



Will Your Money Last? Risks to Retirement Income

A sound retirement income plan takes into account several financial risks, including the potential for the retiree to outlive his or her assets, the effects of inflation on future income, rising health care costs, and the uncertain future of the Social Security system. For example, inflation increases the future cost of goods and services; inflation can also erode the value of assets set aside to meet future costs if the assets earn less than the rate of inflation. In addition to these considerations, a plan should take care to avoid excessive withdrawals in the early years of retirement that could lead to premature depletion of assets. The overall objective of planning should be to create a sustainable stream of income that also has the potential to increase over time.

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With so much at stake when planning a retirement income stream, it pays to take a step back and see whether your plan takes into account the major obstacles to retirement income adequacy. When you take this big-picture view, consider the five major challenges most retirees face: the potential for outliving one's assets; the threat of rising living costs; the impact of increasing health care costs; uncertainty about the future level of Social Security benefits; and the damage to long-term financial security that can be caused by excessive withdrawals in the early years of retirement.

Understanding each of these challenges can lead to more confident preparation.

Examining the Issues

Longevity. While most people look forward to living a long life, they also want to make sure their longevity is supported by a comfortable financial cushion. As the average life span has steadily lengthened due to advances in medicine and sanitation, the chance of prematurely depleting one's retirement assets has become a matter of great concern.

Consider a few numbers: According to the latest government data, average life expectancy in the United States climbed to 77.9 years for a child born in 2007, compared to 47.3 years in 1900. But most people don't live an average number of years. In reality, there's a 50% chance that at least one spouse of a healthy couple aged 65 will reach age 89 (see table).¹

Perspectives on Longevity: Probabilities of Reaching Specific Ages

Chance of Living to a Specific Age		
	50%	25%
Male aged 65	age 83	age 88
Female aged 65	age 86	age 90

50% chance at least one of a 65-year-old couple will reach age 89.
Source: Social Security Administration, Period Life Table, 2007.



Inflation, or the tendency of prices to increase, varies over time as well as from region to region and according to personal lifestyle. Through many ups and downs, U.S. consumer inflation averaged about 4% over the 50 years ended December 31, 2012. If inflation were to continue increasing at a 4% annual rate, a dollar would be worth 46 cents in just 20 years. Conversely, the price of an automobile that costs \$23,000 today would rise to more than \$50,000 within two decades.

For retirees who no longer fund their living expenses out of wages, inflation affects retirement planning in two ways: It increases the future cost of goods and services, and it potentially erodes the value of assets set aside to meet those costs -- if those assets earn less than the rate of inflation.

Health care. The cost of medical care has emerged as a more important element of retirement planning in recent years. That's primarily due to three reasons: health care expenses have increased at a faster pace than the overall inflation rate; many employers have reduced or eliminated medical coverage for retired employees; and life expectancy has lengthened. In addition, the nation's aging population has placed a heavier burden on Medicare, the federal medical insurance program for those aged 65 and older, in turn forcing Medicare recipients to contribute more toward their benefits and to purchase supplemental insurance policies.

The Employee Benefit Research Institute has estimated that if recent trends continue, a typical retiree who is age 65 now and lives to age 90 will need to allocate about \$180,000 of his or her nest egg just for medical costs, including premiums for Medicare and "Medigap" insurance to supplement Medicare. Because of the higher cost trends affecting private health insurance, the same retiree relying on insurance coverage from a former employer may need to allot nearly \$300,000 to pay health insurance and Medicare premiums, as well as out-of-pocket medical bills.

Social Security. The demographic forces that have led to an increasingly older population are expected to continue, putting more pressure on the financial resources of the Social Security system - the government safety net that currently provides more than half of the income for six out of 10 Americans aged 65 or older.

In fact, the number of workers supporting each Social Security beneficiary through payroll taxes is projected to decline from 3.3 to 2.1 by 2031. At that ratio there would not be enough workers to pay scheduled benefits at current payroll tax rates. If no action is taken to fix Social Security's financial problems, the system's trust funds may be exhausted by 2033.² These trends have raised uncertainty about how Social Security can be financed in future years and whether benefit levels and eligibility requirements may have to be changed as the population continues to age.

Excess withdrawals. The decision about how much money may be safely withdrawn each year from a retirement nest egg needs to take into consideration all the risks mentioned above. But retirees also must consider the fluctuating returns that their personal savings and investments are likely to produce over time, as well as the overall health of the financial markets and the economy during their withdrawal period.

Addressing the Risks

While the risks discussed above are common to most people, their impact on retirement income varies from person to person. Before you can develop a realistic plan aimed at providing a sustainable stream of income for your retirement, you will have to relate each risk to your situation. For example, if you are in good health and intend to retire in your mid-60s, you may want to plan for a retirement lasting 30 years or longer. And when you estimate the effects of inflation, you may decide that after you retire you should continue to invest a portion of your assets in investments with the potential to outpace inflation.



Developing a realistic plan to address the financial risks you face in retirement may seem beyond you. But you don't have to go it alone. An experienced financial professional can provide useful information, as well as valuable perspective on the options for successfully managing what may stand in the way of your long-term financial security.

Points to Remember

1. Today's retirees have to assess several threats to enjoying a financially comfortable retirement. These include the potential for outliving their assets and the corrosive effects of inflation on future income.
2. A sound retirement income plan needs to address specific risks, such as longevity, rising health care costs, and excessive withdrawal rates, that can lead to premature depletion of assets.
3. Demographic trends are likely to put added stress on government-run programs, including Social Security and Medicare, which help retirees balance their budgets.
4. The goal of retirement income planning is to create a sustainable, predictable stream of income that also has the potential to increase over time.

¹Source: Social Security Administration, *Period Life Table, 2007 (latest available)*.

²Source: Social Security Administration, *2012 Annual Report, April 2012*.

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