Income Tax (not adjusted for inflation)	29



Employer-Sponsored Retiree Health Coverage Among Organizations with 500+ Employees



Source: Employee Benefit Research Institute, 2003



Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2010

	Median Prescription Drug Expenses Throughout Retirement	75th Percentile of Prescription Drug Expenses Throughout Retirement	90th Percentile of Prescription Drug Expenses Throughout Retirement
Men			
Median	\$ 70,000	\$ 79,000	\$ 100,000
75th Percentile	104,000	118,000	147,000
90th Percentile	133,000	151,000	187,000
Women			
Median	93,000	105,000	131,000
75th Percentile	121,000	137,000	170,000
90th Percentile	152,000	173,000	213,000

Source: EBRI



Under-Funding Retirement

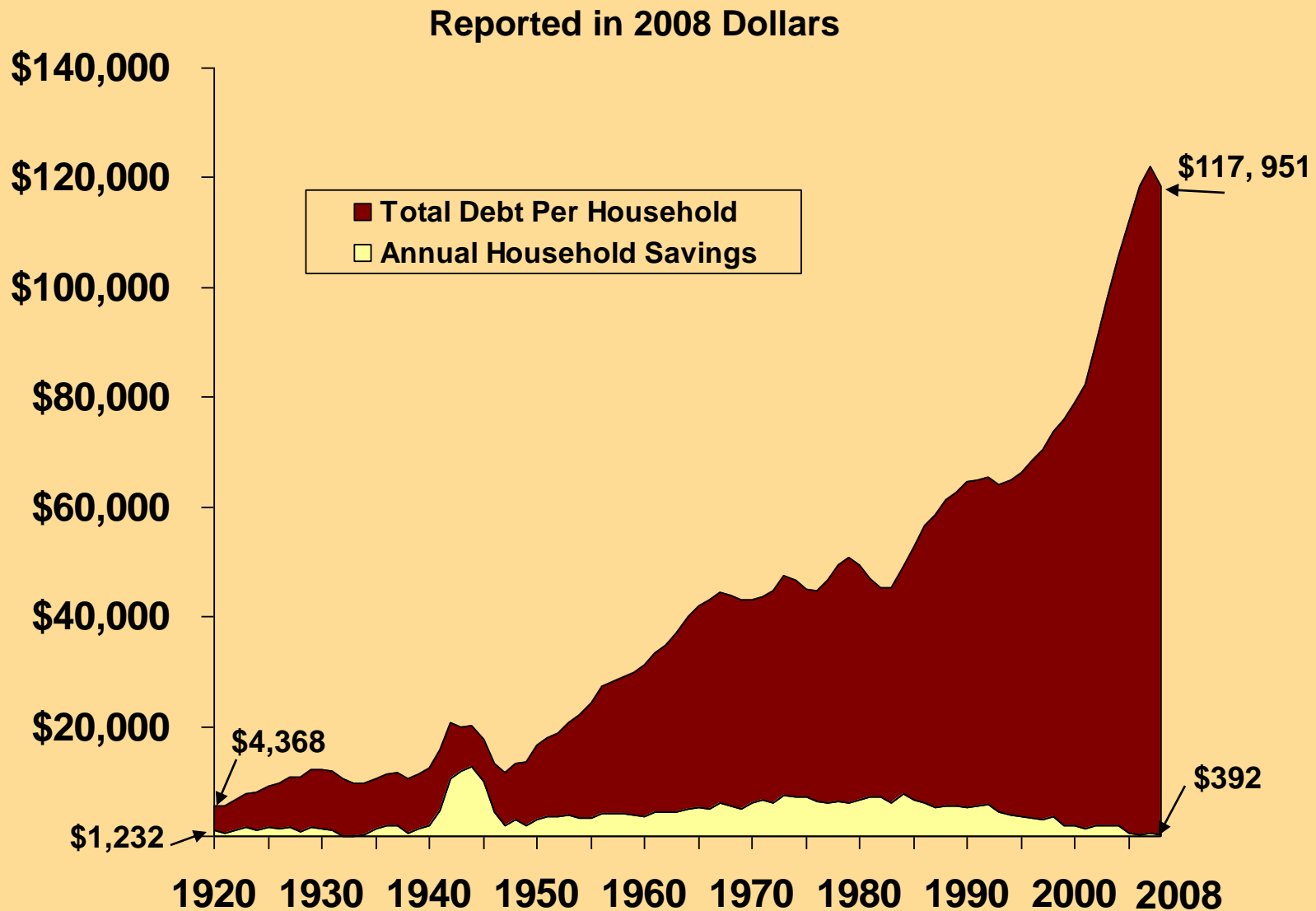
Income of Families Headed by 55- to 64-year olds

	<u>Under \$75,000</u>	<u>\$75,000 to \$100,000</u>	<u>\$100,000 to \$150,000</u>	<u>\$150,000 to \$200,000</u>	<u>\$200,000 to \$250,000</u>	<u>\$250,000 and over</u>
	%	%	%	%	%	%
Under \$200,000	86	64	44	29	13	14
\$200,000 to \$300,000	4	15	17	5	18	4
\$300,000 to \$500,000	6	7	19	20	11	5
\$500,000 to \$750,000	3	9	11	18	9	5
\$750,000 to \$1 million	*	2	4	11	5	8
\$1 million to \$2 million	1	*	4	12	29	26
\$2 million to \$5 million	*	2	1	5	15	22
\$5 million and over	*	1	*	1	*	16

* Less than 0.5%

Source: Employee Benefit Research Institute estimates from the 2007 Survey of Consumer Finances

Household Debt and Savings: 1920 – 2008



Source: New York Times (7/20/08)



Sub-optimal Practices of Many Financial Advisors

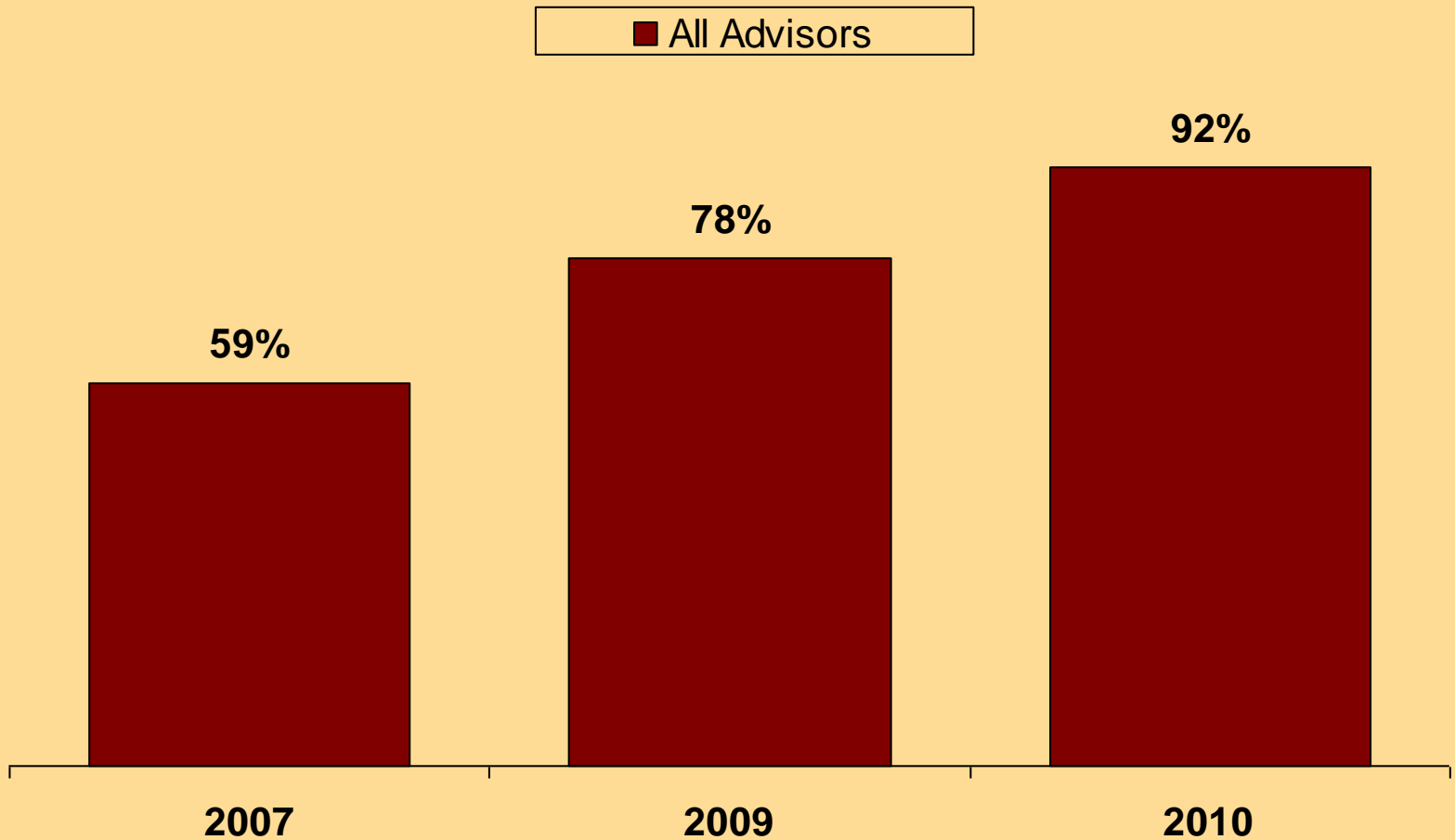
- **Most advisors do not address longevity risk**
- **Many advisors suggest clients assume they will live to age 90-92, often without assessing health**
- **Clients do not get a chance to assess how much risk they are taking with their spending levels**



Reducing Exposure to Equities

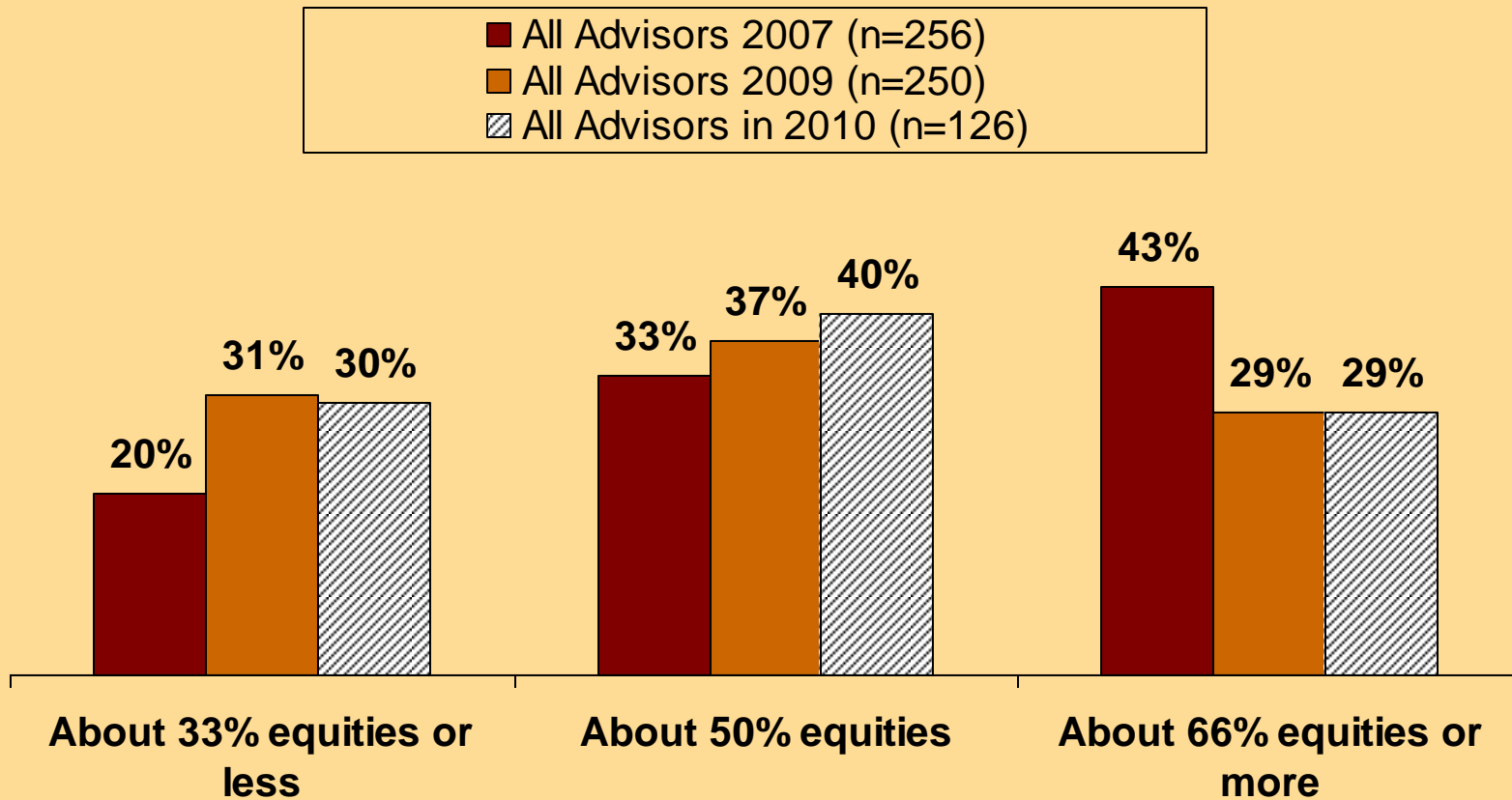
Generally, do you believe that clients who are retired should reduce their exposure to equities as they get into their late 70s and 80s?

Percent saying yes



Reaction to Specific Retiree Scenario

What type of asset allocation would you usually recommend for a couple, both age 65, with moderate risk tolerance, who had about \$500,000 of investable assets, with no defined benefit plan, who wanted to support a lifestyle costing about \$35,000 per year in addition to their Social Security benefit?



Recommended Withdrawal Rate for 65 Year Old Couple with \$1 Million

- Monte Carlo analysis suggests withdrawal of \$37,500 in the first year for a 90% chance of having enough money until age 92
- Assumes 50% in equities
- This equals about \$2,250 a month in first year after taxes, plus Social Security
- 25% likelihood one will live longer if both are healthy at age 65
- Spending rises 3% a year, inflation for older people may exceed that



Financial Strategies During Retirement Must Be Different Than During Accumulation

Accumulation

Plan to date certain

Low penalty if not
prepared on date

Volatility ally

Focus should be on
equities

Low risk of major
unpredictable
expense

During Retirement

No certain end date

Major penalty if run
out

Volatility enemy

Focus should be on
income

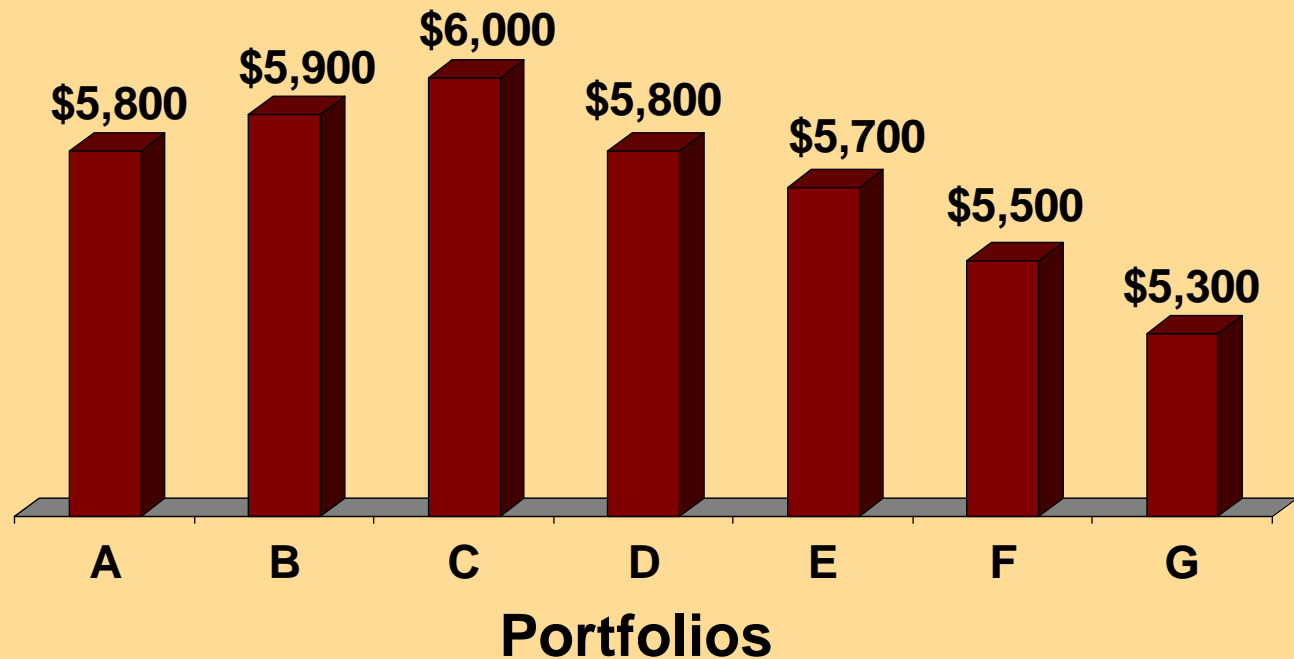
High risk of major
unpredictable
expense



The Importance of Longevity

T. Rowe Price Calculation

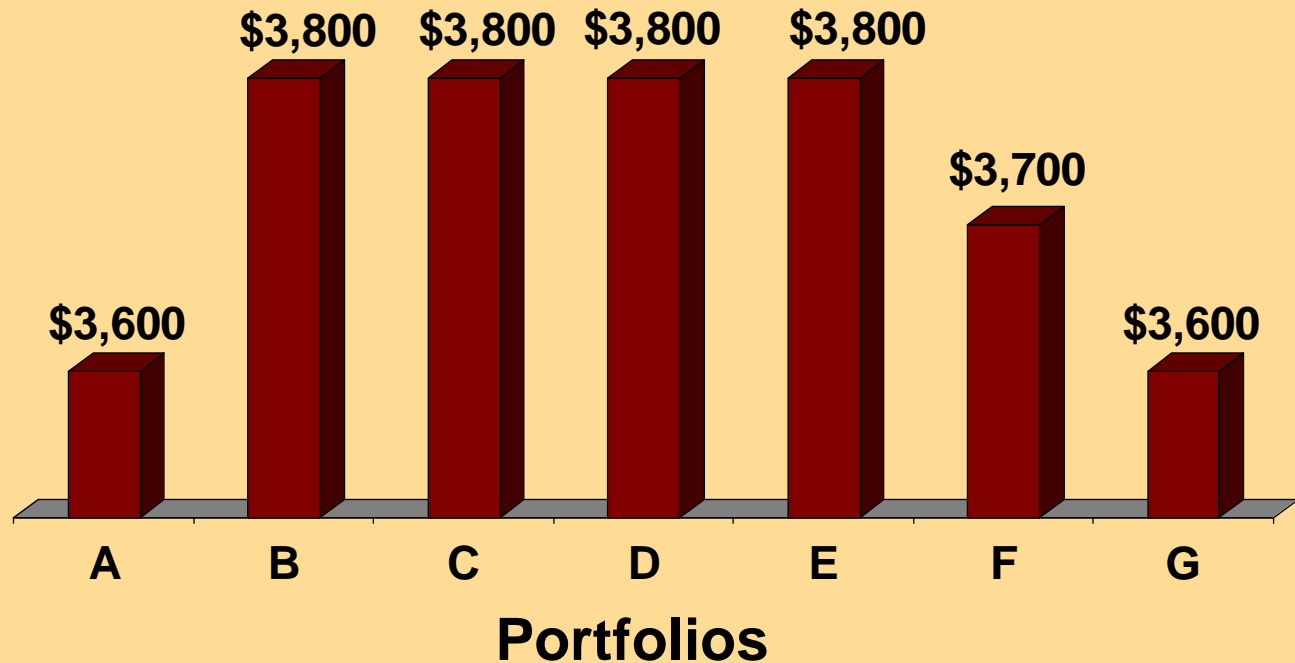
1. Start Age 65 years
2. Retirement Length 15 years
3. Retirement Assets \$1,000,000
4. Simulated Success Rate 90%



The Importance of Longevity

T. Rowe Price Calculation

1. Start Age 65 years
2. Retirement Length 25 years
3. Retirement Assets \$1,000,000
4. Simulated Success Rate 90%



More Prevalent Use of Mortality Risk Pooling Is a Key to Great Financial Security

- **Creates more income and liquidity in short term than other fixed investments**
- **Makes planning easier**
- **Likely to create more income (because of mortality credits) and assets for those who live longer than life expectancy (and are at most risk of outliving resources)**



Obtaining Monthly Income of \$1,000 with \$300,000: A 70 Year Old Man

(A 70 year old man has a life expectancy of 17 years)

10 Year AAA Corp. Bond

At 4% = \$1,000 a Month for Ten Years

In Ten Years
\$300,000

Life Annuity

\$136,444 = \$1,000 a Month for Life
Invest other \$163,556

In Ten Years

\$1,000 a Month for Life, Plus \$266,415 (Assuming Return of 5% a Year)



Myths About Value of the Estate and Liquidity: Return to the 70 Year Old Man (who needs \$1,000 a month)

Life expectancy for male at age 70 is 17 years

Ten Years After
With Bond

\$300,000

In Seven
Additional Years

Value of \$300,000
bond

Ten Years with
Life Annuity

\$1,000 a Month for
Life, Plus \$266,415
(Assuming Return
of 5% a Year)

In Seven
Additional Years

\$374,873
(Assuming a Return
of 5% a Year)

