TIAA Institute

Want to know when you can retire?

It's about what you'll spend, not what you've saved

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Why do we save for retirement?
It sounds like a simple question with an obvious answer: We save (or at least most of us do) so we can maintain our standard of living after we retire. We save so we will have money to spend on the goods and services we need to live comfortably.

But notice what is not included in this answer—a number.
In all the years I've been asking this question, no one has ever said the point of retirement is to have $1 million at age 65—even though much of Wall Street promotes this very concept. That's because "the number," the amount of wealth we're supposed to accumulate, is not the real goal. It's an intermediate step toward what really matters, which is creating a secure and happy retirement. It's not even a real measure: After all, how much is enough when the number of years you'll live in retirement (your longevity) is unknown?

Guaranteed lifetime income helps solve the longevity problem. Stocks and bonds are good for growth. But according to six decades of academic research, we're likely to be better off when annuities play a significant role in retirement plans, providing a predictable stream of income that never runs out. It shows that income, not wealth, is the outcome that matters most for financial security and peace of mind.[1]

I am the son of two high school teachers. My dad taught social studies, and my mom taught office skills such as typing and shorthand. My parents never earned a lot, but they were savers. They clipped coupons. I wore hand-me-down clothes. Thanks to their saving habits, my parents built up a decent nest egg.

A few years before I entered my PhD program, my parents retired. They were in their mid-50s. They needed to figure out how much they could spend each month, and to do that they had to guess how long they would live.

Mom and dad are now healthy, self-sufficient 84-year-olds. Had they planned for only 25 years of retirement, they could have spent more, but they would have outlived their money. Instead, they lived frugally—too frugally I'd argue. Their biggest fear was running out of money. They never wanted to be a burden to me or my siblings.

When I started graduate school, the subject of retirement planning resonated with me, and it led to a 25-year career in research and education. Here's what I've learned:

- Having enough guaranteed lifetime income to cover basic needs provides financial security and peace of mind. Our well-being does not come from how much money is in our account on a given day. It comes from having the money we need when we need it. If we all knew how long we had to live, it would be easy to toggle back and forth between wealth and income. We don't.
- We have a retirement system built around wealth (unfortunately). There's a disconnect between what we want from retirement and how we've been told to get there. We obsess about how much money we will have the day we retire, when what we really need to know is how much money we can spend each month. Policymakers feed this obsession. The government endorses the use of default investment options based solely on how they facilitate wealth accumulation. The IRS requires a minimum rate at which you must withdraw, without considering whether you will have enough money left at older ages. Regulators impose fiduciary duties to diversify investment options and keep expenses low but no duty to consider lifetime income.
- Converting savings to income is psychologically difficult when you've spent your life defining success by how much money you have. The human brain is hard-wired to look for mental shortcuts. These shortcuts are often valuable—hear a growl in the bushes, and nobody sticks around to see if it's a bear or a possum—but they sometimes mislead. And one of those sometimes involves retirement planning. In psychology, the word "framing" is used to describe how decisions can be influenced by mental shortcuts instead of facts and outcomes. About 15 years ago, I partnered with researchers from Harvard University and Brookings Institution to test the impact of a wealth frame versus an income frame when thinking about retirement. We explained a savings account and a life annuity and gave respondents a choice. In half the test cases, we used words like "spend" and "payment" to get them focused on consumption. Within this group, seven in 10 people chose the life annuity over the savings product. For the other half, we provided identical information but used words like "invest" or "earnings" to get them thinking about wealth instead. When we framed the choice this way, only two in 10 chose a life annuity over a savings product.[2]

People should view guaranteed lifetime income as a glass half full: "I am never going to run out of money no matter how long I live."

Instead, we have conditioned them to think of guaranteed income as a glass half empty: "I used to be a millionaire, but now I live on a fixed income."

What can we do to fix this?

One option is to try to educate. I am an educator, and I almost always believe more education is a good thing. But I am also a social scientist who cares about data and evidence. And what I can tell you is that educating our way toward secure retirements will not be enough.

We must also focus on product design and plan architecture. Think about the powerful influence automatic enrollment has had on savings rates. If we built lifetime income into our plans and products—making lifetime annuities a default option in 401(k)s, for instance—people could have happier, more secure retirements.

The third thing we can do—one that can be implemented right away—is shift our communication strategy away from a relentless focus on wealth. We should stop obsessing over "the number." We should stop making account balances the yardsticks of success. We should maybe even stop talking about whether someone has "saved enough" for retirement.

Instead, we should be talking about how much future income we have provided ourselves. About how we have ensured that we can maintain our standard of living. About what we have done to guarantee that we will not run out of money in retirement.

Income is the outcome. It's a powerful frame. It's time we put it to use for good.

1. Jeffrey R. Brown, 2014. “Income as the Outcome: How to Broaden the Narrow Framing of U.S. Retirement Policy,” Risk Management and Insurance Review, American Risk and Insurance Association, vol. 17(1), pages 7-16, March.

2. Brown, Jeffrey R. and Kling, Jeffrey and Mullainathan, Sendhil and Wrobel, Marian, Framing Lifetime Income (May 2013). NBER Working Paper No. w19063, Available at SSRN: https://ssrn.com/abstract=3431847

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