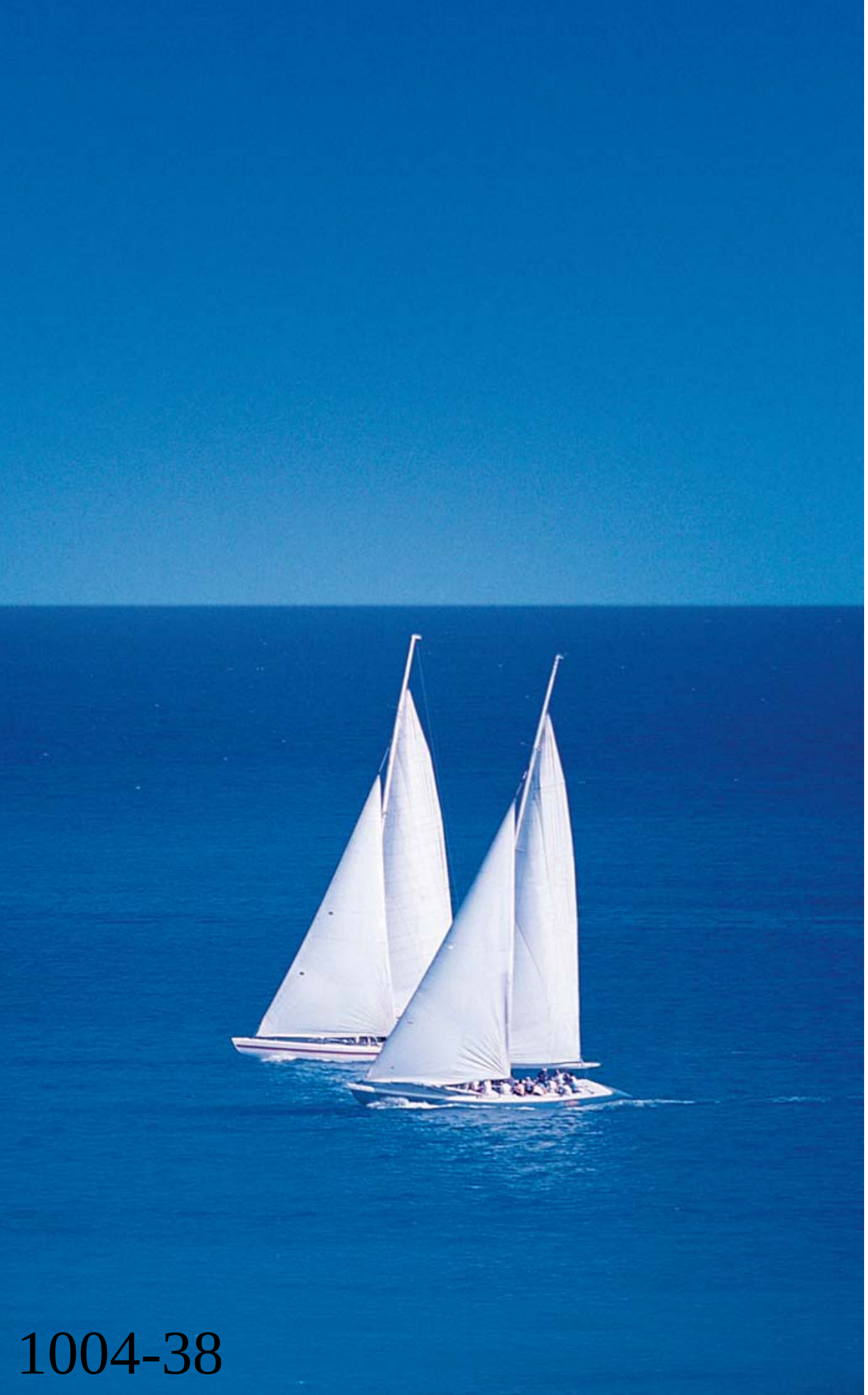

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Preparing
for the
New Retirement

John Darrington, Moderator

Gordon Tiffany, CFP®, CFS

Director, Financial and Retirement Planning

ICMA Retirement Corporation

SAN DIEGO
ICMA's 90th Annual Conference
October 17-20, 2004

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Disclaimer: What you are about to hear are my own thoughts & nobody else is to blame if I am right.

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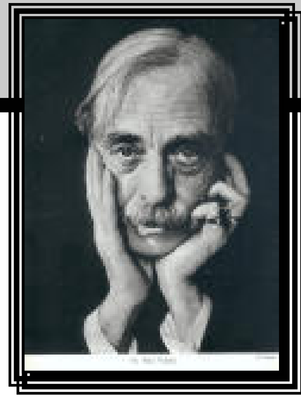
"The Future Is Not What It Used To Be."

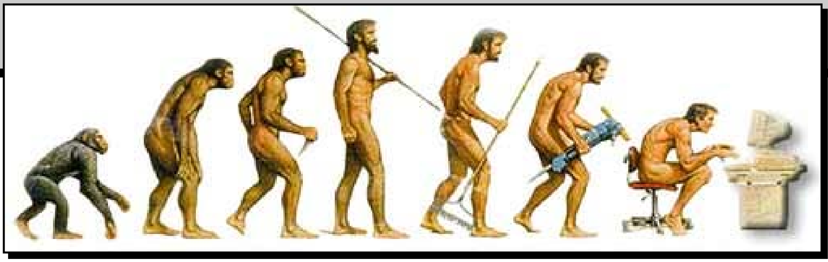
- Paul Valery (1871-1945)

- A Brief History Of Retirement: *Four Paradigms*.
- The New Retirement in the New Economy:
  - Economic & Demographic Forces.
  - Boomer Generation Retirement Readiness.
- What the "New Retirement" Means To You:
  - Risk and Your Responses.



A Brief History of Retirement
Four Retirement Paradigms

1. Pre Modern
2. Urbanizing/Industrializing
3. Mature Industrial
4. Post Industrial



1. Pre Modern Retirement

As recently as 1900, the average American male spent just 3% of life retired.

- Family farming was prevailing way of life.
- Always labor shortage on farm.
- Large families, everybody works, always.
- Family cared for elderly.
- Hard, short lives.
- Retirement when incapacitated.
- Retirement as disability.

2. Urbanizing/Industrializing Retirement

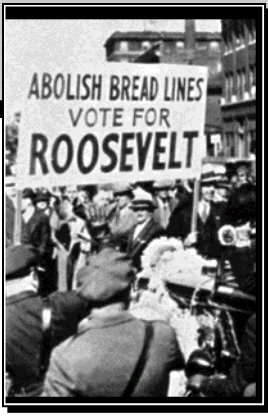
In 1900, only 5 US companies had pensions for industrial workers.

- Mobility up, birth rate down, less family support for elderly.
- Long hours, specialized tasks, low skills.
- Physical exhaustion requires retirement.
- Specialization means obsolescence: few alternate jobs.
- Retirement as <u>fatigue</u>.

3. Mature Industrial Retirement

Emergence of Social Security & DB Plans

- Rapid urbanization -
  - In 1890, 28% of US population in cities.
  - By 1930, doubled to 56%.
- Labor needs cyclical, surplus with business cycle.
- *Government began to subsidize retirement to get older workers out of the way for younger workers*.
- Retirement as entitlement.



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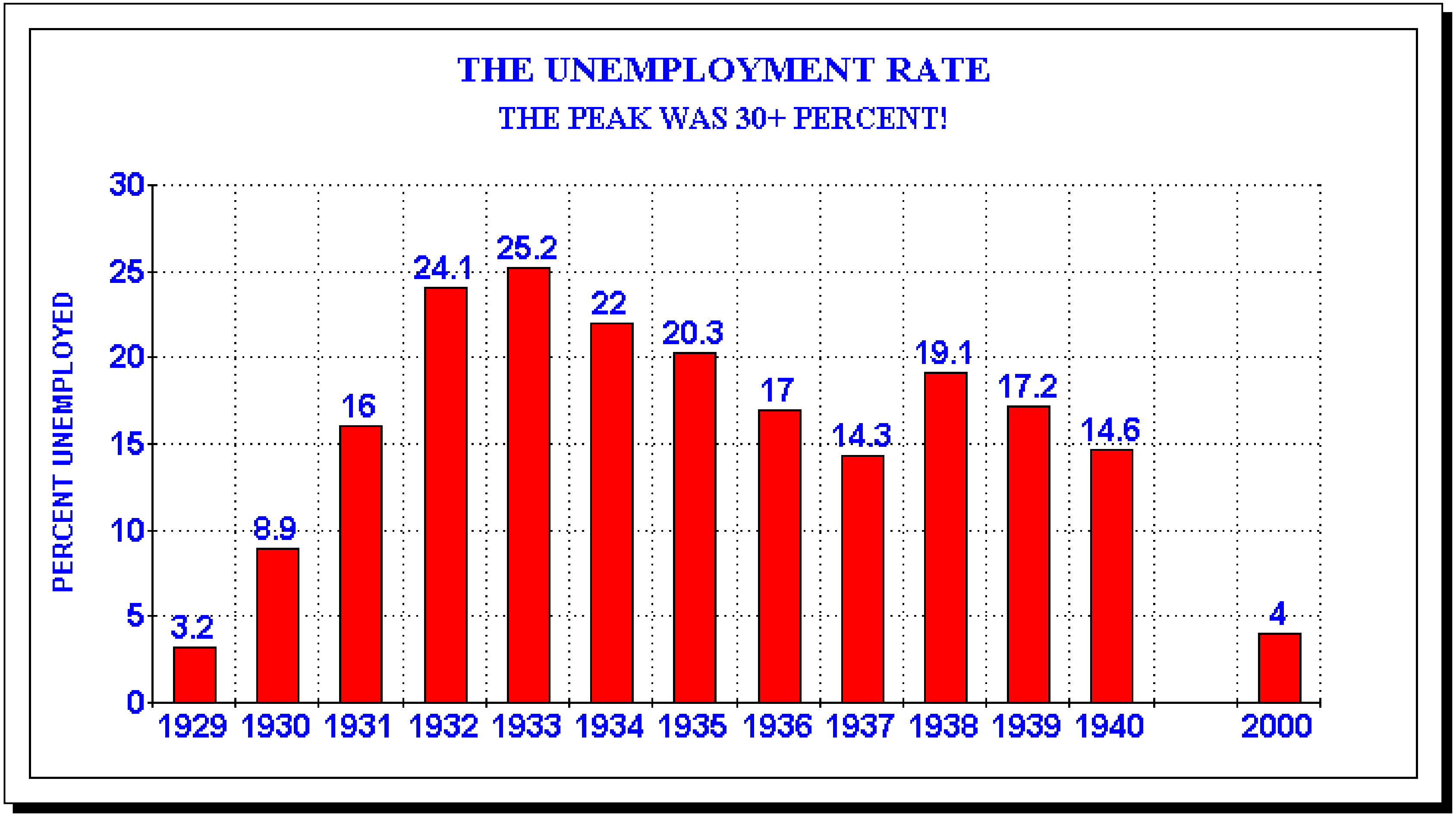
Social Security was response to Depression's labor surplus.



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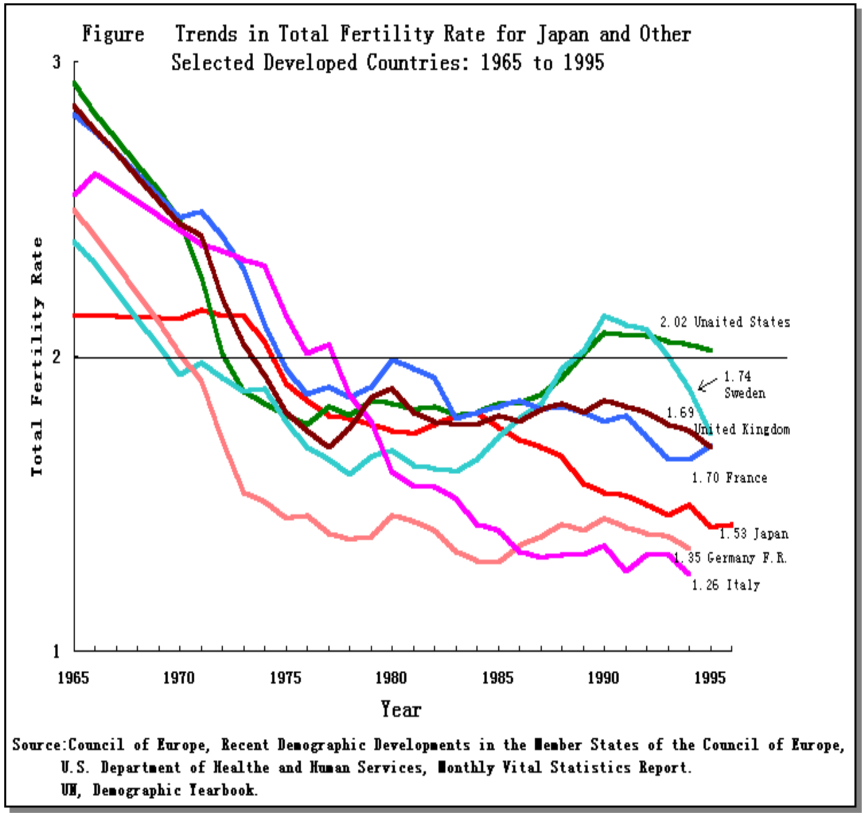
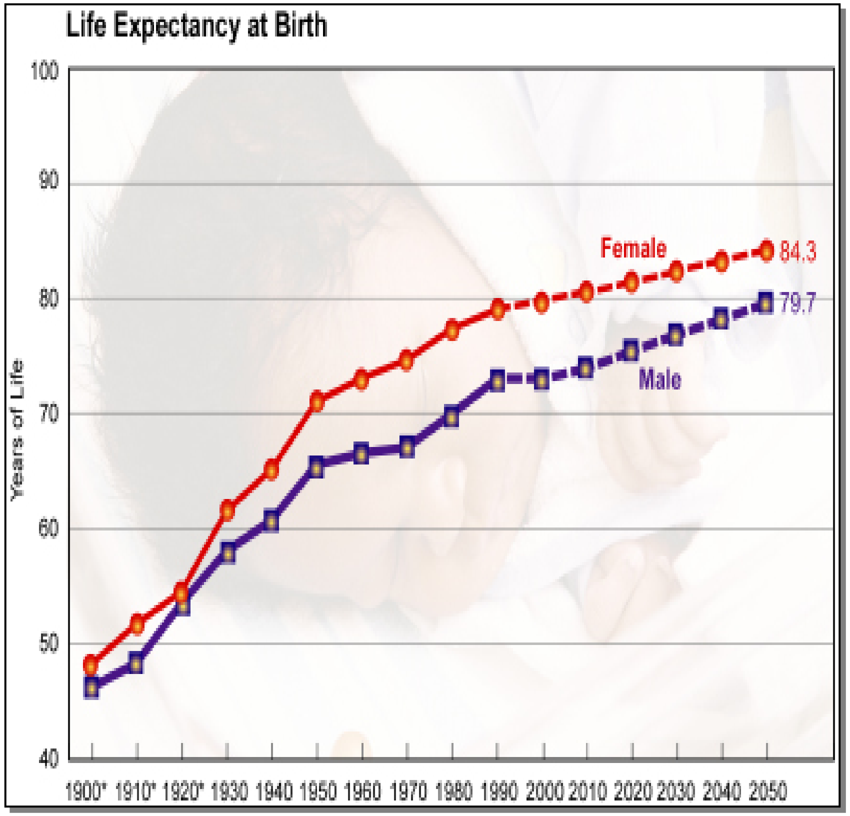
4. Post Industrial Retirement

"The New Retirement"

- Knowledge economy, entrepreneurial.
- High mobility, successive careers.
- Global competition squeezes wages, profits.
- Birth rate falls some places below replacement.
- *Skilled, experienced* labor shortage.
- Retirement as <u>productive aging</u>.

Declining Birth Rates + Longer Life Spans = <u>Higher % of Population Elderly</u>



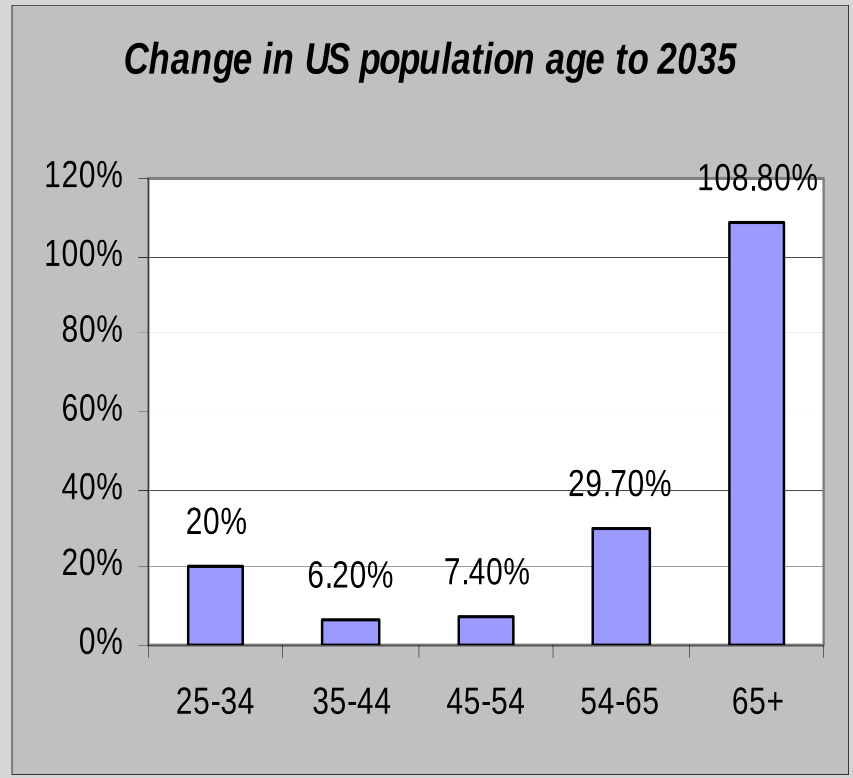


77 million "Boomers" born 1946-1964!

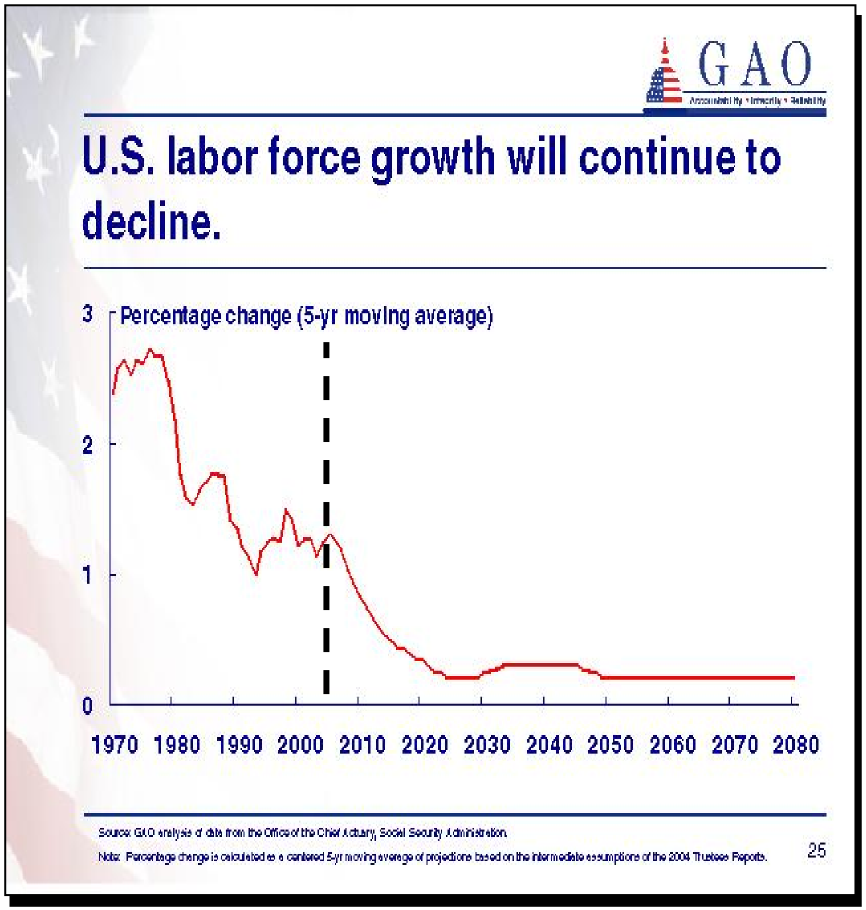
"Half of baby boomers will see their hundredth birthday."

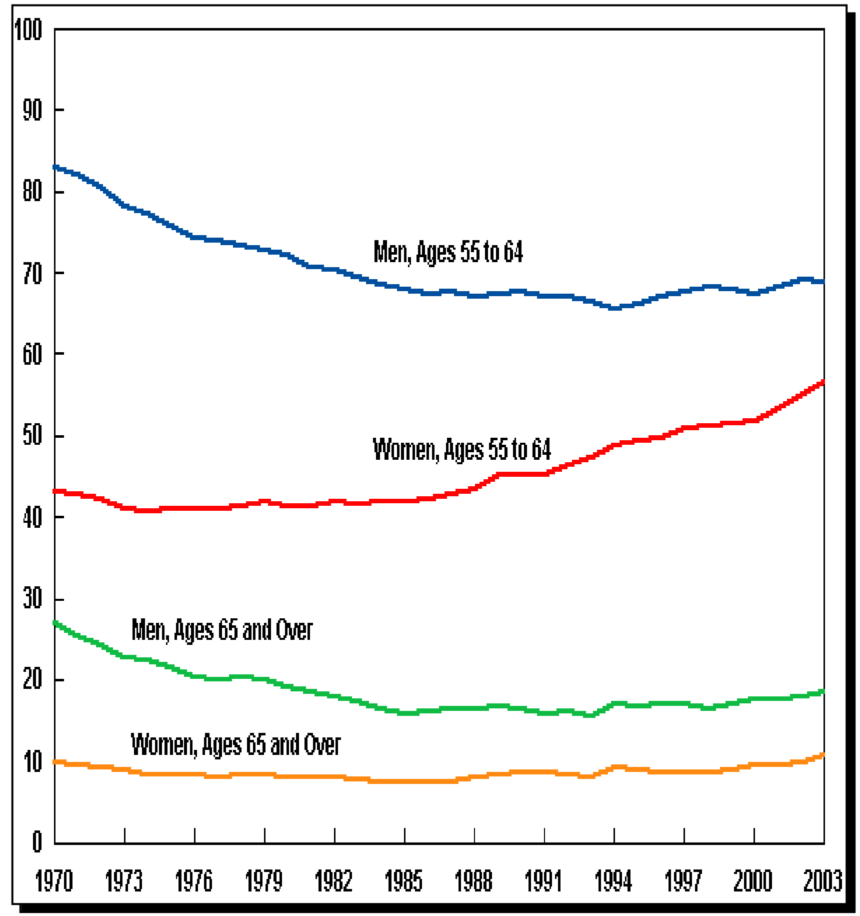
Dr. Ronald Klatz, Pres, Am. Academy of Anti-Aging Medicine.

- From 2011 to 2029, a boomer will turn 65 every 8 seconds.
- Oldest now within
  - 4 years of Social Security.
  - 7 years of Medicare.
- 65+ share of population
  - In 1900, was 4%.
  - Now 15%
  - Will more than double by 2035.



US Labor Force Growth Slowing.
Are older Workers Responding by Working Longer?





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The coming of the “Old-Old”

- “Old-old“ are 85+.
- “Old-Old” will increase 133% by 2030!
- 85+ mortality rate declined 26% in single decade.
- Nursing home admission rates are *falling:* old-old are healthier, active.

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"The New Retirement"

[We cannot afford to mass produce a dependent class.]

- Robert N. Butler, MD, Professor of Geriatrics

- ***Post Industrial Economy Requires <u>Productive Aging</u>.***
  - Able elderly expected to be economically productive, self sufficient.
  - Longer working life, return to work, part time, flex & volunteer jobs.
  - Elders as care givers, not just care receivers.

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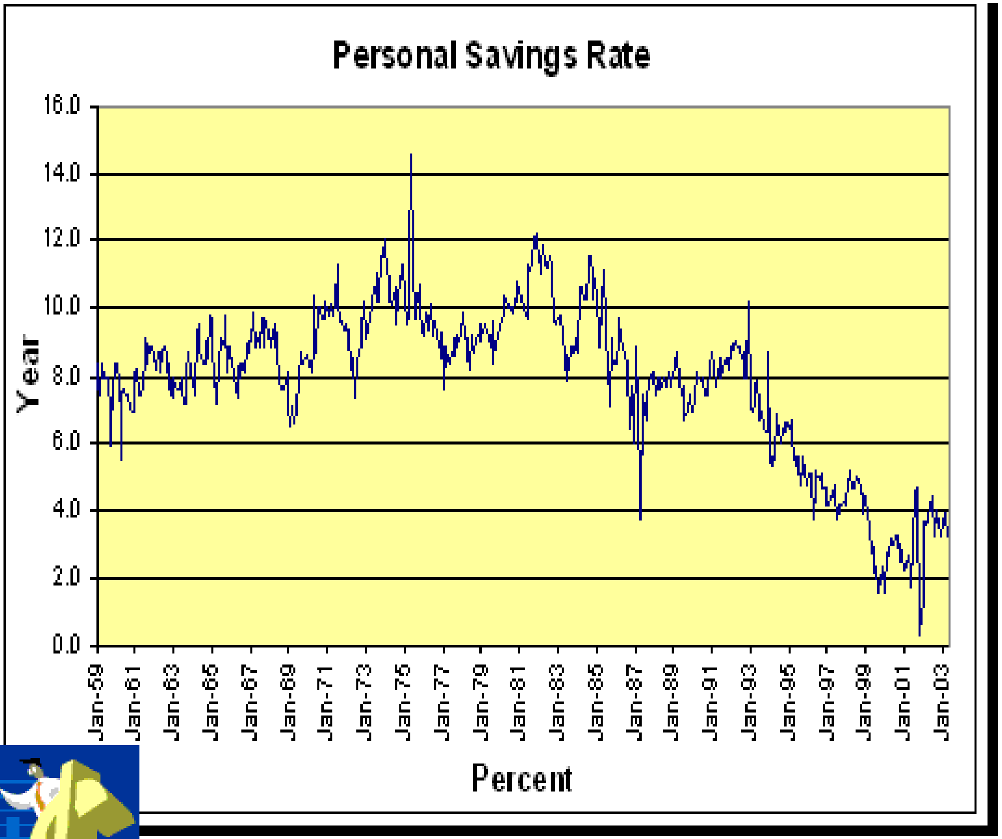
How prepared will we be?

Personal Savings Rate Less Than 4%

- Most Boomers are poor savers:
  - 67% of workers say they are behind
  - 20% of workers say they have done nothing
  - 18% say they have a plan.



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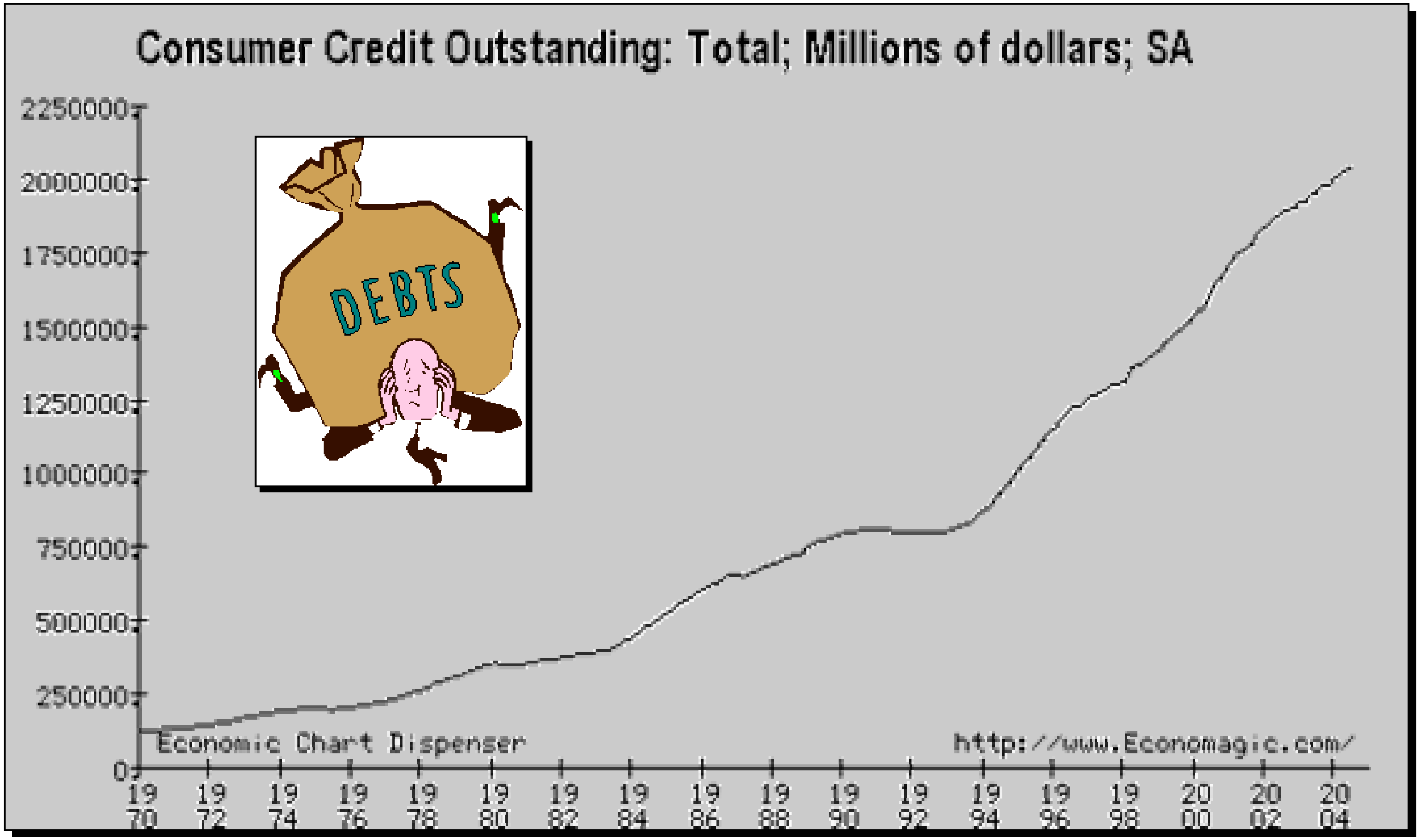
We may not save, but can we ever borrow!



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Our retirement preparation problem:

- We live in the richest country and richest time in world history, *yet only 5% of the population will achieve financial independence.*

The problem is not the high cost of living, it's <u>the cost of living high</u>.

What will your spending needs be?

- Only 3% of pre-retirees said they'll spend more after they retire than they did before . . .
- . . . but 22% of those in retirement say they are spending more in retirement than they did before they retired!

  - Diversified Services Group, Inc.

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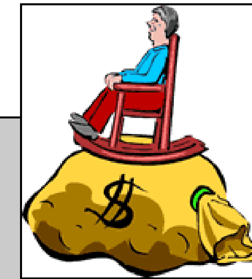
What, me worry?
"Boomers will be OKAY because . . ."



"They will be inheriting trillions of dollars."

- Fewer than 2% will get more than $100k.
- Great majority will inherit nothing.
- Median inheritance less than $50,000; most goes to financially secure.
- 15% still expect an inheritance, down from 27% in 1989: **Parents really are spending their children's inheritance!**

"Boomers will be OKAY because . . ."

"They have lots of home equity wealth."

- Realizing this *paper wealth* requires real buyers willing to pay.
- Baby bust = lower demand.
- Are some R.E. markets now in price bubble?

"...if the reason that the housing prices are high is that the price will be higher tomorrow, when fundamental factors do not justify the price, then a bubble exists."

- Symposium on Bubbles

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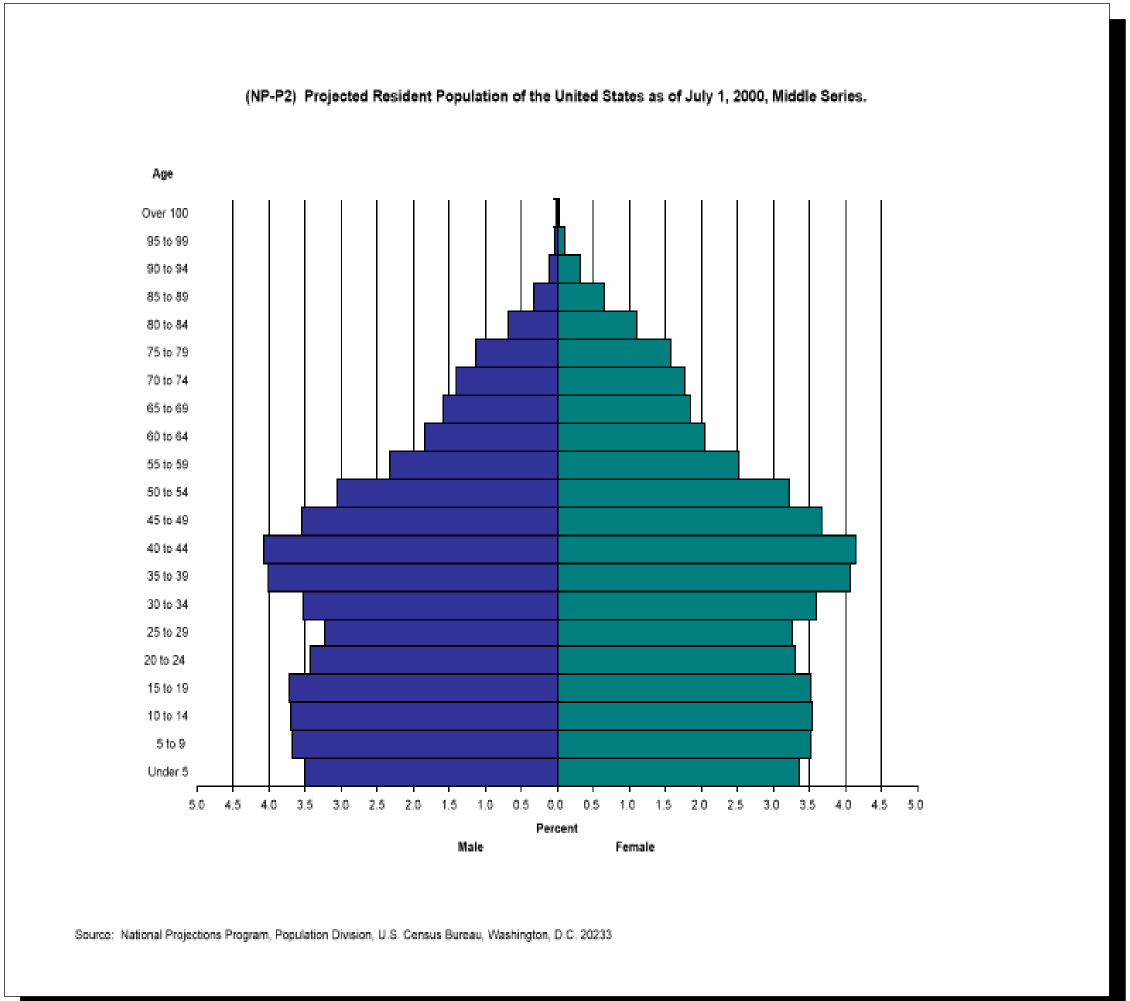
Where will the home buyers come from?



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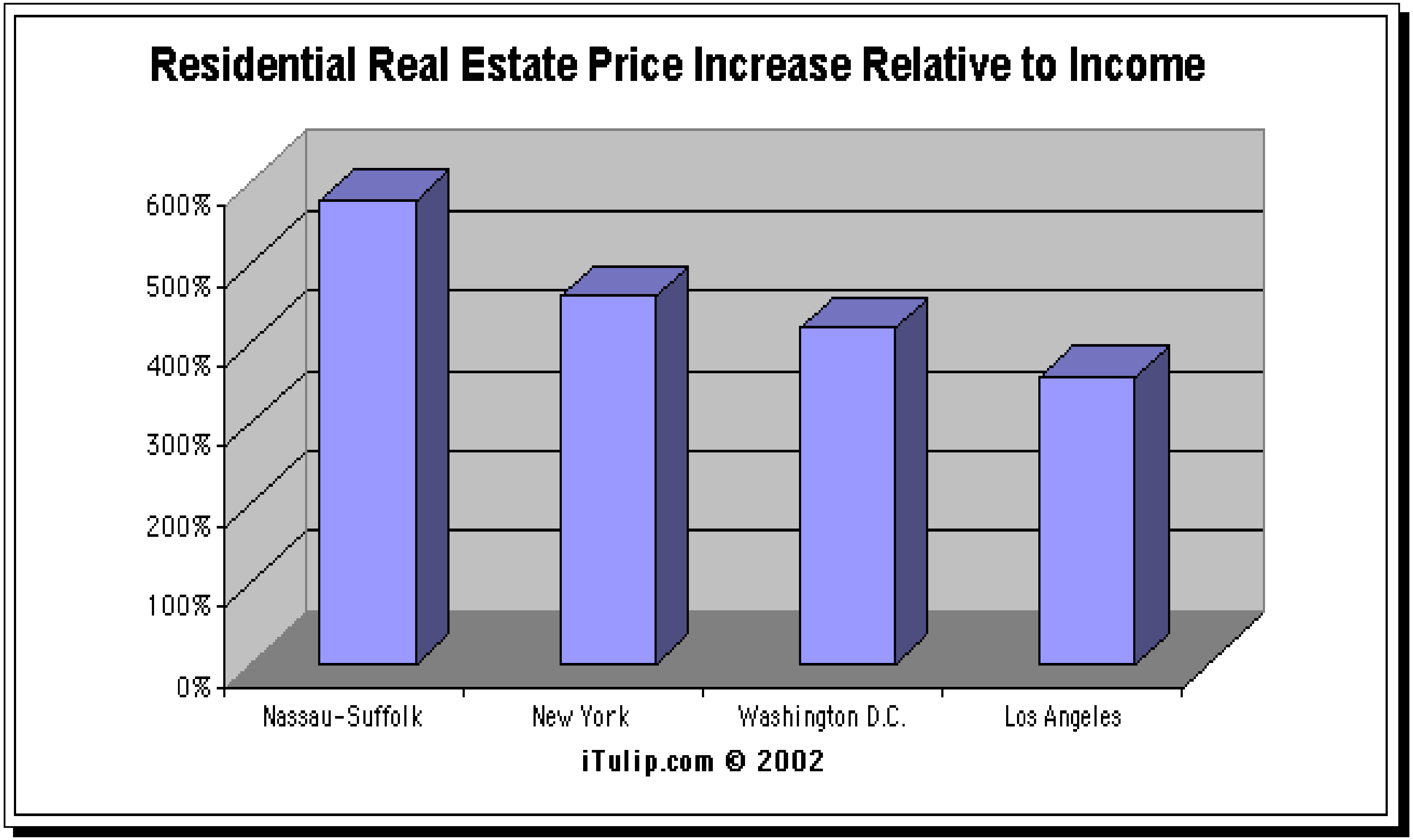
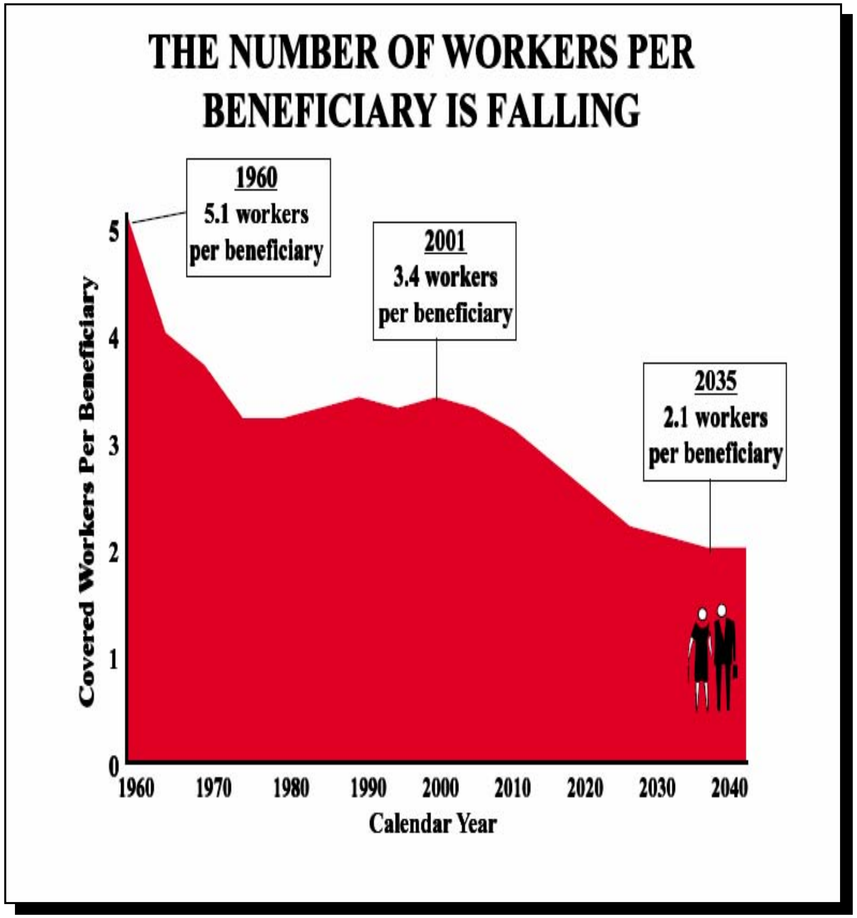
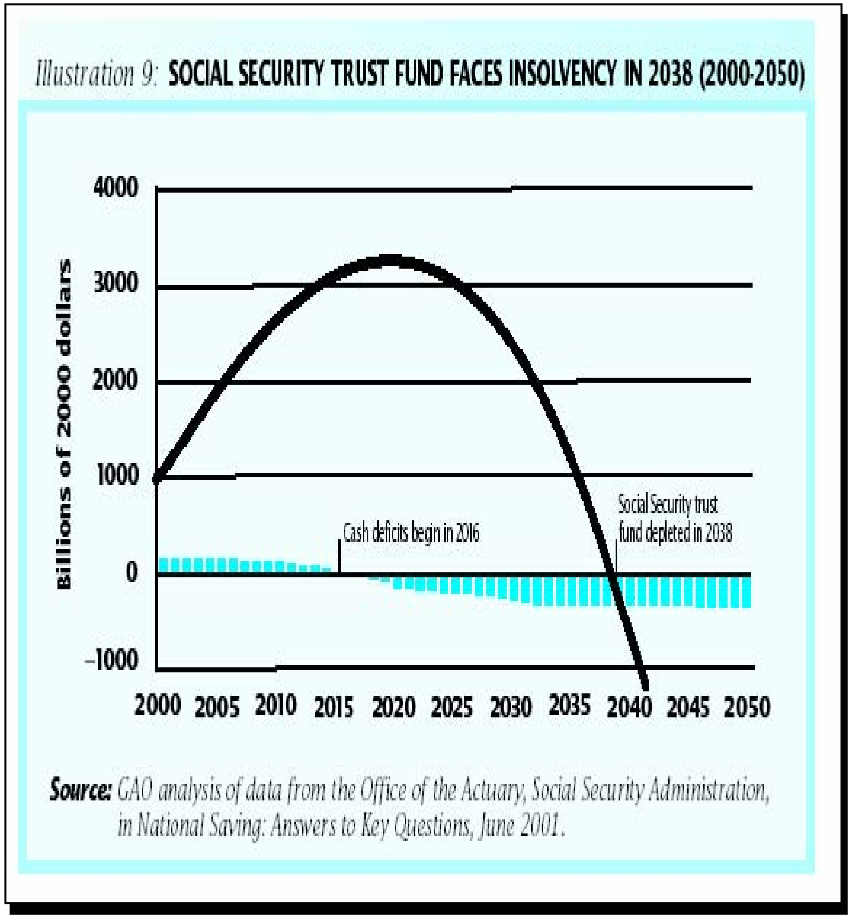
If wages, prices disconnect, will housing prices hold?



What is Social Security's Future?





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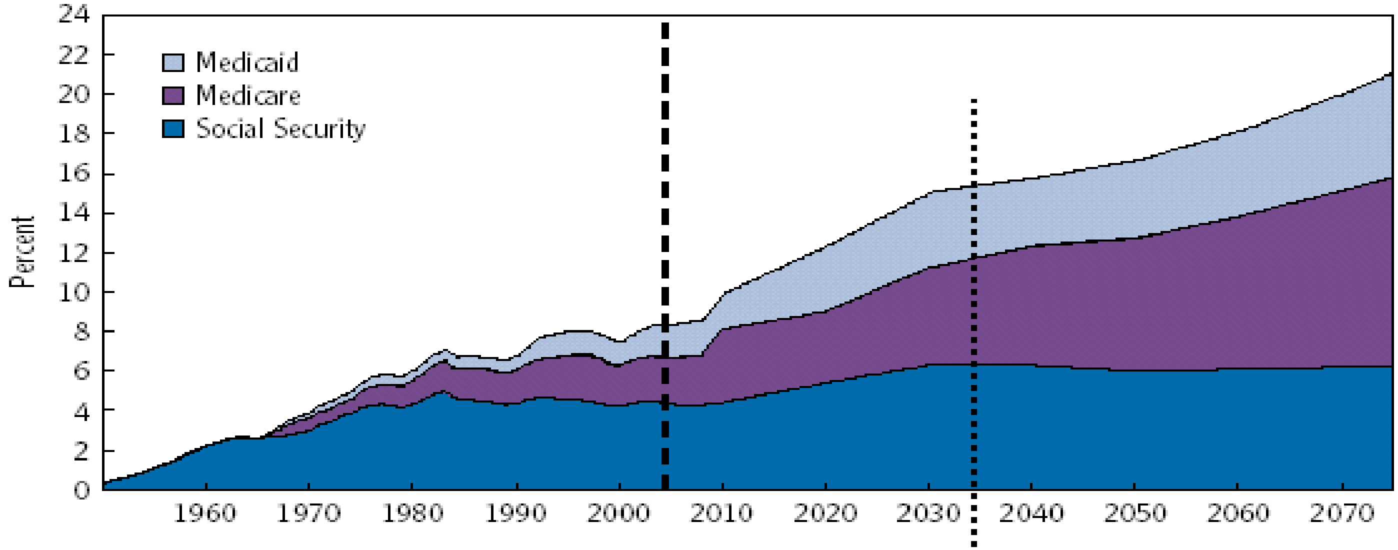
Unfunded liability of Social Security now $10.5 trillion, about equal to entire U.S. economy.



SOURCE: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2003. Based on data from the Congressional Budget Office, "A 125-Year Picture of the Federal Government's Share of the Economy, 1950 to 2075," July 3, 2002, table 2.

By 2040, combined Social Security, Medicare and Medicaid will double relative to economy, from 7.6% to 15.5% of GDP.

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Pon·zi scheme

Pronunciation: 'pän-zE-

Function: *noun*

Etymology: Charles A. *Ponzi* died 1949 American (Italian-born) swindler

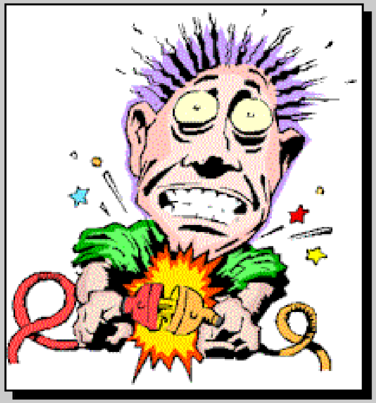
: ***an investment swindle in which some early investors are paid off with money put up by later ones in order to encourage more and bigger risks***

"As a nation, we owe it to our retirees to promise only the benefits that can be delivered."
– Alan Greenspan

- Promised benefits *cannot* be paid from expected revenue.
  - *Current household unfunded liability for Medicare, Social Security & Public Pensions =* ***$473,456/household****. (USA Today)*
  - Social Security is still solvable, Medicare less so.
- Borrowing to pay benefits leads to interest rate and inflation pressures that have negative economic growth consequences.

"The Third Rail of Politics" - Many proposals, little action

- Raise retirement ages for Social Security to 70.
- Move to consumer driven medical system.
- Tax or reduce benefits for "wealthy."
- Raise Medicare eligibility to 70.
- Increase payroll taxes.
- Reduce benefits.
- Allow SS investment in market.



Economic Competitors are Dealing with Similar Issues

- **BRITAIN** - Retirement age 65 for men and 60 for women (public sector age now 60, proposed 65.)
- **FRANCE** - Retirement age 60 years, pays into fund 40 yrs. for full benefits (public sector same by 2008.)
- **GERMANY** - Retirement age 65, average age to stop work 63.
- **ITALY** - Retirement is 65 years, 40 yrs. for full benefits.
- **JAPAN** - Normal retirement age was 55, now 60.
  - 21% age 65+ are working at retirement jobs.
  - Government subsidizes employment of elderly.

(US uses 35 years for Social Security, much less for pensions. Normal age going to 67.)

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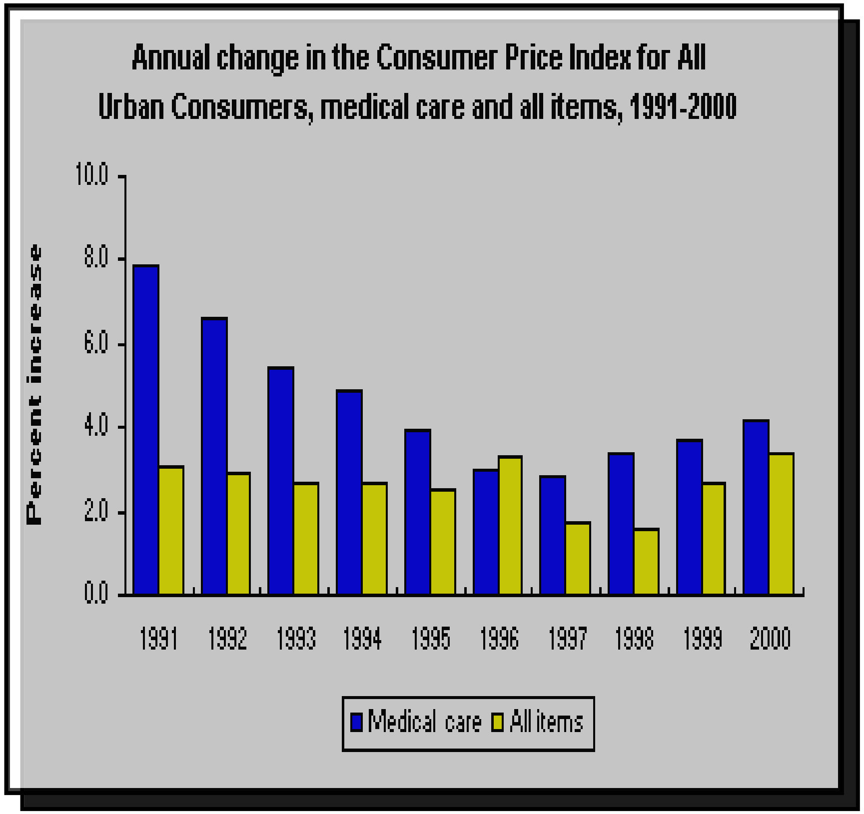
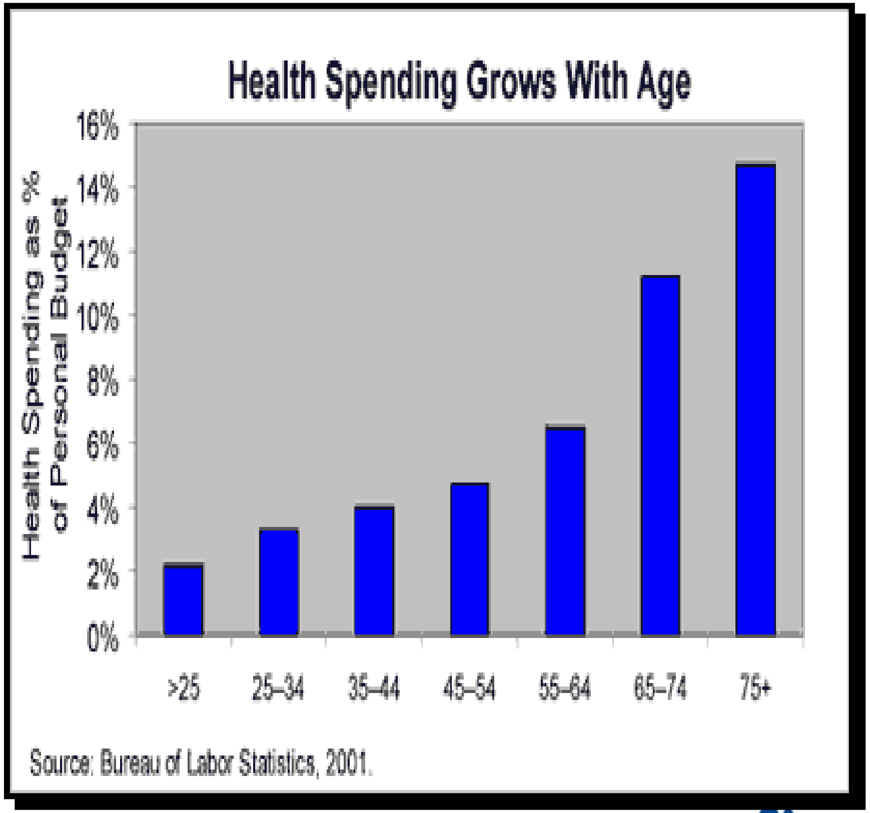
Health costs rise faster than CPI, increase with age

Only 16% of Boomers expect their own health to affect them financially.





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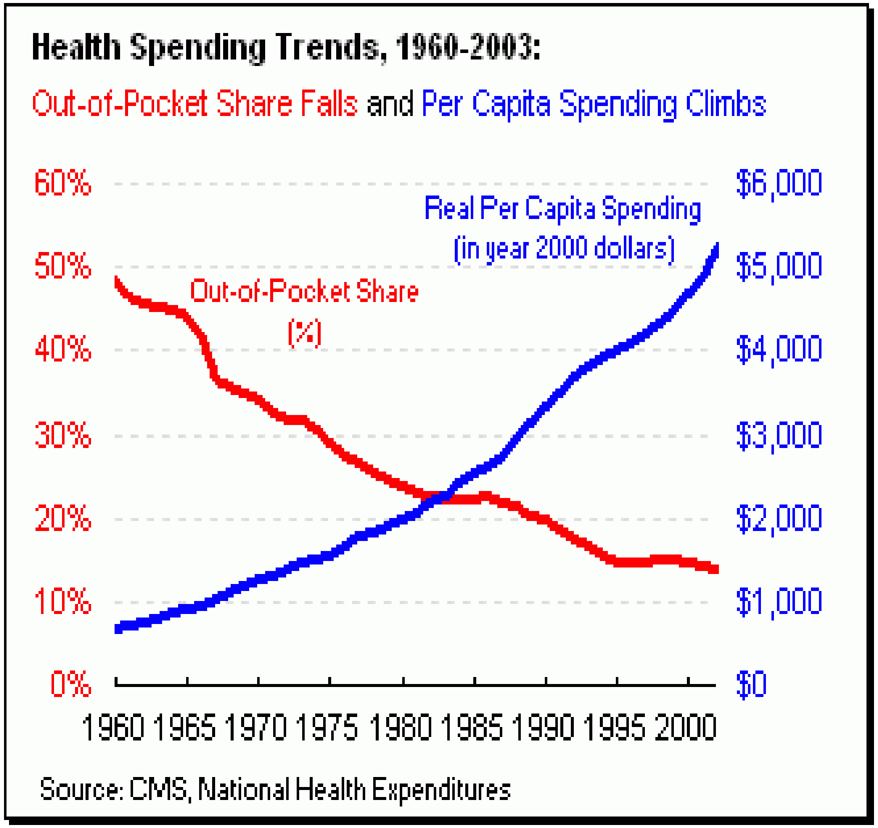
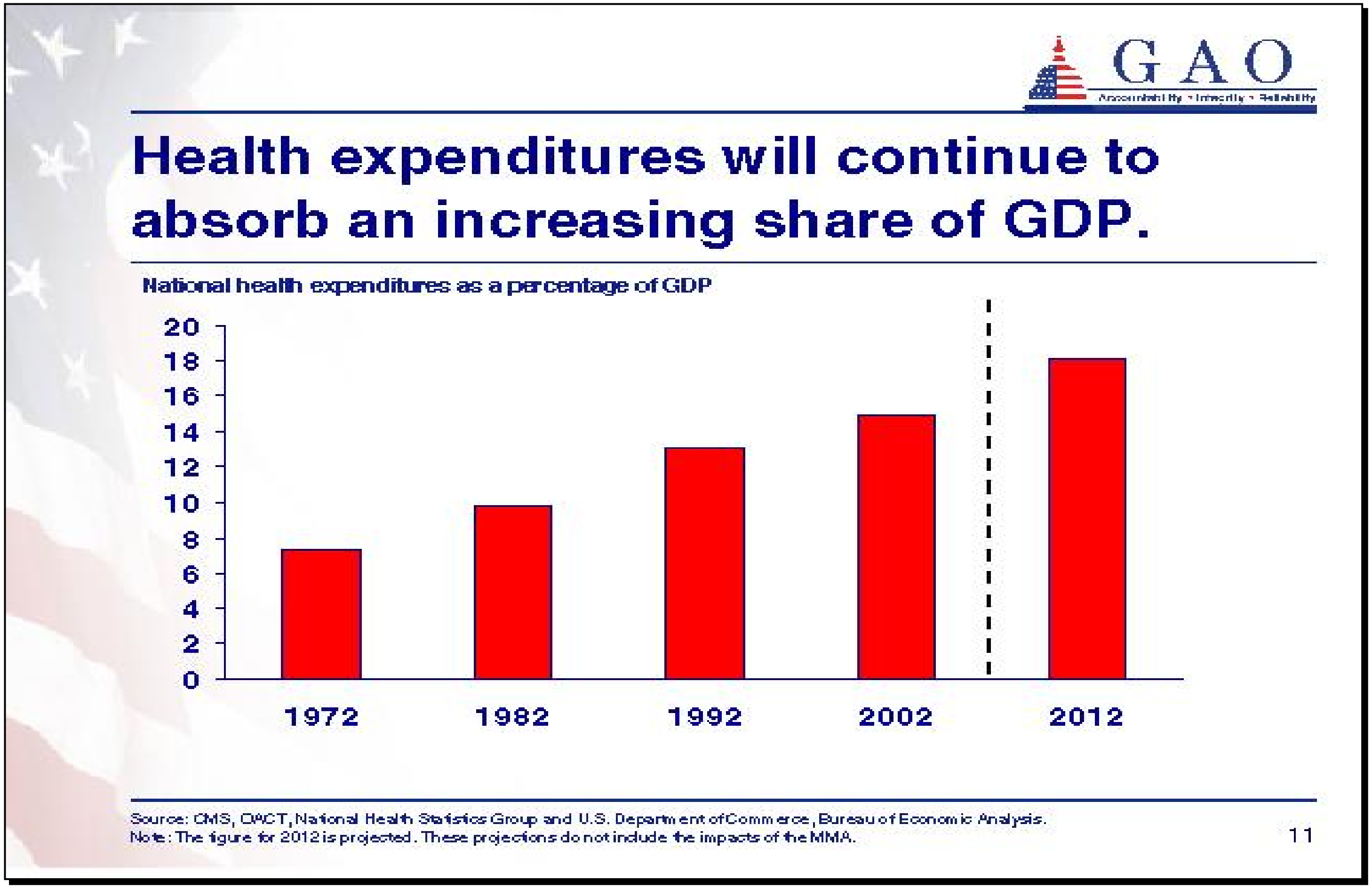
Consumer Cost Increases VS. Health Care Entitlement:

- Lower out of pocket share means low consumer interest in cost control, efficiency.
- Consumer driven system means more out of pocket costs for middle class & affluent.
- Will Medicare become means tested?



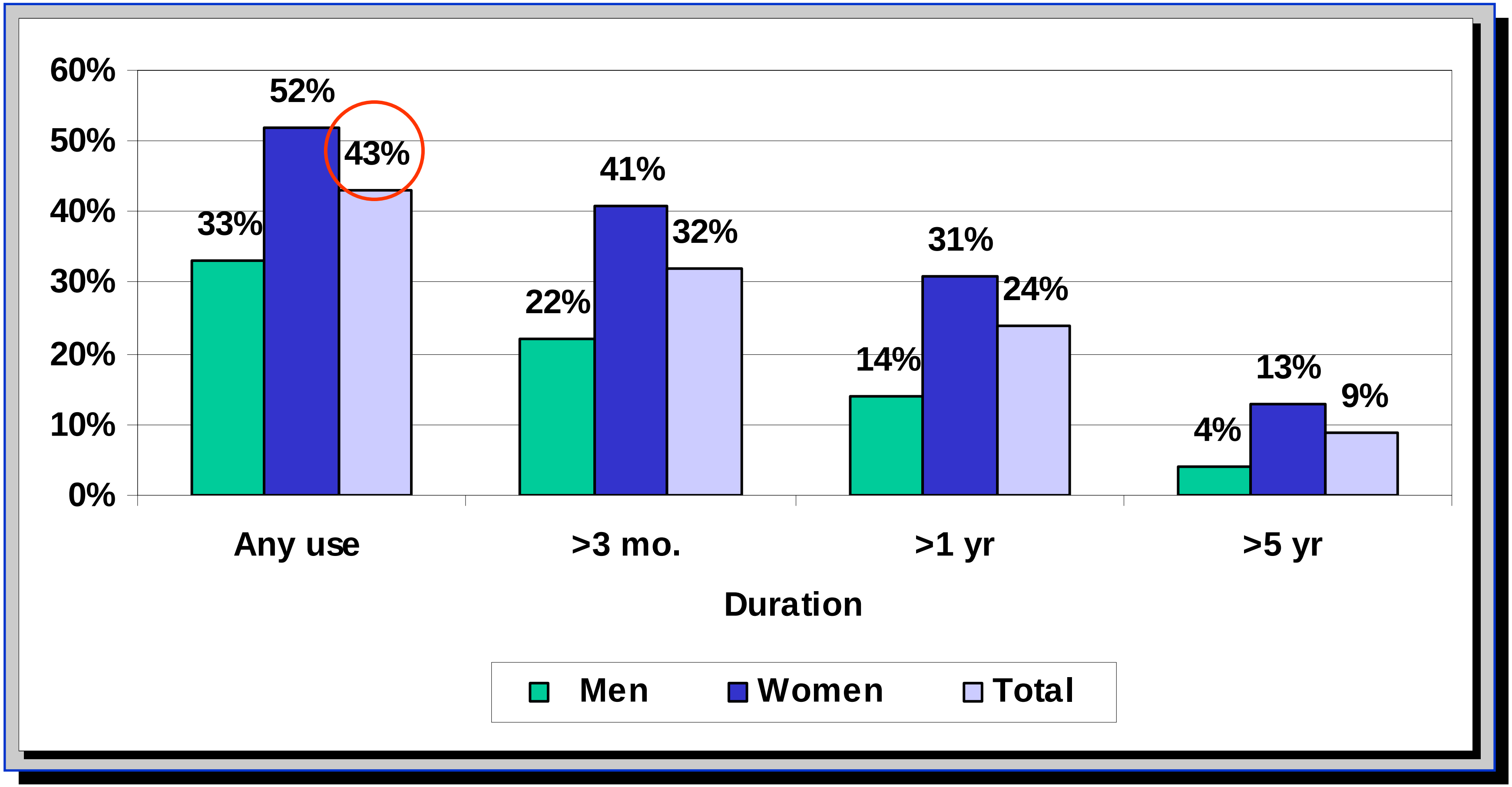
Health Care, now 15% of GDP, will be 19% by 2012



LTC Risk Assessment: *Who is most at risk?*

- **Those age 85+ years.**
  - 85+ highest need, majority remain independent.
- **Those with chronic health problems.**
  - Need help with ADLs.
- **Those lacking family support.**
  - Family sizes smaller, dispersed.
- **Women.**
  - 75% women 95+ need nursing home care,
  - 50% of men need such care.

Long Term Care Risk Assessment: What's the insurable risk?



- NE Journal of Medicine 1990

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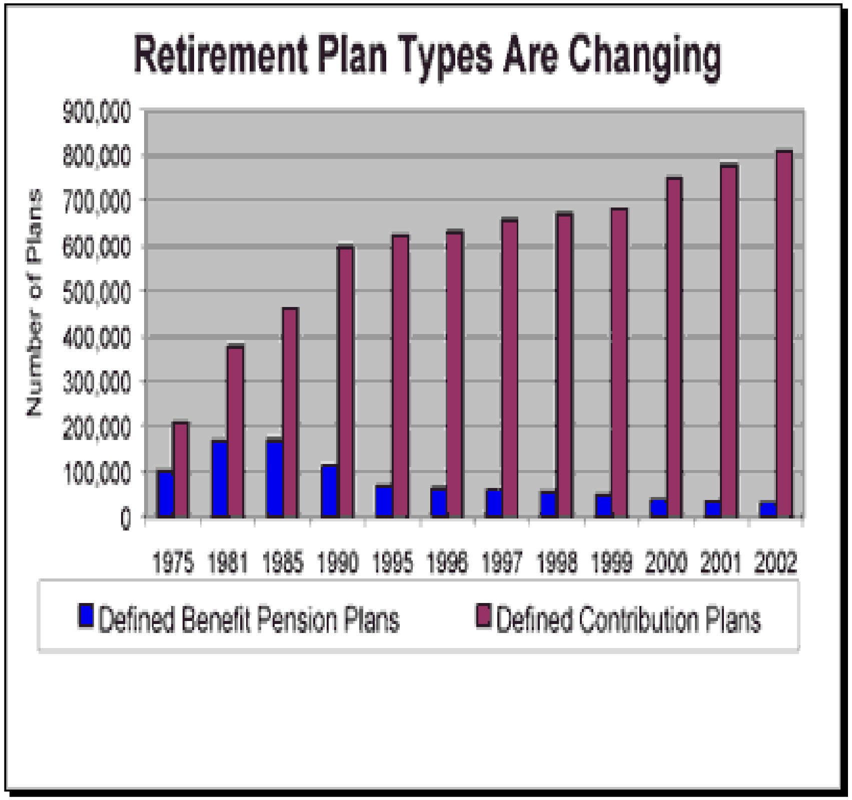
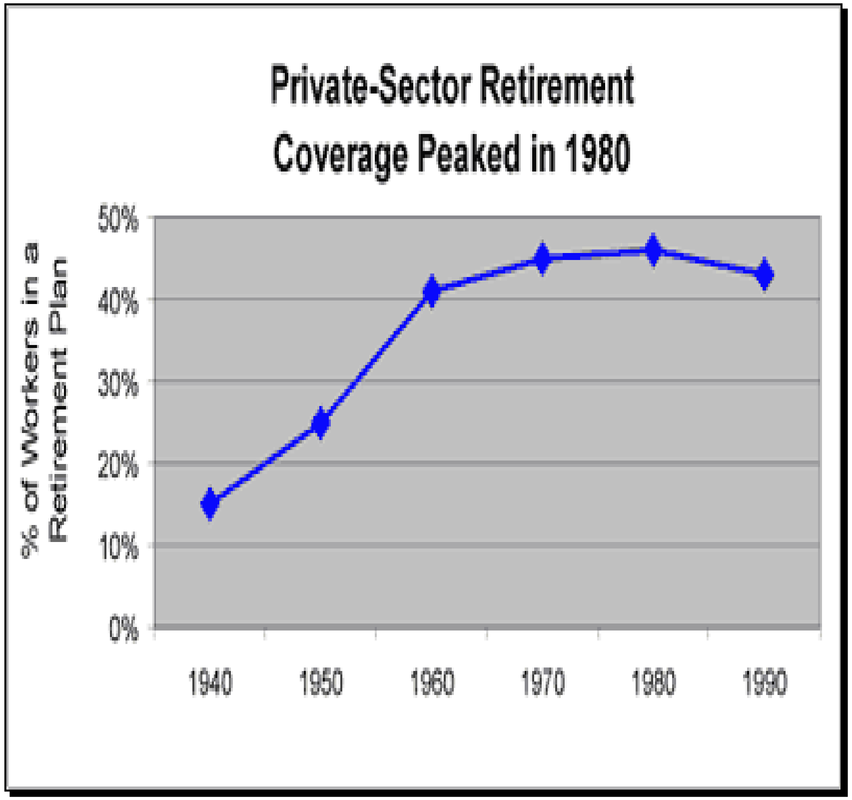
Assessing Risk to Pension:

Private sector has been moving to DC plans, closing DB plans.
Nearly half of private sector jobs have no retirement plan





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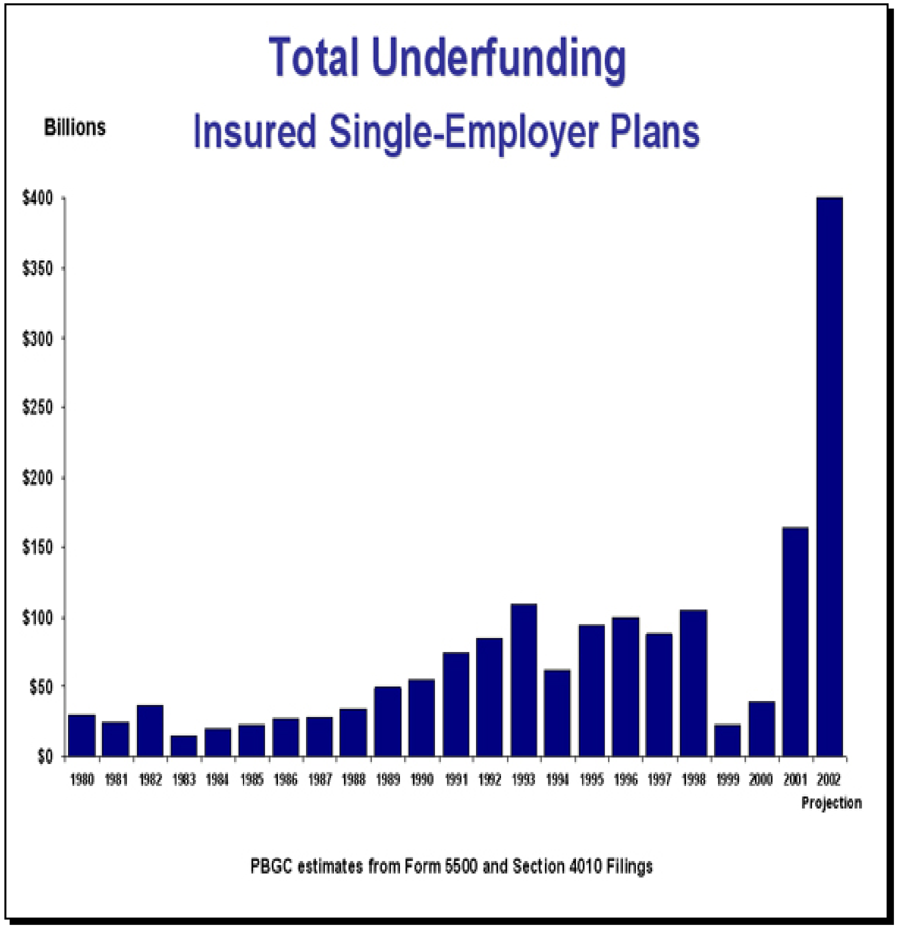
Private sector retirement benefits in trouble.

- Private pensions at risk to competitive pressures.
- Dramatic DB to DC shift, few new or improved benefits of any type.
- Retiree health benefits disappearing.
- *PBGC reports $111 billion unfunded liability, 4x 2001, double previous high.*



Perception of private-public retirement benefits disparity.

- Public employee retirement benefits:
  - 96% employees are in a plan.
  - 90% of these are DB plans.
  - Average PERS multiplier 2.14% (2.48% if no SS.)
  - 97% of public employees are in plans allowing retirement before 65.
  - COLA: 80% public VS. 13% private pensions.
  - 6 million public employees pay no SS tax.
  - 90% of state governments (and larger local governments) offer some retiree health care.

What is Political Risk to Public Benefits?

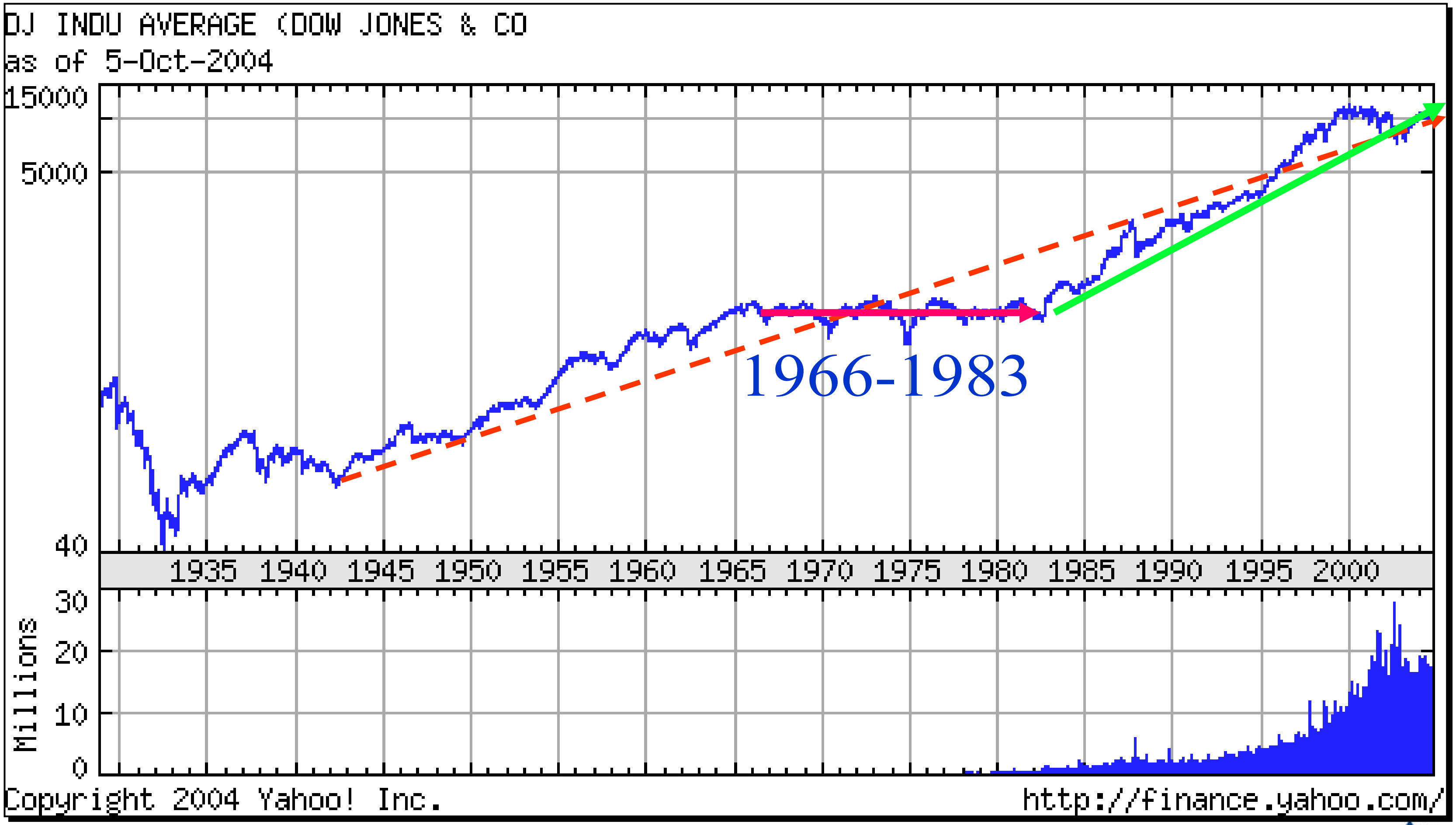
- Private sector plans in trouble:
  - Nearly half of private sector jobs have no retirement plan.
  - Remaining plans are less generous, carry more personal risk.
  - Private sector retiree health benefits disappearing.
- Competitive forces curtailing private benefits & eliminating plans.
- Public benefits seen as more generous than private:
  - **News item**: ***there are 1,100 LA County public retirees with pensions of $100k+, with COLA!***
- ***What is political risk for public retirement benefits if they are disconnected with voter's at-risk benefits?***

San Diego retirement plan action

- Infusion of $600 million into the plan over the next three years, with a minimum of $200 million in the 2005-06 fiscal year.
- Raising of retirement age by seven years.
- Halting payments for retirement health care benefits through the pension plan
- Elimination of deferred retirement program.
- Exclude city employees, union representatives and participants in the pension system from Retirement Board.

Assessing Investment Return Risk:

Has there already been an investment climate change?



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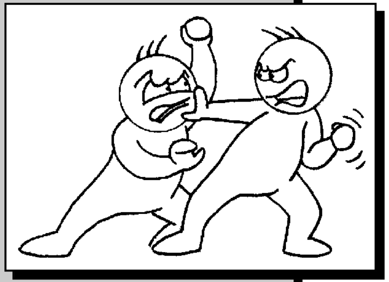
Demographics, Economics and Politics: Conflicting Forces

- Will we have a "generational war" over these issues?
- More complex conflicts probable -
  1. Retirees VS. employed
  2. Older boomers VS. younger boomers
  3. Adult children of elderly VS. others
  4. Prepared retirees (savers + public employees) VS. unprepared retirees.



Recap: Expectations for The New Retirement

- Population Aging.
- Slower Labor & Economic Growth.
- Medical Costs Soaring.
- Boomers Poorly Prepared.
  - Few DB Plans, Low Saving/High Debt.
- Benefits Problematic.
  - Social Security, Medicare, Pension Plans.
- Inflation & Interest Rate Pressures.
- Investment Returns Prospects?
- New Expectation Of *Productive Aging*.

Strategies for the New Retirement: 1. *Pre-Retirement*

- Reduce/eliminate non tax advantaged debts.
- Save at maximum capacity, use catch up.
- Shift investments to consider preservation of capital as well as growth as distribution phase nears.
- Fund Roth IRA (if eligible) for late expenses.
- Identify (and reduce) unnecessary expenses before retirement.

Strategies for the New Retirement:
2. *Planning for a Long Life*

Male now age 58	*Female now age 58*
58 to 83 = 50%	58 to 86 = 50%
83 to 90 = 25%	86 to 93 = 25%
90 to 94 = 12.5%	93 to 97 = 12.5%
94 to 97 = 6.25%	97 to 100 = 6.25%
97 to 100 = 3.12%	100 to 102 = 3.12%
100 to 102 = 1.5%	

Strategies for the New Retirement:
3. *Securing Lifetime Income*

- Assess risk to Pension, Social Security, other benefits.
- Control early retirement spending to protect savings.
- Pay fixed retirement expenses from DB, variable expenses from DC.
- More lifetime income needed?
  1. First, consider purchase of DB service credit to secure minimum expenses fixed <u>especially if subsidized</u>.
  2. Last, consider single premium immediate payment annuities from strong company.
     - Delay annuity purchase until needs are clear, cost is less.
     - Consider periodically purchasing smaller annuities, not committing everything to one large one early.

Strategies for the New Retirement: 4. *Reserving for Contingencies*

1. General reserve.
   - At retirement, have 3 to 4 years expenses invested for 20% +/- spending & emergency flexibility.
   - Spend down this reserve at no more than 6% year.
2. Reserve for pension COLA and personal inflation gap.
   - Reserve of $25,000 provides difference between 2% COLA VS. 3% cost increases on $50,000 income
3. Reserve for health care, LTC as situation requires.
   - Reserve for uncovered health care costs as situation dictates.
   - Reserves to self insure at least 1st year LTC at $60k+/-?

Strategies for the New Retirement: 5. *Earning Income*

- Prolonging FT work may increase pension, Social Security, investments (and shorten planning horizon.)
  - Example: One year more work resulted in pension + Social Security increase of $3,000/year equaling about $45,000 PV.
- Part time work in retirement may increase security substantially.
  - Example: Retire at 63, continue earning 40% of salary to 70, retirement income through age 95 may be 21% higher. - *Smart Money* Magazine

Strategies for the New Retirement: 6. *Investing*

- Use conservative assumptions.
  - Diversified portfolio return 5% to 6% long term return, less in later years with less risk.
  - Reserve all “excess investment earnings” as offset for underperforming years.
- Continue to invest a (diminishing) portion of portfolio for growth.
- Follow the rules: Diversify, avoid market timing, etc.

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Strategies for the New Retirement: 7. *Planning for Disbursements*

- Use self managed funds for variable expenses.
- Anticipate 4% to 5% annual withdrawals for life income, including COLA.
- Using tax efficient disbursement plan:
  - Use non-tax advantaged savings first, tax deferred later, Roth last.
  - Consider IRA, other penalties.
  - 457 has no 59 ½ penalty.

Strategies for the New Retirement: 8. *Providing for Health Care*

- Assess risk of employer health care benefits.
- Assess Medicare out of pocket cost risk.
  - See medicare.gov
- Shift medical cost risk to insurance.
  - Purchase strong health policy from strong company.
  - Consider vision & dental coverage.
- Reserve $20,000+ for uncovered health care costs (if you have good health insurance.)

Strategies for the New Retirement:
9. ***Planning for Long Term Care***

- Do LTC risk assessment.
  - Self insure at least one year.
    - Reserve earmarked asset to cover 1st year LTC ($60k+/-) invested for 5% +/- growth.
  - Investigate LTC insurance for catastrophic exposure, unless used as estate protection.
    - Consider longest elimination period available.

Self Sufficiency Risk Assessment Checklist For The New Retirement

- ❑ Lifespan risk:
  - ❑ Self & spouse heredity, health.
- ❑ Contingency need
  - ❑ General
  - ❑ Health care
- ❑ Expenses
  - ❑ Indefinite budget
  - ❑ <u>Early</u> spending
  - ❑ Tax rates

- ❑ Income risk
  - ❑ Pension: political risk
  - ❑ Social Security & Medicare: formula change, means testing.
  - ❑ Annuity: company, purchasing power (or market), estate, death benefit, fees.
  - ❑ Health benefits: political risk, benefit exclusions
- ❑ Investment risk