RETIREMENT PLANNING TOOLS

How Do You Know If You Are Saving Enough for Retirement?

From a Society of Actuaries Research Institute Report authored by a team from Financial Finesse led by Greg Ward and Mark Dennis
How Do You Know If You Are Saving Enough for Retirement?

RETIREMENT PLANNING TOOLS

From a Society of Actuaries Research Institute Report authored by a team from Financial Finesse led by Greg Ward and Mark Dennis


It may seem like a simple question. Can I afford to retire? If you have ever begun to ask and answer this question, you may have started looking for an online retirement tool to assist in your quest for answers. You quickly find there is no shortage of retirement calculators these days. However, you may be surprised to find they can and most likely will produce different answers. After all, starting with a simple question doesn’t always find its way to a simple answer.

Not all retirement tools are created equal. Often there is more than one question to ask if you are thinking about retirement. Maybe you would like to know if you can retire at a certain age and still keep up your current style of living. You also might be concerned about how long your retirement savings will last or the best strategy if there is a significant age difference between you and your spouse.

Among these various scenarios, calculators will have differences in styles and the level of detail needed to generate accurate results. Use this guide as a helpful tool in understanding how retirement calculators can be used and what to look for when picking out the retirement calculator that best fits your situation.

This guide from the Society of Actuaries Research Institute written by Financial Finesse is a resource to help you better understand how different retirement planning tools are used to estimate how much money you should be saving to retire comfortably with a reasonable assurance of meeting your future spending needs.

WHERE TO BEGIN?
What question would you like the tool to answer? Determining how prepared you are for retirement depends on how you frame the question. Be sure the tool you are using was intended to answer the question(s) you are asking. For instance, are you looking for a range of acceptable outcomes or are you seeking a very specific number as your goal? Retirement planning tools are designed differently to be able to answer various types of retirement scenarios.

What is your situation? Given the complexity of the variables that make up one’s retirement-income needs, it is unlikely that any single retirement planning tool will be able to do it all. You might use more than one retirement tool and discover that each of them gives you a significantly different answer.

Is the tool user friendly? Do you feel your retirement planning tool is asking you too many questions or too few? Is the output easy to understand or is it confusing? Take the tool for a test drive; if you don’t like the way it handles, keep looking. In the end, the best retirement planning tool for you may be the one you are most likely to use.

Who created the tool? Bias, whether intentional or unintentional, is also a potential concern. The output of a retirement planning tool may be influenced by the entity that produces it. This could affect whether the output is biased or unbiased, so consider the source of the retirement planning tool when evaluating your options.

ADDITIONAL CONSIDERATIONS METHODOLOGIES
What methodologies are being used? Retirement planning tools use a variety of methods when estimating outcomes. Some tools may use stochastic modeling that simulates volatility to forecast probabilities and ranges of future values. Stochastic retirement tools assign random values to various input variables and produce a distribution of retirement outcome probabilities rather than predicting precise values.

Other tools may use a fixed or deterministic approach to arrive at a more specific outcome. Average values are assumed for unknown variables, such
as investment rate of return, in order to estimate future retirement outcomes. Deterministic retirement planning tools apply relatively fixed parameters representing one’s financial situation to produce projections of future retirement spending based on estimated rates of investment return.

It is vital to understand these differences and how they can influence your level of confidence in the outcomes when evaluating a particular retirement planning tool. A recommended practice is to explore your retirement possibilities by applying and comparing several retirement tools or calculators. If you can identify a common trend among the different outcomes, you can use that information to help see if you are making progress toward your retirement goals.

ASSUMPTIONS
Tools must assume values and conditions for variables to remain user friendly across a broad audience. A basic retirement calculator, for instance, might focus primarily on calculating the future value of one’s nest egg by assuming average rates for investment return, inflation, longevity, etc. Users must take care not to underestimate the range and depth of risk that may be hidden within these assumptions.

A more complex tool, on the other hand, uses fewer fixed assumptions and allows for a greater amount of customization and flexibility with respect to evaluating changeable variables across ranges of possible values. This added flexibility brings with it additional levels of complexity and potential confusion. Users who are not familiar with statistical concepts of variance and standard deviation, for example, may construct unrealistic scenarios, misinterpret the tool’s output, or both.

RETIREMENT PLANNING TOOLS
THE BREAKDOWN
To better understand what type of calculator will help in your retirement planning, we have classified them into three groups: simple, intermediate, and advanced. All can have a use in retirement planning, but not all are right for everyone.

Simple calculators. Simple calculators generally ask for less information and rely more heavily on assumptions, which may result in less precise output than more advanced tools. Simple calculators may be best for someone who is just getting started with retirement planning or who is looking for a quick calculation that does not require a lot of information.

Grab a cup of coffee, your financial documents, and have a seat. These calculators are going to ask you for many details about your specific retirement situation, so take your time.

Intermediate calculators. Intermediate-level retirement calculators offer more flexibility and potentially higher levels of detail than simple calculators. These tools may allow users to adjust certain factors that likely will affect a retirement outcome, such as inflation rates and investment rates of return. Intermediate calculators may be best for someone who already has done some preliminary retirement planning and has more information available to run a more precise estimate.

Advanced calculators. Grab a cup of coffee, your financial documents, and have a seat. These calculators are going to ask you for many details about your specific retirement situation, so take your time. The more accurate the information going in, the more precise the results coming out. These calculators, although time-consuming, have the potential to be very helpful in complex retirement situations. Advanced calculators may be best for someone approaching retirement, especially if the individual has a variety of assets and income sources that cannot be handled by an intermediate calculator.

Typical questions all three calculators consider:

- Retirement accounts: current balance, annual additions, growth rate
- Age (you and spouse): current, longevity, desired age at start of retirement
- Duration of retirement: length in years, annual withdrawal, growth rate on accounts
- Income (you and spouse): current, annual increases, desired replacement percentage, Social Security
- Taxes: current income tax bracket, anticipated income tax bracket in retirement
- Retirement expenses: approximate healthcare costs, debts, family members needing financial help

SIMPLE CALCULATORS
DESCRIPTION
A simple retirement calculator typically will have fewer questions and rely on more assumptions in its result. These calculators are meant to give a more general type of answer. Given their limited objectives, they avoid asking very detailed questions about your current or future spending habits or whether you have any specific goals in retirement that would need funding.

ROLE OF ASSUMPTIONS
Simple retirement calculators extensively use common assumptions about retirement to do the heavy lifting and offer little in the way of customization. Key assumptions include but are not limited to:

- Inflation constant at 3 percent
- Tax rates remain constant
- Life expectancy: typically age 95
- Expenses remain constant

LIMITATIONS
Simple retirement tools are helpful at estimating the future value of your savings and can help you see if you
How Do You Know If You Are Saving Enough for Retirement?

IDEAL USERS
Younger individuals looking for ballpark estimates on employee deferral rates and additional retirement savings needs are the ideal users of simple retirement calculators.

INTERMEDIATE CALCULATORS
DESCRIPTION
An intermediate-level retirement calculator will go into more detail, but it also may be more difficult to use. It will ask you a variety of detailed questions about your current finances and your future goals, and it also may allow for some variation in some of the variables, such as rates of return on investment, tax rates, longevity, etc.

ROLE OF ASSUMPTIONS
Assumptions start to lessen in importance because this calculator tends to ask more details about your specific situation. Key assumptions include but are not limited to:

- Inflation constant at 3 percent
- Tax rates remain constant throughout life
- Expenses remain constant

LIMITATIONS
Intermediate calculators are more advanced and can give you a better idea of how your retirement savings and investment efforts are coming along. However, they may not take into account future conditions for taxes, healthcare costs, Social Security decisions, etc.

IDEAL USERS
Mid-career individuals inching closer to retirement who can use these calculators to understand how long current retirement account balances may last are the ideal users of intermediate retirement calculators.

ADVANCED CALCULATORS
DESCRIPTION
Advanced retirement calculators may be geared more toward use by financial professionals or those who have a significant amount of personal finance experience. Featuring the ability to evaluate many adjustable inputs and outcomes, these tools often employ stochastic models that evaluate a variety of random outcomes such as prolonged market downturns, higher taxes or healthcare costs, variations in spending patterns, and so forth. Consequently, the output from these tools often illustrates the probability of achieving various retirement goals.

ROLE OF ASSUMPTIONS
These tools still use plenty of assumptions regarding longevity, tax rates, rates of return on investment, etc. It is, therefore, important that the tool or professional discloses any assumptions used in the calculations. In addition, the end-user often is able to modify several or even all these variable inputs and construct rather elaborate and multiple scenarios for comparison.

LIMITATIONS
Advanced retirement planning tools are great for someone who is within a few years of retirement. However, they can be very complicated to use, and interpreting the results may be difficult. This might be a good time to compare different calculators or, better still, consult a trusted financial professional for a second opinion.

IDEAL USERS
Individuals who are actively thinking about retiring within the next five years or financial professionals who provide clients with guidance or advice about retirement are the ideal users of advanced retirement calculators.

CONCLUSION
A good practice is to find more than one retirement tool with desirable features and assumptions that are appropriate for your individual needs. If your outcomes across multiple tools begin to produce similar trends, you are probably looking at a reasonable retirement forecast.

It is also a good idea to periodically revisit your retirement preparedness. Your financial and lifestyle circumstances are likely to change over time. Fortunately, new and improved tools tied to the marketing and selling of financial products with caution and compare results with a less biased retirement planning tool.

Whatever assumptions the tool incorporates, they also should be reasonable and appropriate for your situation. The tool should clearly disclose what types of assumptions are made.

Even the best retirement calculator is going to produce bad output if the information fed into it is incorrect or missing. With this in mind, be sure you have a good working knowledge of the inputs needed by your chosen retirement calculator. Make sure you also have all the necessary details available, so the data you feed to the tool is as accurate as possible.

A better practice is to combine the use of retirement planning tools with additional guidance from a trusted financial coach to help you translate the results and discuss your individual financial strategy.

WHAT DOES A GOOD CALCULATOR LOOK LIKE?

The calculator or similar tool you select should be unbiased in its approach. Use tools tied to the marketing and selling of financial products with caution and compare results with a less biased retirement planning tool.

A variety of detailed questions about your specific situation. The tool should clearly disclose what types of assumptions are made.

Even the best retirement calculator is going to produce bad output if the information fed into it is incorrect or missing. With this in mind, be sure you have a good working knowledge of the inputs needed by your chosen retirement calculator. Make sure you also have all the necessary details available, so the data you feed to the tool is as accurate as possible.

A better practice is to combine the use of retirement planning tools with additional guidance from a trusted financial coach to help you translate the results and discuss your individual financial strategy.
How Do You Know If You Are Saving Enough for Retirement?

Retirement planning tools are being developed continuously, making it easier to compare projections and re-evaluate your retirement preparedness along the way.

About the Society of Actuaries Research Institute

Serving as the research arm of the Society of Actuaries (SOA), the SOA Research Institute provides objective, data-driven research bringing together tried and true practices and future-focused approaches to address societal challenges and your business needs. The Institute provides trusted knowledge, extensive experience, and new technologies to help effectively identify, predict, and manage risks. Learn more at www.soa.org.

Appendix A: Who Can Help

Retirement planning is one of the more complex and dynamic aspects of personal financial planning. A periodic look at a general or basic retirement planning tool can provide helpful feedback to see if your retirement planning efforts are on track. Many company retirement plans (401(k), 403(b), etc.) provide these tools to help guide plan participants, and it is a good practice to use these at least once a year or so to measure the general direction of your retirement preparedness efforts.

What if you need more detailed information, however, or suppose you are getting very close to making a retirement decision? With so many different retirement planning tools available, how can you be more confident? Reviewing the tips and best practices mentioned in this guide is a good start. In addition to comparing the results of several different retirement planning tools and calculators, a second opinion from a trusted financial professional can also help. Be sure to also verify the licenses or credentials of any advisor you choose.

Retirement Management Advisor (RMA®)

The Investments & Wealth Institute is a professional association, advanced education provider, and standards body for financial advisors, investment consultants, and wealth managers who embrace excellence and ethics. RMA-certified professionals are trained to build custom retirement-income plans that mitigate your risks.

Find a certified advisor: https://investmenthelp.org

Certified Financial Planner™

The CFP Board of Standards and the Financial Planning Association each have convenient online search features available for the public to use to identify and contact Certified Financial Planner™ professionals in their local areas:

- CFP Board, Find a CFP® Professional: https://www.letsmakeaplan.org/

Certified Public Accountant (CPA)

The American Institute of Certified Public Accountants (AICPA) is the national professional organization of CPAs in the United States. In particular, CPAs who also hold the Personal Financial Specialist (PFS) designation include personal financial planning as an area of focus for their accounting practices.

- AICPA, CPA License Verification - Find a CPA: https://us.aicpa.org/forthepeople/findacpa.html

Social Security Administration

Your Social Security retirement benefit plays an important role in retirement planning. In particular, the age at which you choose to begin receiving these funds will permanently affect the size of your benefit check. Based on anticipated longevity and other factors, claiming early at age 62 might be an appropriate choice for some, while delaying to age 70 in order to claim a larger monthly benefit check might be a better choice for others. The Social Security website’s retirement estimator tool can help you see how these timing choices may affect your future benefits.

- Social Security Retirement Estimator: https://www.ssa.gov/prepare/plan-retirement

Longevity Calculators

None of us can know for sure how long we might live, but we can estimate the likelihood of living to a particular age range. Based on a best-guess approach using reasonable probabilities, you can use this information to help make decisions about timing your retirement or activating income benefits. Using just six basic questions, the longevity estimation tool available from the Society of Actuaries and American Academy of Actuaries can help you quickly estimate your potential longevity. Those interested in a deeper dive into their longevity odds can answer a more detailed and lengthier battery of health and lifestyle questions at Livingto100.com.

- Society of Actuaries and American Academy of Actuaries, Longevity Illustrator: https://www.longevityillustrator.org/
- Living to 100, Life Expectancy Calculator: https://www.livingto100.com/

Appendix B: Additional Reading

As we have seen, retirement planning tools are numerous and can be quite complex. A detailed description of the various inner workings of these tools is beyond the scope of this guide, however. Readers who are interested in more details regarding the use of retirement planning tools, methodologies, assumptions, and other technical aspects of this software may wish to review some of the following literature on this and related topics:

Continued on page 68


Disclaimer:
The information presented in this guide is intended for general education use only. It does not recommend any specific investment or tax strategies, nor does it endorse any particular software tools. Readers are advised to consult with their individual financial and tax professionals before acting on any information or strategies presented here. This document does not provide advice for specific individual situations and should not be construed as doing so. It is an informational resource intended for general guidance. Individuals needing specific advice should seek the services of a qualified professional.
