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How's your retirement literacy?

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By Elliot Raphaelson The Savings Game

The American College of Financial Services conducted an online survey to assess retirement literacy among those near or in retirement. Respondents were between ages 60 and 75 with at least \$100,000 in household assets, not including their primary residence.

The participants, representing a cross-section of American families, showed a significant lack of knowledge in several important areas. The average score of correct answers was 47 percent, and 74 percent of the participants had a failing grade. Only 5 percent earned a grade higher than C.

The following are the major areas of concern:

Sustaining income and preserving assets

The general understanding of concepts in this area is quite low. For example, only 38 percent of respondents knew that, to preserve a \$100,000 nest egg for a lifetime, the maximum rate of withdrawal is 4 percent.

Only 34 percent knew that a substantial negative return on assets at retirement age would have a much bigger impact than the same negative return either before or after retirement age.

Approximately one-half underestimated the life expectancy of a 65-year old man.

Most respondents failed to identify the best strategy to improve retirement security in advance. Only 33 percent understood that it would be more effective to work two years longer, or defer Social Security for two years as opposed to increase their retirement contributions by 3 percent for five years prior to retirement. And fewer than half knew that purchasing a life annuity can protect against the uncertainty of life expectancy.

Understanding investments

Results overall showed a significant lack of knowledge about how basic market instruments perform.

One in three respondents understood that the value of individual bonds and bond funds decreases when interest rates increase.

Only 10 percent knew that small company stock funds, on average, have shown higher returns than large company stock funds, dividend-paying stocks and high-yield bond funds.

Long-term care

Most of the participants underestimated the share of the population that will need assistance with “activities of daily living.” Only 18 percent correctly answered that 70 percent of the population will need such assistance.

Only one-third of the participants knew that Medicaid — not Medicare — pays for the majority of long-term care expenses provided in nursing homes. And only 30 percent knew that family members — not nursing homes, assisted living facilities or hospitals — provide the majority of long-term care services.

Annuities

Nineteen percent of respondents said that they are not knowledgeable about annuity products. Given that 74 percent indicated that having a guaranteed lifetime income in retirement is important, education about annuity options would be useful.

Only 29 percent knew that buying an immediate annuity is more expensive for younger persons than older ones. A mere 17 percent correctly identified the lifetime payout for a 65-year old: 6 to 7 percent. Fourteen percent knew that a deferred annuity with lifetime withdrawal benefits can pay income even if the investment account has a zero balance.

Individual retirement accounts

Participants showed a moderate amount of knowledge about IRAs, with some exceptions. For example, only one-third could identify the best time to convert from a traditional IRA to a Roth IRA (ideally, when your marginal tax rate is lower than normal for a given year).

Social Security

Although Social Security is a staple for many, a number of respondents did not know when to claim it.

The full results of the study are easily found online (type “Retirement Income Literacy Report” into a search engine).