The 2 Main Retirement Income Problems For Individuals

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The 2 Main Retirement Income Problems For Individuals

1) Longevity
   - As individuals we have no way of knowing how long we are going to live.
   - No discernable leverage point for age of death to use for income planning.
   - What do we have to plan for? (Life Expectancy vs. Life Potential)
   - As an individual what does this do to our income rates? Increase or decrease them?
2) Determining our Income Rate before knowing the rates of return we will earn on our money
   - As individuals we have no way of knowing what we are going to earn on our money before we have to spend it for income in retirement.
   - What do we have to plan for? (High Rates or Low Rates of Return?)
   - As an individual what does this do to our income rates? Increase or decrease them?

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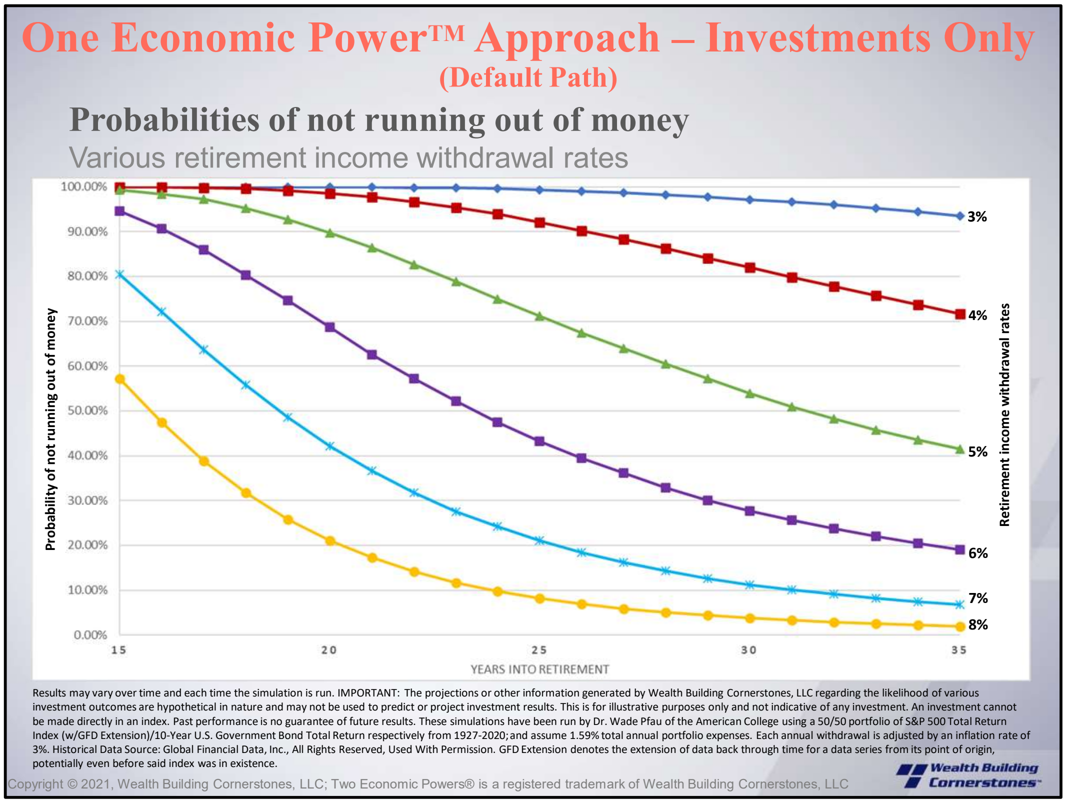
The 2 main retirement income problems for individuals are: 1) Longevity. As individuals we have no way of knowing how long we are going to live. We have no discernable leverage point for our age of death to use for income planning. So, assuming it would never be ok to run out of money or income, what do we have to plan for? Living to life potential which might be age 100 or 105 or beyond. When we have to plan on our money lasting longer into the future what does that do to the annual income amount we can spend along the way? Does it increase or decrease it? It would decrease it. The second problem is that we have to determine our income rate before knowing the rates of return we will earn on our money. As individuals we have no way of knowing what we are going to earn on our invested assets into the future. So again, assuming it would never be ok to run out of money or income what do we have to plan for? Do we assume earning high rates of return or lower to be safer? Probably lower to be safe. Does that increase or decrease the amount of income we can pull along the way? It would decrease it again. So, these are the two problems people face for creating their retirement income if they go about it in an individualistic manner.



These two problems manifest themselves on the withdrawal rate simulation curves we see here for invested assets. Let's take a look at the results of these simulations. This chart shows the historic probabilities of not running out of money years into retirement based on the withdrawal rate someone chose off the beginning asset base. **It is important to understand that these are withdrawal rates on the right side and not interest rates on your money in retirement. These simulations and curves exist because we are acknowledging that we have to establish our income withdrawal rate before knowing the fluctuating returns we will earn on our money into the future.** As an example, let's say you chose an 8% withdrawal rate, which would be $80,000/yr from a starting asset value of $1,000,000. This would put us on the orange line on the bottom. What this is saying is 25 years into retirement, historically I've had about a 10% chance of not running out of money and around a 90% chance of running out of money. So it doesn't take a rocket scientist to tell us that by lowering our withdrawal rate we'll have a better chance of not running out of money. The financial industry has generally settled on somewhere between a 2.5%-4.5% withdrawal rate as being a quote "safe withdrawal rate" depending on the chance of failure you are willing to accept. So, that would be $25,000-$45,000/yr of retirement income per $1,000,000 that you would have accumulated by retirement age. But at a 4% withdrawal rate, you would have to be willing to accept around a 30% chance of running out of money long term with this strategy.

The 2 Main Retirement Income Problems For Individuals

So, how do we solve these two problems?

The Power of Actuarial Science was built to solve these two problems for individuals through a pooling effect.

Insurance companies make products that allow individuals to access a discernable death leverage point (life expectancy for millions of lives) for establishing income rates from, and take away the risk of individuals not knowing what they might earn on their own individual assets.

Products that are part of the pool of millions of lives is what allows this to happen. Only insurance companies can create these types of products.

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Actuarial Science is a very good distribution power, meaning it can be used to establish higher income (distribution) rates in a safer or even guaranteed manner, relative to the individualistic approach of withdrawal rate simulations.

One reason it can do this is because it establishes a defined “Anchor Point” or “Leverage Point” for the age of death.

As an individual, I have no Anchor Point by myself for the age of my death. When establishing income (distribution) rates from assets for retirement income if I act individualistically I have to plan on having assets last longer to life potential so I don’t run out of money.

When I use products that are part of the pool of millions of lives of Actuarial Science I now get access to a defined Anchor Point for the age of death (life expectancy) that can be used to establish higher, safer, and potentially guaranteed income streams.

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This Anchor Point for the age of death is part of what creates the Power of Actuarial Science in personal finance. It gives you a defined end point to leverage from for establishing income (distribution) rates.

This is one of the reasons why the Two Economic Powers®:

1) Rate of Return/Interest Rates (Accumulation)
2) Actuarial Science (Distribution)

were always meant to work together in tandem for retirement income planning. Both powers together complete the picture. When you try to use one power to do the other power's job you can lose efficiency very quickly.

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