WHY ARE SO MANY PEOPLE BAD AT PLANNING FOR RETIREMENT?

BY CHRIS HEYE, PHD

Starting this year, and for the next three years, more people than ever will turn 65 in the U.S. as the youngest Baby Boomers reach the traditional age of retirement. There is even a name for it - Peak 65®.[1] It is difficult to read a magazine, watch a news broadcast, or view a sporting event and not see a commercial highlighting the importance of good retirement planning. If you search Amazon books using the word "retirement", you get over 50,000 results. Retirement gurus offering advice on how to successfully live out your later years are seemingly everywhere.

And yet, there is considerable evidence that most Americans continue to struggle with retirement planning. Surveys consistently show that many people in the US are not feeling great about their ability to afford retirement. A recent study by the Alliance For Lifetime Income (ALI) found that about one-half of adults between age 61 and 65 are not confident that their savings will last their lifetime.[2] Only 21% of adults surveyed in EBRI's 2024 Retirement Confidence Survey (RCS) said they felt "very confident" that they would have enough money in retirement.[3] A study by Voya in 2023 found that just 16% of survey respondents replied that they feel "very prepared" for retirement.[4]

Perhaps the most telling statistic related to retirement planning is the finding by the credit bureau Experian that almost three-quarters of Americans die with debt. Experian estimated that 68% of deceased individuals had outstanding credit card debt, 37% had unpaid mortgages, 25% had unpaid car loans, 12% had unpaid personal loans. The average amount of debt was estimated to be around $62,000.[5]

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It is important to state upfront that there are large wage and earnings disparities in the U.S. and that many individuals and families simply cannot afford to put money aside for retirement. The federal minimum wage is only $7.25 per hour and was last increased in 2009 (though many states have higher minimum wages). Real household income in the US stayed essentially flat between 1999 and 2015 – peak earning years for most younger Baby Boomers.[6]

1. Fichtner, J, The Peak 65® Zone Is Here – Creating A New Framework For America's Retirement Security, Alliance Lifetime Income, Retirement Income Institute, January 2024.
2. Alliance Lifetime Income, 2024 Protected Retirement Income And Planning Study, https://www.protectedincome.org/alliance-research/#PRIP
3. 2 Employee Benefit Research Institute (EBRI), 2024 Retirement Confidence Survey (RCS) https://www.ebri.org/docs/default-source/rcs/2024-rcs/rcs_24-fs-1_confid.pdf?sfvrsn=2747072f_1
4. Voya, Survey of the Retirement Landscape: Participant Sentiments 2023 https://individuals.voya.com/insights/education/survey-retirement-landscape-participant-sentiments
5. Credit.com https://www.debt.org/family/people-are-dying-in-debt/
6. Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED) https://fred.stlouisfed.org/series/MEHOINUSA672N

But even for wealthier segments of the US population, saving enough for a comfortable retirement remains difficult. A 2024 Policygenius survey showed that 58% of adults earning at least $150,000 annually expect their loved ones to inherit their debts when they die.[7]

One reason for our struggles is that the whole concept of "retirement" is only about as old as the gasoline-powered internal combustion engine. The establishment of the Old Age and Disability Insurance Law by Germany's Bismarck government in 1889 is generally viewed as the dawn of the retirement era. Bismarck's program was the first implementation of a government-funded, national pension plan. The Social Security Act in the United States, which was modeled after Bismarck's system, was only passed in 1935, within living memory of some members of the Silent Generation. And it wasn't until the passage of the Revenue Act of 1921 allowing companies to deduct contributions to pension plans from their taxes that company-funded pensions became widespread in the US.

So, for most of recorded history (and long before), there really wasn't a concept of working up until a certain age, and then stopping to "retire". Most people "retired" only when they were too sick to work, or they passed away.

It is not a coincidence that innovations in federally- and company-funded pension plans occurred during a time when human life expectancy was increasing rapidly. The late 19th through early 20th centuries were a time of rapid advancements in medical research. Ether was first used in a surgery at Massachusetts General Hospital in 1846 and its utilization became widespread by the late 19th century. John Snow's work on cholera in London in the 1850s led to the establishment of new public health measures designed to protect water supplies. X-rays were discovered by Wilhelm Conrad Roentgen in 1895. Penicillin was developed in 1928 by Alexander Fleming and was first used to treat patients in the early 1940s. Insulin was discovered in 1921, and its widespread use began in the 1920s.

In short, the concept of retirement is relatively new, even to those of us fortunate to live in the most economically developed parts of the world. Most of our not-so-distant ancestors did not have to worry about planning for retirement, because they were very unlikely to live to be 65 years old, or even 55.

There is considerable evidence that humans by nature are not great at long-term planning. Many studies have shown that planning horizons are often as short as 6 months or less.[8] Our species evolved to focus on the short-term and to heavily discount long-term outcomes. For much of human existence, life expectancy was only around 30 years – perhaps 40 if you survived childbirth. Our human ancestors lived in a world that was characterized by almost daily threats to survival and the need to successfully, and quickly, reproduce. Individuals who were able to rapidly assess and respond to situations and threats were more likely to survive and pass their genes on to subsequent generations. Our forebearers were not rewarded in an evolutionary sense for their ability to slowly and methodically plan for multiple alternative scenarios far into the future.

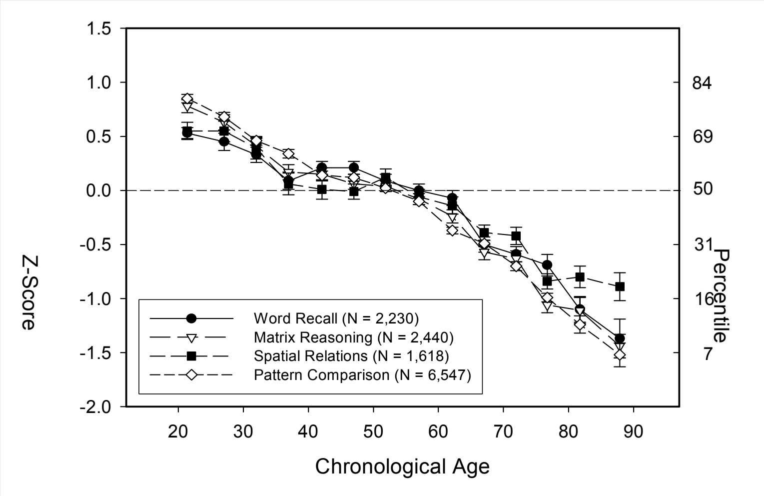
There is also significant proof that humans are lousy statisticians.[9] We evolved with a limited ability to think abstractly and look at the "big picture". Being good at abstract thinking did not help us escape from the stalking lion or survive a surprise attack by a rival tribe. Even for the special few who did have a capacity to interpret a large volume of information, there simply were not sufficient data points to draw anything resembling a statistically significant conclusion. Humans instead learned to satisfice, that is, to aim for a satisfactory or adequate result based on the (limited amount of) available evidence, rather than the optimal solution.

Our need to make sense of the world around us also contributed to our poor understanding of probability and risk, as we tended to see patterns where none existed.[10] Our estimations of the likely costs and benefits of any action were heavily influenced by biases, overconfidence, and random events that we did not understand.

Of course, the situation is better now with our access to superior data, research, education, and ad-

7. Policygenius 2024 Financial Planning Survey, https://www.policygenius.com/life-insurance/2024-financial-planning-survey-passing-on-debt-after-death/
8. For a review of the literature, see Frederick, S, Loewenstein, G, O'Donoghue, T. "Time Discounting and Time Preference: A Critical Review", Journal Of Economic Literature, Vol. 40, No. 2, June 2002
9. See for example Tversky, A, Kahneman, D. "Judgment under Uncertainty: Heuristics and Biases", Science, 27 Sep 1974, Vol 185, Issue 4157
10. See for example Lusardi, A, Risk Literacy In The Us: New Evidence And Implications For Retirement Planning And Financial Fragility, Alliance Lifetime Income, Retirement Income Institute, December 2023

Salthouse Studies – Memory and Analytic Tasks



Source: Agarwal S, Driscoll JC, Gabaix X, Laibson D. The Age of Reason: Financial Decisions over the Life-Cycle with Implications for Regulation

vice. But even today our ability to plan, organize, and connect the dots becomes more limited later in life.[11] A large Harvard study concluded that our financial decision-making capabilities peak around age 53 and steadily decline thereafter.[12] This means that we begin to lose our capacity to successfully manage finances just as we approach our peak earning and saving years, with potentially devastating consequences for our retirement planning.

SO, WHAT CAN WE DO?

EDUCATE

It is no secret that most Americans lack good financial literacy. One study found that only 30% of those surveyed could correctly answer three basic questions about financial management.[13] The ability to understand the importance of two of the three questions – one about the power of compound interest rates and another about the differences between real and nominal values – have direct bearings on planning for retirement. Especially for younger adults in the US, the knowledge that saving only a small portion of your income over time can result in almost unimaginable savings later in life is something that needs to be driven home on a regular basis.

Surveys also show that most people in the US have only a limited understanding of the financial products that can help them plan for and afford their retirement. A survey conducted by the Alliance for Lifetime Income (ALI) asked adults between the ages of 61 and 65 which financial products could provide them with protected income in retirement. While 70% and 61%, respectively, (correctly) answered Social Security and company pensions, 54% incorrectly thought their IRA could provide them with guaranteed income. Similarly, 53% thought their 401K furnished them with protected income, but only 44% knew that annuities offered guaranteed income in retirement.[14]

Fortunately for younger adults, many states are starting to offer financial literacy courses in public schools. Currently there are 28 states that require students to take a personal finance course in order to graduate.[15] We can only hope that financial literacy requirements

11. Weiner, A, Heye, C, Baer, L, Fava, M, and Sherman, J. "Cognitive Function As A Proxy Of Financial Decision Making In Older Primary Care Adults", Alzheimer's & Dementia, Volume 13, Issue 7, Supplement, Pages P1558–P1560
12. Agarwal S, Driscoll JC, Gabaix X, Laibson D. "The age of reason. Financial decisions over the life-cycle with implications for regulation". Brookings Papers on Economic Activity 2009; Fall: 51-101
13. Lusardi, A, Streeter, J. "Financial literacy and financial well-being: Evidence from the US", Journal of Financial Literacy and Wellbeing , Volume 1 , Issue 2 , July 2023 , pp. 169 - 198
14. Alliance Lifetime Income, 2024 Protected Retirement Income And Planning Study
15. Council for Economic Education, https://www.councilforeconed.org/policy-advocacy/survey-of-the-states/

are adopted in every state, as the importance of early planning cannot be understated.

For older adults, more educational resources are becoming available from government and especially private employers. Many large companies now offer courses and software tools designed to improve employees' levels of financial literacy and wellness. I also expect AI to play a major role in educational and planning efforts in the future. We are likely to see a growing number of personal assistants and chatbots designed to improve financial literacy, personal financial management, and retirement planning efforts.

SIMPLIFY

Planning for retirement in the US is incredibly complicated. There are so many financial, health, and legal aspects of the planning process, involving virtually infinite combinations of government programs and regulations, financial services companies and products, and healthcare and insurance providers and services. Even ostensibly simple programs like Medicare and Social Security can be complex to navigate. When should I start taking Social Security? Age 62? Age 70? Should I enroll in Medicare Part B? Should I purchase additional private health insurance? If so what kind? Medicare Advantage plan? Medicare Supplement plan?

While there is not much you can do as an individual or a financial planner in the short term to reduce complexity at the macro level, there are things you can do to simplify your own personal finances (or those of a client). There can be many benefits, especially for older adults, from simplifying your financial life. Specifically, it can be advantageous to reduce the number of accounts to:

- One checking and one savings account at one institution.
- One IRA account and all old retirement plans such as 401k and 403b accounts rolled into this IRA.
- One Roth IRA account with all Roth 401k and Roth 403b contributions rolled into this Roth.
- One brokerage account – all outstanding stock certificates, mutual fund holdings, and other investments should be held in this account.

Financial institutions and insurance companies can also help reduce complexity. There is strong consumer interest in securing protected income in retirement, as well as being insured against the often-prohibitive costs of long-term care. The same ALI study found that 62% of individuals between the ages 45 of 72 who have $150k or more in investable assets say they are either "somewhat" or "extremely" interested in purchasing an annuity. Another 19% already own one. In a 2023 survey of Baby Boomers, Gen-Xers, and Millennials by Nationwide, 71% of respondents thought it was important or very important to have long-term care insurance.[16]

This desire to have income guarantees and cost protection later in life is only likely to grow as the US population ages. But currently annuities and long-term care insurance options are often viewed as too expensive, too complicated, or both. More product innovation and educational outreach in these areas is needed, but the possibly payoffs are enormous. Financial and insurance firms that are successful at finding ways to structure simple protected income products that can meet the growing needs of an aging population at an affordable price are likely to be the big winners in the future.

CONCLUSION

Planning for a safe and comfortable retirement is difficult, and humans are not genetically wired for long-term thinking. So, to overcome our inherent behavioral shortcomings and biases, it is important that you start early, build a team of trusted family members and professionals, and continually educate yourself on retirement strategies and financial products. There are no guarantees, but at least you will have the emotional satisfaction of knowing you have a plan and that you are doing the best you can. After all, the only thing harder than preparing for retirement is not being prepared.

16. The Nationwide Retirement Institute 2023 Long-term Care Survey, https://nationwidefinancial.com/media/pdf/NFM-21387AO.pdf