VIEW POINT

Planning for the golden years

Are you on track?

Abstract

A fabulous retirement is every worker's paradise. Most of us aspire to successfully move from work-life to home-life. But the big question of 'funding resources' looms large for a successful retirement – am I on track financially to a comfortable retirement?

Innovations in science, technology and medicine have palpably revamped lifestyle and longevity. We now live longer and healthier, including in the retirement phase. But this reality demands an even larger asset base for retirement. The market too is shifting from defined benefit (DB) to defined contribution (DC) pension plans. In such a scenario, awareness, realization and a carefully thought-out plan is the best success strategy.

Infosys be more

Retirement – the different shades

Retirement stirs up different emotions – for many, it is an exciting phase, for some others, it is a reason for anxiety. Then there are some who aren't really aware. Whatever the case, retirement is a compulsory stage of life for the working class, whether one can afford it or not. Besides, the meaning of retirement is changing swiftly as a result of the evolving forces of market, demography and technology.

Like all other things in life, retirement too calls for a realistic vision and planning. Although these days, the retirement planning process is more scientific and methodical, they are all based on a set of assumptions. A periodic monitoring and review of the retirement plan are therefore critical to adjust the assumptions, process and strategy.

Knowing about our 'retirement readiness reality' is a step closer to successful retirement planning. Several surveys at the macro level detail retirement readiness of the entire economy or a country's population. But these surveys findings vary broadly due to their assumptions, process and sampling techniques. Despite their differences, they provide the overall trend and fulfill their primary research objectives so that policymakers and people have an economy-wide macro view of the situation. On an individual level, a macro view may not align with the personal situation. Hence, a personal review and evaluation of the retirement goals are necessary. The good news is that technological advancements have made evaluation tools available at our fingertips, 24X7. All that is needed is a realization of the situation and an interest in knowing and improving the situation. Hence, it is recommended to have your own 'retirement readiness reality' check periodically and take suitable actions, if needed.

Over the last two decades, changes in the context of retirement have increased significantly. It is expected to become even more volatile in the near future. Therefore, no strategy is future-proof while planning for retirement. That said, continuous monitoring and evaluation of retirement goals can help you prepare for your dream retirement.

Money matters

Finances for retirement may come from different sources but are mostly linked with work-life situations. During the working years, funds or credits are accumulated, some of which is then distributed during retirement. As straightforward as it may seem, there are several internal and external factors complicating the complete design of retirement.

Money manners

The three pillars of retirement finances

Broadly, there are three pillars of retirement finances which may differ across geographies and some may or may not be available in a particular country.

Social security benefits from the government	Employment-based benefits such as DB or DC pension plans	Personal savings

External and internal factors

Work year contributions are not the only factor in retirement finances. There are other external and internal factors as well. While external factors are beyond an individual's control, internal forces are within control.

External factors	Internal factors
Demographic changes An aging population, the emergence of a gig economy, migration of workers to non-traditional jobs, increasingly restrictive immigration policies, and more are complicating retirement planning.	**Saving capacity** The bigger the saving during working years, the stronger the third pillar of retirement finances. Saving capacity depends on several factors such as income, responsibilities and lifestyle. While all these factors may not be controllable, prudent management certainly helps save some extra dollars.
Macroeconomic factors The interplay of different macroeconomic factors may not be consistent at all times and a lag effect is generally seen in some of these factors. Hence, before a policy measure is taken, some damage could have already been done. Policy measures also take their time to produce the intended effects. Interest rate cycles, investment cycles, political regimes, and more are beyond an individual's control. The current shift from DB to DC plans is an outcome of the employer's difficulties in estimating changes in macroeconomic and demographic factors.	**Time of retirement** Some control over the timing of retirement is possible and so depending on the retirement age, adjustments to the periods of accumulation and distribution can potentially be made.
Technological innovation Retirement planning services without a digital interface to connect with customers are inconceivable. Without sophisticated data and modeling techniques, real-time management of an individual's retirement goals is improbable, rendering irreparable disadvantages to both businesses and their clients.	**Awareness and education** An individual's financial awareness and education level play a significant role in retirement planning as people with higher education and financial awareness are better equipped to realize their retirement needs and plan.
Regulation The effect of regulatory changes is profound and can reshape the structure and functioning of a retirement strategy quickly. Just imagine, how you would respond if your IRA contributions limits are, say, halved or doubled? Individuals are just takers when regulations change and so should build flexibilities into their retirement strategy.	**Strategy and behavioral biases** Retirement strategy is crucial to achieving the desired outcome as the same risk-taking ability does not remain the same all through life. Furthermore, investment decisions are not always made rationally following the principles of risk-return trade-off as inherent behavioral biases creep in.
Unique circumstances This includes both positive and negative events that one may experience – death, disability, severe health conditions, a significant bequest, and more. However, these are rare and unpredictable. For impairing events, it is prudent to adopt risk management strategies such as insurance.	**Lifestyle and preferences** Lifestyle and preferences during both the accumulation and distribution phases have a significant impact on the overall retirement success.

More longevity: A blessing or a curse?

Life expectancies have increased gradually over the last few decades and a 2017 study led by scientists from the Imperial College London concluded that the average life expectancy is set to increase further in many countries by 2030. Consequently, time spent as a retiree increases and so does the resources we need.

Women, in general, have greater longevity than men and can face many other challenges such as less income during working years, widowhood, and more. Pew Research Center finds that in 2014, 67% of men over the age of 65 lived with a spouse or partner compared to only 41% of women over the age of 65. As women earn less during their working years and are affected by high healthcare expenses, divorce, widowhood and long-term care needs, almost 50% of women over the age of 65 experience income shortfall during their retirement phase.

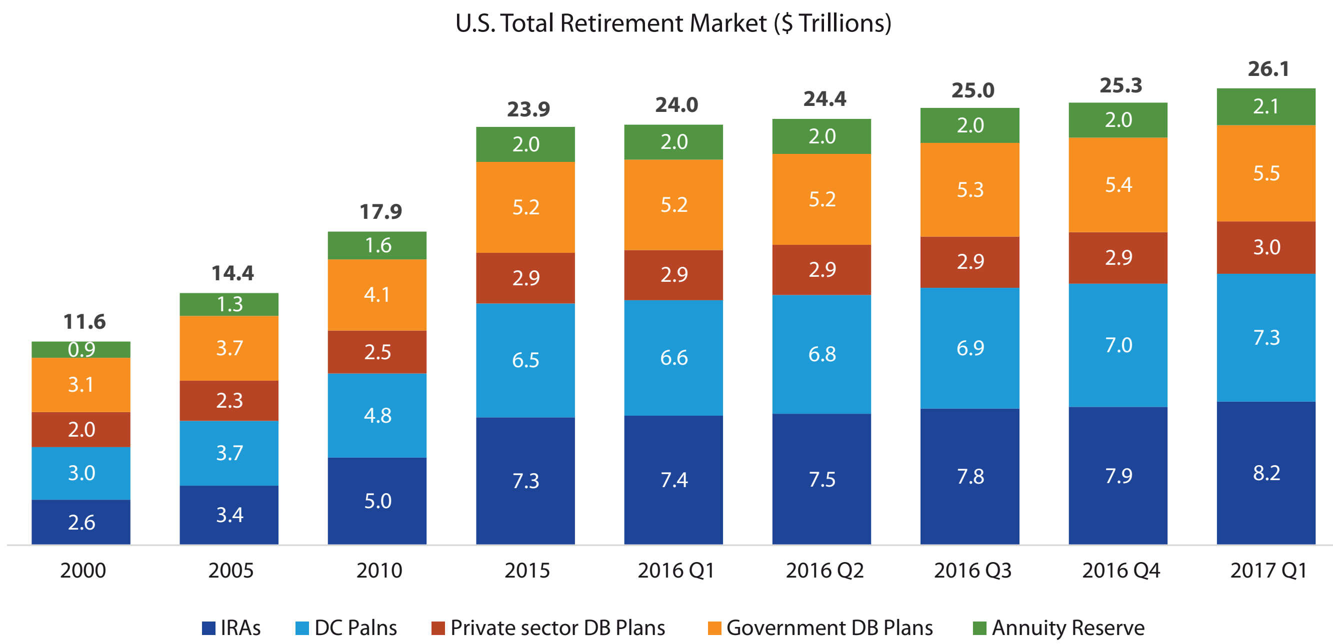
Retirement readiness reality

According to the Employee Benefit Research Institute, American households between the ages 25 and 64 faced a total retirement shortfall of USD4.13 trillion in 2015. Another 2017 National Institute on Retirement Security research report found that:

- 76% Americans are concerned about economic conditions affecting their ability to secure retirement
- 88% Americans agree that nation faces a retirement crisis
- 82% Americans have a favorable view of pension and see them as better than 401(k) plans

Then again, in 2016, the credit rating agency Moody's estimated that the pension and benefits shortfall put together amounted to USD20.4 trillion. This means that the US government has nowhere near enough money to pay retirees.

The Investment Company Institute reported that the total US retirement assets were USD26.1 trillion as of March 31, 2017. From this, 32.75% were dedicated to DB plans only. This report also summarized that 34% of all household financial assets were accounted as retirement assets. Also, the total retirement entitlements in the US was USD30.3 trillion, way above USD26.1 trillion in retirement assets, creating a gap of USD4.2 trillion of unfunded liabilities.



Total retirement market in the US (in USD Trillions)

Source: Investment Company Institute

Although these numbers are at the macro level and indicate a general trend, it reflects an individual's retirement situation for a majority of the population. Our analysis concludes, without an iota of doubt that these numbers are insinuating to a common problem – we are not well-prepared, in general, to attain our dream retirement.

Retire rich: Formulate a smart retirement strategy

While there is no fool-proof time-tested strategy for retiring rich, there is a time-tested methodology to prepare well. But it requires planning, timely action, rationality and discipline.

A similar set of principles do not apply equally to everybody, and therefore, a personalized strategy is essential. Additionally, consultation and help from expert planners help find the best-suited strategy.

From a retirement planning perspective, there are six lifecycle stages before and during retirement. Here are recommendations for each stage to better plan your retirement outcomes. But these recommendations only provide the framework and your retirement strategy must reflect you as an individual.

Foundation

Typically begins after 2-3 years of entering the workforce. There is higher tolerance to risk, being young.

Adopt aggressive growth characteristics in your retirement portfolio

Accumulation

Accumulation begins while in mid-career, still a long time to retire.

Despite having good risk tolerance ability at this stage, your retirement portfolio should become less aggressive

Pre-retirement

This phase generally triggers 5 to 10 years before actual retirement.

A lower tolerance to risk is generally seen. Hence, your retirement portfolio should reflect 'balanced funds'

Early retirement

Begins as soon as you retire and continues until mid-seventies. This is sometimes also referred as the honeymoon period.

Stick to conservative investments and plan to start receiving payouts from annuities

Mid retirement

From mid-seventies to mid-eighties, retirees generally prefer to stay at home. Health expenses also increase.

Payouts from annuities and other sources materialize. Refrain from risky investments in this stage

Late Retirement

Over the age of 85 years, a major part of finances goes towards achieving health and long-term care needs. Late annuity payouts trigger. Retirement portfolios generally have lower assets and the focus is on maintaining incoming payouts.

Plan for a bequest to the next generation, if left with enough assets

Conclusion

Many socio-economic changes are shaping aging, making retirement more complicated. The shift from DB to DC pension plans effectively transfers the retirement planning responsibility from the employer to employees. Furthermore, increase in life expectancy requires a bigger retirement asset base. In our analysis, we find that this problem is much bigger than our imagination and unless it is fixed soon, we are fast approaching a towering trouble. It is best to plan in a timely manner before the realities of aging sets in.

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