WHAT IS A "REASONABLE" RETIREMENT SAVINGS RATE?

The answer to that question varies per person.

Presented by Glazer Financial Network

How much salary should you defer into a retirement plan? Ultimately, the answer is "however much your budget allows you to contribute". The big-picture question, however, is whether you need to contribute more to your retirement savings in order to maintain your lifestyle after your career is done.

An Aon Hewitt analysis (*The Real Deal: 2012 Retirement Income Adequacy at Large Companies)* finds that the average corporate employee makes a pre-tax contribution equal to 7.2% of his or her pay to an employer-sponsored retirement plan. Aon Hewett has found this level of contribution to be pretty consistent across the past few years. The Employee Benefit Research Institute puts the number at 7.5%.[1,2]

Hopefully, these employees are basing their contributions on math. Retirement savings calculators are everywhere online, and while often criticized for their simplicity, they can bring you a useful ballpark figure. If you try them out, you may decide to boost your retirement savings rate as a result.

As an example, using CNNMoney's What You Need to Save calculator, a 34-year-old with $20,000 in retirement savings who makes $78,000 annually would need to save $11,544 a year to hope to retire at age 65 at 80% of pre-retirement income. That $11,544 represents 14.8% of his or her yearly salary.[3]

Our hypothetical 34-year-old is quite affluent and has gotten a decent start on retirement savings compared to many of his peers – yet according to this calculation, a 7.2% retirement savings rate won't cut it. Of course, the calculator is ignorant of such factors as home equity, inherited wealth, profit from business enterprises and so forth – but even so, many people are not saving enough for their retirement target.

More to the point, many people are saving for retirement without a savings target.

One established approach. If you are approaching your retirement years, you may be asking "How much do I need to save?" In the eyes of financial services professionals, the answer is linked to the question, "How much do you plan to withdraw?"

In 1994, a financial advisor (and MIT grad) named Bill Bengen published a long and highly influential article in the *Journal of Financial Planning* advocating that retirees withdraw a little more than 4% of their retirement savings each year. Bengen's suggestion was labeled the "4% rule", and many financial services professionals paid attention to it when consulting their clients.[4]

First, they helped their clients project how much would be needed to pay for planned annual retirement costs beyond what Social Security and pension benefits could absorb. Next, they asked clients to decide on a retirement savings *withdrawal rate*

(4% or something else) in light of historical data. Then, they helped the client set a *retirement savings target,* roughly expressed as annual planned retirement expenses divided by the annual planned withdrawal rate, i.e., 45,000/.04 = 1,125,000, with $1.125 million being the target retirement savings goal. Lastly, a *retirement savings rate* was determined for the remainder of a client's working years to him or her reach that goal (though the financial target could certainly be attained by other means).[5]

There are even simpler approaches. Other financial services professionals simply suggest that you should estimate your planned retirement expenses and adopt a savings rate (taking historical data into account) that you feel comfortable with in order to reach them. After all, different people derive retirement savings from different sources beyond 401(k)s and IRAs, and make different asset allocation choices with their investments.

So what is that savings rate, and how then might it be reasonably figured? Some retirement planners suggest a simple rule of 12 – take your current salary, multiply it by 12, and what you get represents the minimum savings you need for retirement.

The simplest approach of all might work better than any other – just save as much as you can. The Center for Retirement Research at Boston College notes that the median U.S. income in the 2010 U.S. Census was $43,084. A 35-year-old with that income and $0 retirement savings would need to defer about 18% of his or her pay annually to have enough to retire at 80% of salary at age 68, with his or her portfolio returning a hypothetical 4% every year for 33 years.[2]

CRR director Alicia Munnell claimed to *U.S. News & World Report* that staying on the job (and waiting longer to claim Social Security) can have a bigger impact on retirement saving than portfolio performance. "If people could work until they're 70, they would have a much higher chance of having a secure retirement. Social Security is higher if you wait until age 70, and it gives your 401(k) assets a longer chance to grow, and it reduces the number of years you have to support yourself."[2]

Save now; save avidly; save consistently. As you do, remember that if you don't yet have a huge IRA or 401(k), it isn't the end of the world – retirement savings and retirement income can be generated from other sources, some less exposed to the volatility of the financial markets.

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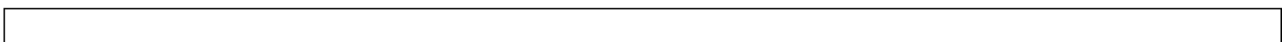

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