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Baby Boomers Head for Retirement

Abstract

In 2008, the oldest of the baby boom generation will turn age 62. By this age, half of their elders have typically considered themselves retired. Recent research shows that many working Americans, boomers included, do not know how much they will need for retirement, how much they have or how to go about planning to meet their needs. The baby boom generation is more than twice as large as today's elderly population. Financial planners need to be prepared with creative options for an enormous generation that has always forged its own path.

by Sophie M. Korczyk, Ph.D.

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The baby boom generation—born between 1946 and 1964—has transformed every stage of life as it has passed through it. Baby boomers had higher college enrollment rates than any previous generation, transforming—perhaps creating—the youth culture in the process. Wider employment opportunities, fueled by the increase in educational attainment, led to the two-income couples that have changed American family life forever.

Now the baby boom generation is headed for perhaps the greatest transformation of all—retirement. Boomers don't think they will follow their parents' model for retirement any more than they followed their parents at any other stage of their lives. Some of their expectations may, indeed, be revolutionary, but others may just be unrealistic. Surveys show that:

- Many Americans don't know when they will be eligible for full Social Security retirement benefits, or what their pension will yield, if they have one
- Many are not prepared to work longer than the "standard" retirement age—nor are they prepared to retire sooner
- Many people don't know how much they will need for retirement, how much they have saved already, or how long they can expect to live in retirement
- Those who aren't prepared for retirement don't know what to do about it

This paper takes a look at what researchers have learned about boomers' retirement expectations and their resources, and the opportunities and challenges this information presents for financial planners. But it's probably not giving away the punch line to say that most retirement-bound baby boomers know less than they should to plan well for retirement and their financial planners may be their best education source.

What Kind of Retirement Do Baby Boomers Expect?

The baby boom generation accounts for over 28 percent of the U.S. population.[1] However, its mind-set has not been explored nearly as thoroughly as that of the 65-and-over population, which is less than half as large. About the elderly, for example, we know that even the frailest want to maintain their independence from their families, that most want to remain in their own homes as long as possible and that they believe that government expenditures on their behalf should be funded through broad-based, not generationally targeted, revenue sources.

Unlike the elderly, baby boomers have tended not to speak with a single voice. And what they do say about their expectations and desires is not necessarily internally consistent. For example, in survey after survey, many working-age Americans say that they do not expect Social Security benefits to be there for them in the same way that Social Security has sustained their parents' and grandparents' generations. Yet saving rates continue at historic lows, suggesting that today's workers do not expect to rely on their own resources, either. Likewise, while Social Security benefits continue to account for a major share of many retirees' incomes, most people do not want to retire on "just" Social Security.[2]

AARP conducted a major study aimed at providing a road map to the retirement of this largest generation in the nation's history.[3] The study suggests that baby boomers envision a new approach to retirement. Here are some of its findings:

- **Make room for work.** Eight in ten baby boomers expect to work at least part time in retirement.
- **No more 9-to-5.** About one in six baby boomers plan to start their own business in retirement.
- **New horizons wanted.** One in 20 baby boomers expects to work full time at a new job or career.
- **Austerity is not on the horizon.** Just over one-third of baby boomers expect to have to scale back their lifestyle in retirement. On the other hand, about a quarter expect to receive inheritances that will affect their retirement planning.
- **Only the healthy need apply.** Baby boomers see themselves as healthy enough to cope with all the activity they envision in their later years. Only one in six expected to have serious health problems in retirement.

Are These Expectations Realistic?

The baby boom generation changed society a great deal. But how drastic a break with the past does its retirement planning represent?

Work after retirement. Baby boomers think they will work far longer than their elders have. However, fewer than one in six men and one in ten women age 65 and older are in the "official" workforce today. Among men, this percentage represents a decline over the last two decades, though older women are more likely to work than in the past.

Self-employment as a goal. The share of boomers who plan to strike out on their own after retirement corresponds almost exactly to the share of self-employed in today's workforce. But today's business owners span the age spectrum. Thus, boomers also anticipate an increase in self-employment compared with their elders.

Starting a business can pose significant financial risks. Roughly half of all new businesses fail within their first five years of existence.[4] Most undoubtedly, they will take a chunk of their owners' savings with them. AARP did not try to find out how many prospective business owners had the resources, skills or experience—or even an idea—with which to start and maintain a business.

New careers. Like a new business, a new career can involve costs and risks, including training and time to acquire proficiency. During this period, the career-changer's earnings may be well below his or her expectations. A career begun in retirement simply may yield more interest and satisfaction than income.

Retirement lifestyles. Whether baby boomers can maintain their lifestyles in retirement will depend on whether—and how much—they plan to work and how much they have saved. If boomers are over-optimistic about their post-retirement employment prospects, will their savings make up for that? This issue has caused a good deal of controversy and is worth the deeper look we give it below. Most researchers agree, however, that baby boomers are pretty much underprepared—the only debate is over how much. We discuss the research and evidence on the baby boom generation's retirement readiness in detail later in this paper.

Health in retirement. The baby boom generation is still in the prime of life. However, research based on the *Health and Retirement Study (HRS),* a major survey in 1992 of people who were ages 51 to 61, suggests that the baby boom generation may be on the threshold of a more difficult life stage. The *HRS* respondents were older than the oldest boomers but not quite at retirement age. Of this group, more than one in five reported a disability that reduced the amount of paid work they could do.[5] Another 12 percent—about one in eight—had experienced an adverse change in their health in the previous year.

In short, it seems that baby boomers expect more out of retirement—health, wealth and happiness, too—than some in previous generations have been able to extract. What demands will these expectations place on the financial planning profession?

Start with Social Security and Pensions

All politics aside, most researchers and policy analysts who have studied the issue agree that Social Security will be there when today's workers retire. (See "Should Social Security Be Included when Projecting Retirement Income?" by Kenn Tacchino on p. 98) For example, Dallas Salisbury, president of the Employee Benefit Research Institute (EBRI), a nonpartisan benefits think tank, argues that the only way to stop benefit checks from going out is to eliminate the payroll tax. Unless Congress does this, baby boomers—and those who follow—can expect at least "safety net" benefits from the system.[6]

And that's a good thing. In 1998, 58 percent of all households with at least one member age 65 or older depended on Social Security for 50 percent or more of their total income, and more than one in four depended on it for 90 percent or more.[7]

That's not to say that benefits and eligibility requirements won't change—they have and they probably will again. The most important recent change was the gradual increase—ultimately to age 67—in the full-benefit retirement age, enacted in 1983 (Table 1). But age 65 has become enshrined in many Americans' minds as the start of retirement. EBRI has found that more than half of all workers expect to reach eligibility for full benefits sooner than they actually will.[8] Most of these are affected by the retirement age increase and have simply not paid attention to it. But some think they will become eligible for full benefits even before age 65!

TABLE 1

The Social Security Full-Benefit Retirement Age, 2002–2025

Year of Birth	Year You Will Reach Age 65	Full Benefit Age *(Years/ Months)*
1937	2002	65
1938	2003	65/2
1939	2004	65/4
1940	2005	65/6
1941	2006	65/8
1942	2007	65/10
1943–1954	2008–2019	66
1955	2020	66/2
1956	2021	66/4
1957	2022	66/6
1958	2023	66/8
1959	2024	66/10
1960 and later	2025 and later	67

Source: Social Security Online (http://www.ssa.gov.)

Every client born after 1937 needs to understand how the Social Security full-benefit retirement age is scheduled to increase.[9] That is because the financial penalty for taking benefits at age 62 is increasing along with the full-benefit age, to ensure that early retirees continue to get the same lifetime benefits as they would had they waited until the full-benefit age.

It might be reasonable for many people not to think about Social Security in their retirement planning, as the timing of retirement is the only control most people can exert over their benefits. But the same is not true of an employer pension. Many people choose a job on the basis of the employee benefits—including the pension—it offers. Employers want prospective employees to do that—many rely on attractive benefits packages to find the employees they want. Then, once they are working, people may have to make numerous pension decisions, including whether to participate, how much to put away, how to invest their accounts and, upon changing jobs, what to do with their accumulated pension assets.

So many people might be surprised—and the typical employer disappointed—to find that ignorance about pensions is widespread, even among people in the last decade before what we commonly think of as retirement age. Using the *Health and Retirement Study*, researchers Gustman and Steinmeier compared what people say about their pension plans with what their employer said about the same plan.[10] Here is what they found:

- Almost half of pension participants for whom employer- and self-reported pension information could be matched were wrong about the type of plan (defined benefit versus defined contribution) under which they were covered.[11]

- Among respondents with a defined benefit plan, only 43 percent knew—within a year—the age at which they would be eligible for early retirement benefits, and 80 percent either thought (incorrectly) they were ineligible to retire early or did not know how much their benefits would be reduced for doing so (typically four to five percent).

- Only 40 percent of participants could report, even roughly, the accumulated dollar value of their pension plan assets.

It is not clear how the client can make informed decisions about when to retire or how much to save—in or out of the pension plan—without at least some of this information. And the financial planner needs to find out this information from the client's plan documents, not directly from the client, to be sure to give the client valid and applicable advice.

Retirement, Ready or Not

If the baby boomers follow the pattern set by prior generations, half will have claimed Social Security benefits by age 62 in 2008—not such a long time away for the oldest boomers. But baby boomers may not follow the retirement patterns of previous generations. The U.S. Bureau of Labor Statistics projects that labor-force participation rates for those age 55 and older will increase by 5.5 percentage points between 1998 (31.3 percent) and 2008 (36.8 percent), the year when the oldest baby boomers reach age 62.[12] And even this large increase could be an understatement. One factor that has revolutionized retirement planning for this generation compared with its elders is the shift from defined benefit to defined contribution pension plans. Defined benefit plans provide the maximum lifetime benefits when taken at the earliest age of eligibility, while defined contribution plans reward those who wait.

Boomers who wait to retire may be glad they did so. The typical young retiree—age 51 to 59 and out of the workforce—is not wealthy and is less well off than the typical worker in the same age group.[13] In 1992, for example, median family income among young retirees was $24,000, while that among workers in the same age group was $41,000. Median household net worth among young retirees was $82,000, while that among workers in the same age group was $99,000.

Both retirees and workers are diverse, making it misleading to focus on the "typical" member of either group. Looking at the diversity makes early retirement look even riskier, however. In 1992, young retirees in the bottom fifth by wealth had no wealth at all. On the other hand, median wealth among the top fifth of young retirees was $583,000. Differences in wealth among workers in the same age group were less extreme, but still significant, with the median in the bottom fifth at $3,000 and that in the top fifth at $446,280.

Some older workers thus clearly continue to work because they want to, while others equally clearly need the income. Likewise, some young retirees retire early to enjoy their wealth, while others retire despite inadequate savings and income.

Some people who retired before appearing financially ready may have been forced to do so by other circumstances. Among people ages 51 to 61 in 1992, nearly one in ten had been forced to retire, at least in part, either by circumstances on the job or by their own or a family member's health.[14] Involuntary retirees tended to be less happy with their lives than others—working or retired—in the same age group. In contrast, workers age 60 and older tended to be healthier than their retired contemporaries.[15]

How Much? How Long?

How much a retiree needs to finance retirement depends on how well the retiree wants to live and how long he or she will spend in retirement.

Most savings studies ask whether people have, or can expect to have, enough income in retirement to maintain their pre-retirement living standard (the Congressional Budget Office study discussed below is an exception). Retirees can generally maintain their pre-retirement living standard with a lower income because certain expenses—for clothing, commuting or business lunches—decline and their need to save decreases. However, an unchanged living standard would not allow for a busier travel schedule, major outlays to start that new business or career, significant financial help to family members, or even a new, expensive hobby to take up the time the retiree is no longer spending at work. Therefore, this measure of savings adequacy may be too modest to support the retirement many baby boomers have in mind.

But current retirees may not even be meeting this standard. Researcher Annamaria Lusardi has found evidence that a household's living standard, as measured by its spending, drops sharply at retirement.[16] If people planned for retirement with maintaining their current living standard in mind, we would expect spending to decline much more gradually as retirees age and their spending needs and preferences change.

This drop is probably a surprise to most people. Lusardi reports that close to 30 percent of households whose head is close to retirement have done little or no planning for retirement. EBRI's *Retirement Confidence Survey* was less optimistic. It found that more than half of today's workers have at least tried to calculate how much they will need to save for a comfortable retirement. But more than one in four of those who did try to make the calculation were unable to come up with an answer, making the results for the workforce as a whole similar to those for workers nearing retirement.

Those who think about retirement need to understand how long they are likely to be retired. Among married couples with at least one partner who was age 51 to 61 in 1992, 70 percent were part of three-generation families and 25 percent were part of four-generation families.[17] While comparable data are not available for past generations, even casual observation suggests that four-generation families are more common today than even a few decades ago.

And "elongated" family structures will become even more common in the future. The SSA projects that the typical man turning age 65 in 2000 will live almost 16 more years, while the typical woman will live more than 19 years. By 2011, when the oldest baby boomers turn 65, the SSA projects that average life expectancy will increase by six months to a year for men and by two to ten months for women. And by 2029, when the youngest boomers turn 65, the typical 65-year-old man can expect to live up to 19 more years and the typical woman up to 22 years.

Contrast these projections with what was in store for the typical 65-year-old in 1940. The typical male retiree could expect to live just under 12 years, while the typical female retiree had over 13 years left. Retirees of 60 years ago probably did not anticipate the longevity improvements the new millennium would bring and some observers likewise believe that even the high-end SSA projections understate how long the baby boom and succeeding generations are likely to live.

Yet one in three workers told EBRI they expected to be retired less than 20 years and more than half of these workers thought they would be retired for 10 years or less. Many who expect short retirements for themselves may expect to work well past age 65, but they may not be able to realize their plans if poor health or job problems intervene.

Is It Enough?

Data on both total savings and savings for retirement clearly suggest that saving knows no demographic or economic bounds. While some people save more than others, at least some savers are found in all economic and demographic groups. Similarly, while higher-income households are more likely to have saved for retirement, some high-income households have no retirement savings at all.[18]

But do the savers save enough? The most realistic answer is probably not. Several studies arrive at different estimates of the shortfall, however.

Economist Douglas Bernheim has developed a widely quoted analysis of the baby boom generation's saving patterns.[19] Using a computer simulation model that projected lifetime consumption needs for different groups of people, he compared those needs with actual saving behavior. The model assumes that people will want to maintain an unchanged living standard in retirement.

He then calculated how much specific households would need to set aside to maintain their living standards in retirement, accounting for differences in household composition, different saving needs among those who do and do not have a traditional employer-sponsored defined benefit plan, and what people can expect to earn on their investments. He found that, if the baby boomers rely only on the savings specifically designated for retirement, they are saving only 16 percent of what they need, while if they use all their assets other than housing to pay for retirement, they are saving 56 percent of the required amount.[20] Under a midpoint assumption—they use all their retirement savings and some of their overall savings to finance retirement—he concludes that baby boomers are saving about 36 percent of what they should.

Among the demographic and economic groups he considered, married couples with a traditional pension were the best off, with most approaching 50 percent of what they should be saving. Single men and single women with traditional pensions were the next best-off group, with 32 to 47 percent of the amounts they would need to maintain an unchanged living standard. The least well off were single men without traditional pensions, whose assets ranged from 19 to 27 percent of the required amount, depending on their incomes.

But others take issue with Bernheim's analysis and results. Brookings Institution scholar William Gale argues that Bernheim's index measures not the adequacy of total resources relative to total retirement needs, but the ratio of "other assets" to those retirement needs not covered by Social Security or pensions. But for some people, Social Security and pensions will cover nearly all their retirement income needs. Thus, Gale argues, a savings adequacy index of 36 percent is consistent with a wide range of post-retirement replacement rates, depending on each individual's Social Security benefits and pension.

Based on a total-resources analysis that includes Social Security and pensions, Gale concludes that one-third of the baby boom generation is doing well by any measure, one-third is doing poorly by any measure and one-third is on the edge. Thus, he concludes, it is equally possible to conclude that two-thirds of baby boomers are on track to a secure retirement as it is to conclude that two-thirds are at risk.[21]

And there may be no undersaving among baby boomers when at least some of their housing equity is counted in total wealth.[22] In the past, many elderly have resisted tapping into their housing equity for their retirement living needs, generally because doing so meant moving and possibly a loss of independence.[23] Reverse annuity mortgages may give more house-rich but cash-short households the option of using some of their housing equity for retirement without disrupting their lives by selling their homes.

A report by the Congressional Budget Office (CBO) took a different approach to assessing saving adequacy. The CBO found that the retirement incomes of most baby boomers are likely to exceed those of their parents by a large margin, even after adjusting for inflation, as long as average real wages grow.[24] The CBO argued that real wage growth, a more educated workforce and higher labor force participation by women will make more saving possible during baby boomers' pre-retirement years. Thus, if the baby boom generation is satisfied to outdo its parents, its savings may not be off track. Critics of this analysis counter, however, that baby boomers' ability to maintain their own pre-retirement living standard—not that of their parents—may be the standard of savings adequacy that ultimately counts.

Little Changes Can Mean a Lot

Research on baby boomers' financial planning behavior suggests a few starting points for this generation's financial planning.

Planning affects behavior. Just by meeting with you, your client is making a difference! EBRI research found that those who have tried to figure out what they need for a successful retirement, even if they do not arrive at a realistic estimate, appear to be doing a better job of preparing for retirement than those who have not tried at all. Half of those who tried to calculate what they will need for retirement have changed their retirement planning as a result, most by saving more or by changing how their money is allocated. Even when their calculations show they need to save a substantial amount to meet their goals, those who have tried to compute what their retirement will cost are more optimistic about their prospects than those who have not tried at all.

The $20 solution. Unlike so many things—sky-diving, for example—saving is actually easier than it looks. EBRI's Retirement Confidence Survey asked workers whether they could save an additional $20 a week for retirement. Half of those who were not already saving for retirement and nearly three in four of those who were already saving said they could.[25] Many said they could do so without giving up anything; others said they would cut back on entertainment or dining out.

A 25-year-old saving $20 a week at a ten percent real rate of return would accumulate over half a million dollars by age 65. Time, of course, is on the younger saver's side—wait ten years to start and the same plan will yield less than $190,000. But the point is this: A good, effective financial plan does not have to be complicated, and a good financial planner will be able to reduce an effective plan to a few simple and reasonable rules that the client will be willing and able to follow.

Early, late: what's the difference? A yearly financial check-up, especially in the years leading up to retirement, could be smart. Another study based on the *Health and Retirement Study* data highlights the importance of those last few years. Researchers Olivia Mitchell and James Moore found that the median household studied in the *HRS* (household head age 51 to 61 in 1992) had about $325,000 in assets, including housing equity, the present value of pensions and Social Security and other financial assets.[26] They projected that this amount would increase to $380,000 by age 62 and to $420,000 by age 65. Thus, delaying retirement by only three years reduces the retirement savings burden and allows for a substantial improvement in living standards both before and after retirement.

Most people may not think working longer is a way to plan for retirement. But many people don't start planning for retirement until it is just around the corner and there are few other planning options left. And ask your clients whether they would rather work a little longer at the job they already have, or try to find a new job once they've been out of the workforce for a few years and found their retirement resources don't stretch far enough. I know what I'd pick.

Conclusion

The financial planning profession faces a major challenge during the coming decade, as the baby boom generation begins to retire. Just their sheer numbers will put a strain on financial planners. In addition, early indications are that baby boomers plan to reshape retirement much like they did every other life stage.

Here are a few things financial planners should keep in mind to communicate effectively with the baby boom generation, both now and as it ages.

Listen for the unexpected. You already know to listen to your clients, or you wouldn't have chosen your business and stayed in it. But baby boomer clients may pose a special challenge because they expect a different retirement path from their elders. Listen for the plans your clients may not have admitted even to themselves, or the hopes they takes for granted. Are they expecting to realize the career or avocational dreams that were put on hold while raising a family? Do they assume they will be able to help their children with their financial goals or struggles? Remember, too, that baby boomers have different views, different levels of preparation for retirement planning and different expectations.

Get the facts. This is a good caution to keep in mind in dealing with clients of any age. Don't assume your clients will accurately report—or even know—their retirement plan features, savings balances or anything else. For employer-sponsored retirement plans, get the plan documents, not just the participant's general impression of the applicable provisions. Ask your client for information on employer-provided health insurance continuation in retirement (especially important for young retirees who are not yet eligible for Medicare), but be sure to point out that the employer has no obligation to continue to offer such benefits to future retirees or to offer them at what your client may consider an affordable price.

Plan for uncertainty. Many of the baby boomers' parents probably did not expect to live as long as they have. The baby boom generation is likely to live longer, but more of their assets will be in forms that may not live longer with them. For example, defined contribution retirement plans may not provide the same lifetime income protection as defined benefit plans. Some experts think these plans could come under siege when massive numbers of new retirees tap into their retirement plans to pay for their living expenses in retirement. Think about how to manage this uncertainty for your clients. Long-term care insurance is one way—it protects against increased living expenses late in life. An annuity for at least part of the client's retirement income can also provide coverage against an unexpectedly long life.

Keep it simple. You already knew this, but now all the research points out that retirement planning isn't easy. The best plan in the world is of no use if the client can't or won't stick to it. Try to reduce the plan to a few basic rules that busy people can follow, and both you and the client will find the planning experience far more rewarding.

Endnotes

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