WYOMING RETIREMENT SYSTEM

Planning for and living in retirement

Retirement is the biggest investment most individuals will undertake during their lifetime, and funding a comfortable retirement requires a substantial amount of savings throughout an individual's working career. There are two main phases of retirement planning—accumulation and decumulation—and it is important to plan for both. The accumulation phase is the retirement savings that occurs during an individuals' working life. The decumulation phase is the spending down of accumulated savings to pay for living expenses during retirement. Decumulation can involve a considerable amount of uncertainty, such as how much to allocate for medical costs and how long retirement savings need to last. The development of a spend-down strategy that determines how savings will be spent over the course of retirement can help minimize the financial stress that may arise from uncertainty.

A critical part of creating a spend-down strategy is understanding how retirement savings translates into a monthly benefit and how long that benefit will last. This brief provides an overview of how retirement savings can be translated into monthly income and some of the considerations related to decumulation.

TRANSITIONING FROM SAVING TO SPENDING

Retirement planning begins as soon as individuals embark on their career. However, only 43% of U.S. adults have ever tried to figure out how much they might need to save for retirement. Even among individuals who have already retired, only 56% report ever having tried to figure out how much they needed before they retired.[1] A lack of planning may result in outliving savings or a lower standard of living in retirement than expected. An understanding of how much you will need in retirement and how long those funds have to last should be personalized to your retirement needs and goals. Tailored spend-down strategies are important since standard approaches, such as the 4% rule (withdrawing 4% of the retirement portfolio each year throughout retirement), may not be the most effective approach for everyone.[2]

INCLUDING ALL SOURCES OF INCOME

Apart from pension benefits, individuals may have other sources of income during retirement, including personal savings (e.g., 457(b) plans) and Social Security. The monthly amount you receive from Social Security will vary based on different factors, including the age at which you claim benefits. For example, if you delay claiming your benefits until age 70, you will receive a substantially higher amount than if you claim at age 62.[3] It is important for you to consider all of your sources of income as part of a complete picture of your retirement decumulation strategy.[4] Monthly benefits that come from pensions or Social Security are guaranteed for life; they will continue throughout your retirement, providing security and predictability. However, the amount you receive from these sources may not cover all of your living expenses or be enough to provide a cushion of easily accessible savings in case of an unexpected personal expense. Personal savings can help cover these additional costs. However, your personal savings are not guaranteed to last throughout your retirement and require a spend-down strategy.

JAMIE'S RETIREMENT PLAN

Considering a likely scenario can help to illustrate the challenges and trade-offs you may face in planning for retirement. Jamie has been saving for retirement and currently contributes 6% of her salary to her personal retirement account. She would like to retire in 10 years at the age of 65. At that point, she will receive a pension benefit and plans to claim Social Security benefits. However, she is concerned that monthly benefits from these two sources will not be enough to equal her pre-retirement salary or to cover additional expenses. Therefore, Jamie plans to take a monthly withdrawal from her personal retirement savings to supplement her monthly income. The table below shows her financial situation and plan for retirement income.

Annual salary	$50,000
Total personal savings at age 65	$200,000
Monthly withdrawal from personal savings	$1,050
Monthly benefit *(Social Security and pension)*	$2,250
TOTAL MONTHLY INCOME	**$3,300**

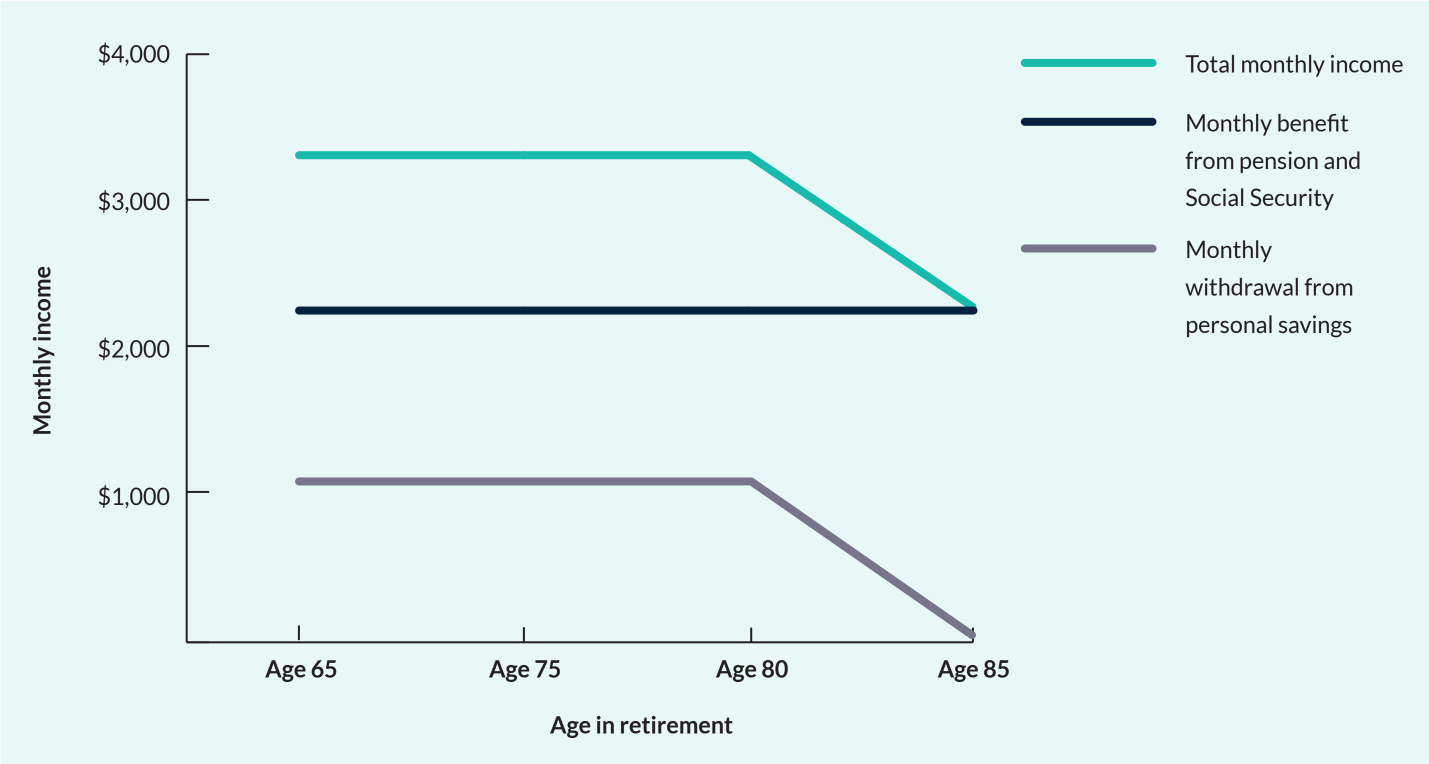
1 Data is from the 2018 National Financial Capability Study (NFCS). The NFCS is a project of the FINRA Investor Education Foundation.

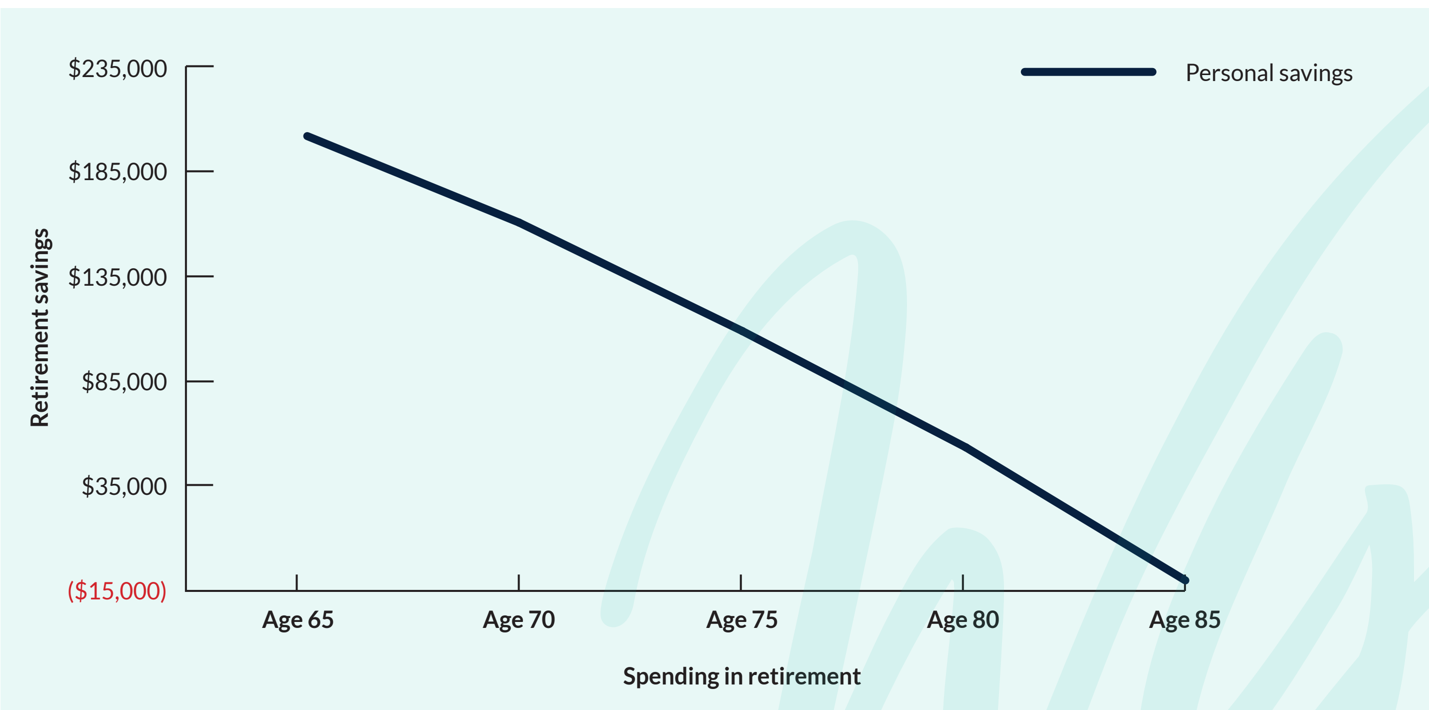
2 Scott, Jason S., William F. Sharpe, and John G. Watson, 2009. "The 4% Rule – At What Price?" *Journal of Investment Management*, 7(3): 31-48.

3 For more information, see *Delaying Social Security Benefits* factsheet.

4 For more information about determining your monthly benefit, see *Evaluating your Financial Readiness for Retirement*.

JAMIE’S RETIREMENT PLAN





The graphs above show the savings Jamie would have throughout retirement. While the monthly benefit Jamie receives from Social Security and her pension will continue for as long as she lives, her personal savings will quickly decrease as she draws it down during retirement. At age 75, 10 years into retirement, almost half of the money will be spent. At age 85, the personal savings will be completely gone. This example illustrates how important it is, when planning for retirement, to understand the total amount of savings you will need and how that savings will be spent throughout retirement.

MAKING YOUR SAVINGS LAST

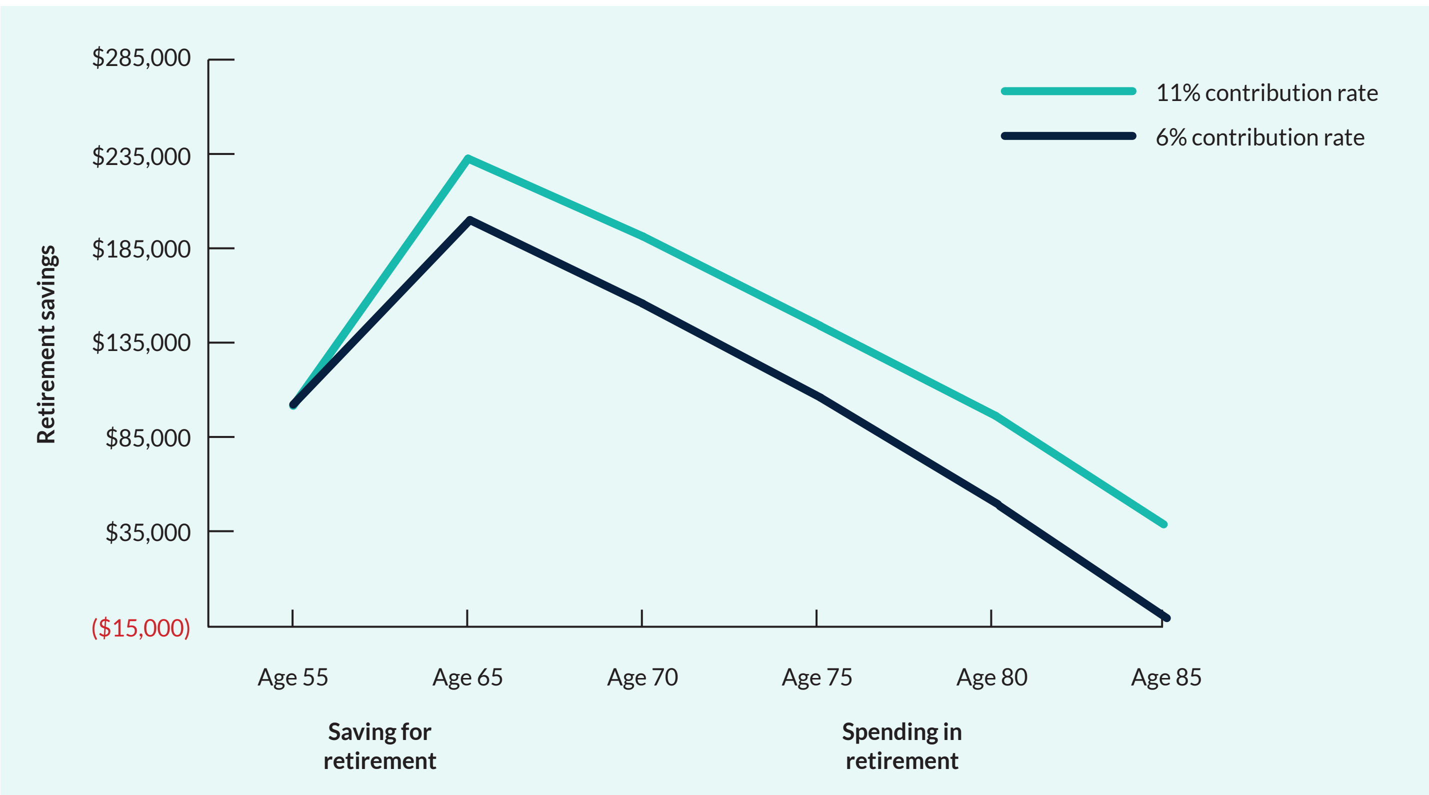
If you are concerned that you will outlive your personal savings or that the amount will not be enough to allow you to achieve your retirement goals, you have three main options: increase savings while working, save the same amount but work longer, or adjust the monthly withdrawal amount in retirement.

1) Increasing savings while working

Starting to save for retirement early, such as when you are in your 20s, provides a big benefit, as the savings have many years to accumulate and grow. If you did not start saving early, and thus have less time for the savings to grow, you may need to increase your savings by a large amount to accumulate enough for retirement.

Jamie, in the previous scenario, would run out of her personal savings before age 85. If, starting at age 55, she were to increase her annual contribution rate from 6% to 11% of her salary, her situation at age 85 would be different. Example 1 shows her estimated savings with the increased contributions.

Example 1: Increased contribution rate



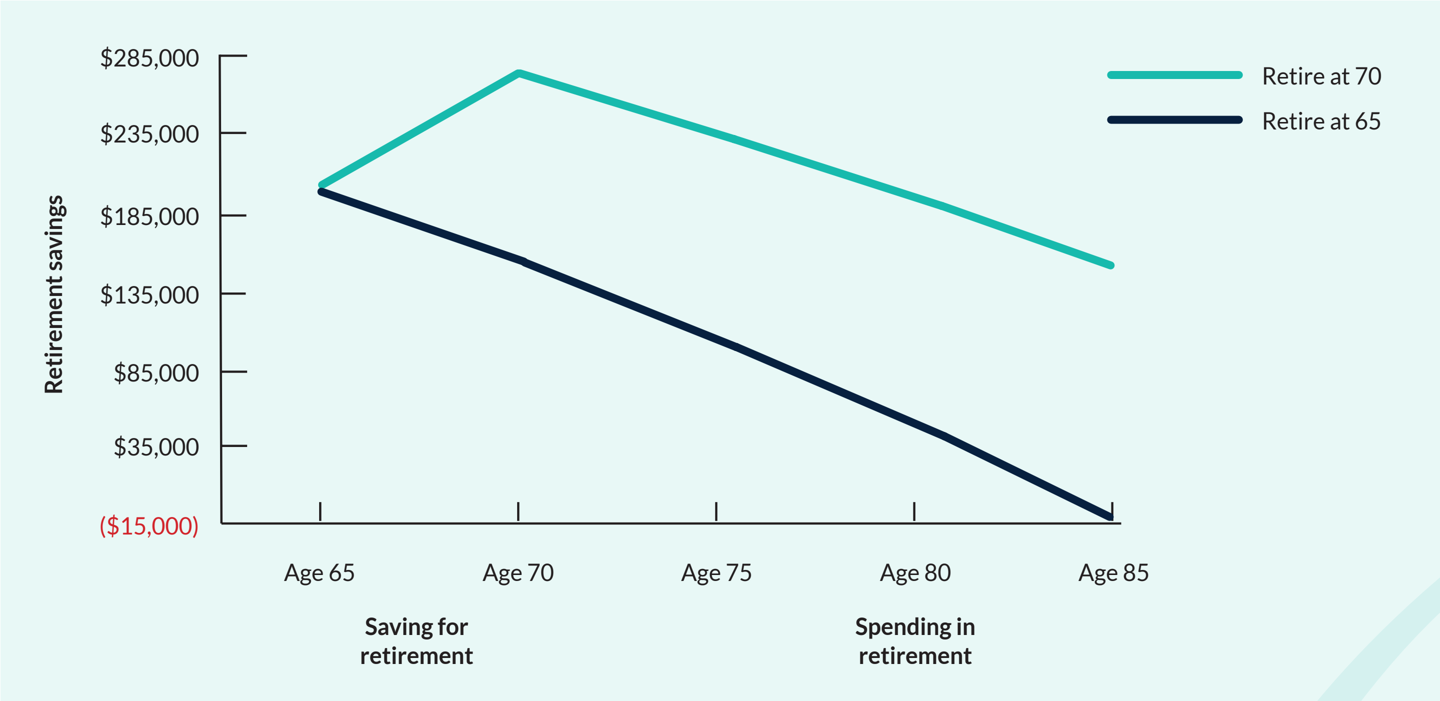
The increased contributions allow Jamie to maintain the same monthly withdrawal amount in retirement and to still retire at age 65, without concern that the money will run out before she turns 85. However, the increase in contributions means less income for other expenses during her working years.

2) Working longer

Another way to increase retirement savings is to delay retirement. This can provide a helpful boost to savings as it allows you to continue to make contributions, and interest continues to accumulate on those contributions.

Working longer would give Jamie enough savings that, in retirement, she could withdraw an amount equal to her pre-retirement salary and have enough to last throughout retirement. She would also have additional savings to cover unexpected medical costs or changes in her living situation. Example 2 shows her estimated private retirement savings if she worked for an additional five years, continuing her 6% contribution rate during those years.

Example 2: Working longer

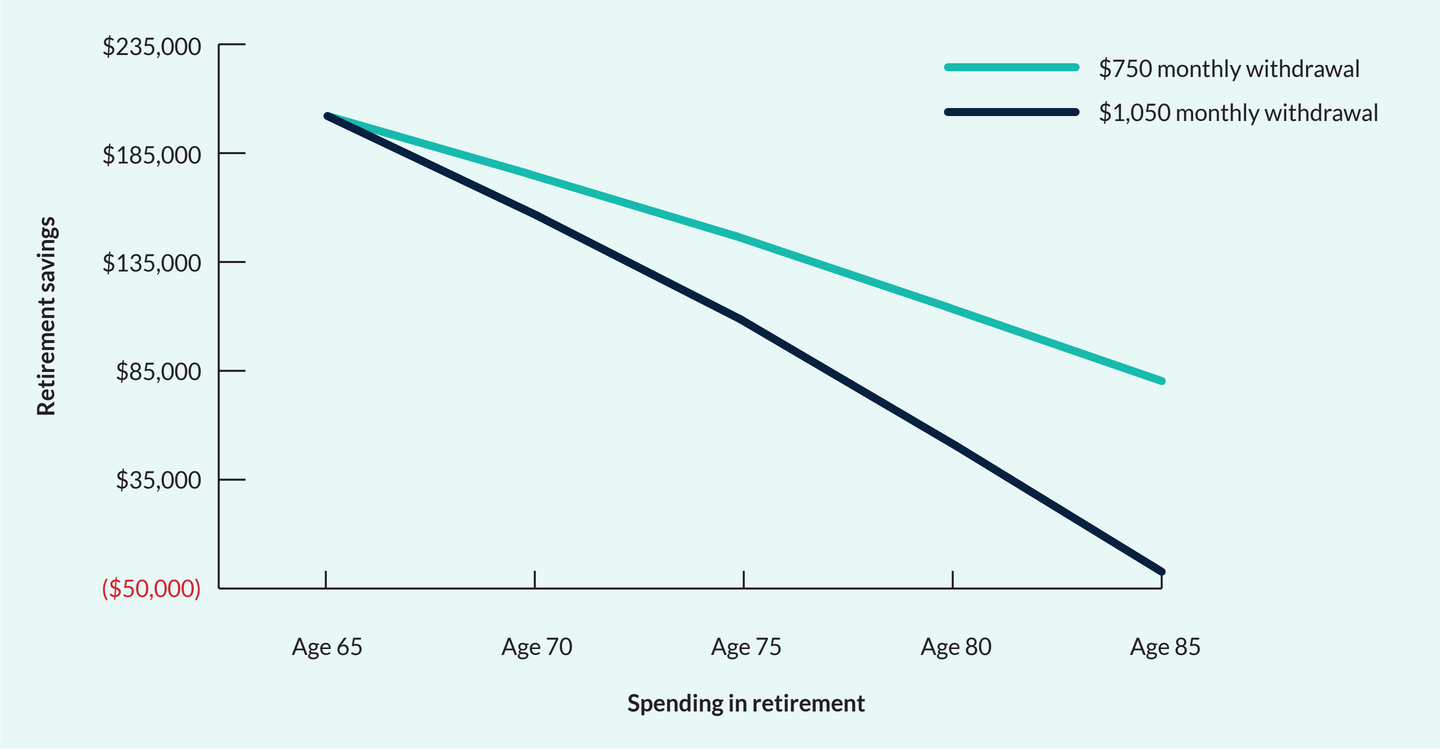


Jamie would increase her savings by 40% by working an additional five years. However, the option to work longer may not be viable for those who encounter obstacles to delaying retirement, such as health problems. Other options for working longer, such as phasing into retirement by working fewer hours, may be possible.

3) Adjusting the monthly withdrawal amount

Lowering the amount that you withdraw in retirement can help make savings last. If Jamie lowered her monthly withdrawal by $300, the savings would last longer and provide an additional cushion for unexpected expenses. Example 3 shows the amount she would have with the lower monthly withdrawal amount.

Example 3: Lower withdrawal amount



The disadvantage to lowering the monthly withdrawal is a lower standard of living. If the withdrawal is too low to cover expenses, it can cause financial stress and increase the likelihood of financial fragility, which is the inability to handle unexpected expenses. Among retired adults, financial fragility is high: Currently one out of five retirees indicate that they could not come up with $2,000 within a month if an unexpected need arose.[5]

RISKS

Planning for and living in retirement comes with a lot of consequential decisions, and there is no one-size-fits-all approach. Taking into account some of the many risks can help you develop a spend-down strategy that works for you.

Inflation and interest rate risk – Inflation decreases the value of money over time, which means that the money you have saved for retirement will be worth a little less each year. Investing in an account that earns interest can offset the effects of inflation. The challenge you face in retirement is choosing investments that will provide a return higher than inflation while still mitigating risk.

Financial risk – This is the risk that an investment has a lower return than what you have planned for or estimated. This can be riskier for individuals nearing or in retirement, as they are using their investment as income and need to depend on the money saved for living expenses. Choosing investments with lower risk and volatility can help offset financial risk. When individuals have many working years ahead of them, they can take on more financial risk, as they have time for the value of their investments to even out price fluctuations.

Investment risk – This risk involves timing of the market. If the market is down, your investments are worth less, and by taking a withdrawal from your investments at this time, you may lose savings. If you can wait for your savings to increase when the market goes up again, the withdrawal will be less harmful to your savings. In retirement, you may encounter an emergency that requires immediate access to funds, so having a stock of savings can help offset investment risk, preserving your savings during a period when the market is down.

Debt – Carrying debt into retirement can quickly eat away at your savings. Research shows that many Americans on the verge of retirement have home mortgage debt and high-cost debt such as from credit cards. This increases the vulnerability of retirees and causes additional financial stress.[6] If you are close to or in retirement and have debt, you may benefit from a financial strategy that aims to first pay off the high-interest debt.

Planning for emergencies – A risk that many Americans face during retirement is emergency expenses, perhaps arising from unexpected healthcare or property repair costs. You should plan and save not only for fixed and calculable expenses, such as housing costs, but for variable and unforeseeable expenses as well.

5 Data is from the 2018 National Financial Capability Study (NFCS). The NFCS is a project of the FINRA Investor Education Foundation.

6 Lusardi, Annamaria, Olivia S. Mitchell, and Noemi Oggero, 2019. "Debt and Financial Vulnerability on the Verge of Retirement," *Forthcoming in the Journal of Money, Credit, and Banking.*

RESOURCES

For additional information, review the resources listed below.

Tools and Calculators from the Wyoming Retirement System

- Retirement Goal Calculator. This calculator helps participants create a goal and strategy for their retirement.
- Pension Benefit Estimate. This estimate helps members understand how much income they might expect from their pension.
- Check Your Progress by Decade. This site provides helpful resources, links, and tools to help plan for retirement for members in their 20s to those in their 70s.
- Evaluating Your Financial Readiness for Retirement. This worksheet is composed of a set of questions to help you assess your financial situation.
- Delaying Social Security Benefits. This factsheet provides an overview of your options to delay Social Security benefits.

Research

- Lusardi, Annamaria, Olivia S. Mitchell, and Noemi Oggero, 2017. "Debt and Financial Vulnerability on the Verge of Retirement," Forthcoming in the Journal of Money, Credit, and Banking. https://gflec.org/research/?item=17819
- Lusardi, Annamaria, Olivia S. Mitchell, and Noemi Oggero, 2018. "The Changing Face of Debt and Financial Fragility at Older Ages," American Economic Association, May. https://gflec.org/research/?item=14120

This information was created for the Wyoming Retirement System by the Global Financial Literacy Excellence Center at the George Washington University School of Business.