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## From GAO, a Primer on Retirement Income

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By Editor Test      *Wed, May 5, 2010*

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*Last week, the Government Accountability Office sent a snapshot of America's retirement income status to Sen. Herb Kohl, who will hold hearings on the topic in June.*

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The Government Accountability Office, which has researched retirement income several times in the past, delivered its latest report on the topic to Senator Herb Kohl (D-WI), chairman of the Senate Special Committee on Aging, on April 28.

Kohl, whose committee will hold hearings on the state of retirement income next month, had asked the GAO to examine the “options that retirees have for drawing on financial assets to replace preretirement income,” the “options retirees choose,” and “how pensions, annuities and other retirement savings vehicles are regulated.”

The GAO's report, [“Retirement Income: Challenges for Ensuring Income throughout Retirement,”](#) surveys the landscape of retirement income thoroughly, without offering many surprises for close followers of the defined contribution and individual annuity markets. For the person who's new to this topic, or who wants a handy compendium of facts and figures on this subject, it could be highly valuable.

The report shows, for instance, that Americans over age 65 live on income from Social Security, employer-sponsored defined benefit pensions, distributions from defined contribution plans, individual annuities, investments in stocks, bonds, and mutual funds, and earned income.

For most people, it doesn't add up to much. After reading the report, you're likely to be left with the impression that the median American retiree—if such a notional character exists—will start retirement with under \$50,000 in guaranteed household income and perhaps \$100,000 in savings.

Whether that amount can suffice will undoubtedly vary from household to household, depending on home equity, health, region and a near-infinite range of other variables. Among some policyholders, it indicates a national retirement crisis.

### **Social Security**

Extrapolating from the GAO data, it appears that for people who earned between about \$48,000 and \$106,800 during their working years, Social Security benefits average about \$25,000 per year.

For people who made less than that, Social Security payments will be lower but will replace a higher percentage of their former income. For people who are used to making over \$100,000, Social Security payouts will level off at about \$25,000 but replace a declining percentage of their former income.

As the GAO puts it, “Social Security benefits for retired workers at full retirement age (age 66) in 2010 provide 90% of the first \$761 of average monthly indexed earnings, 32% of additional earnings up to

\$4,586, and 15% of earnings above \$4,586, up to the limit on the annual base of covered earnings each year or \$106,800 per year (\$8,900 per month) in 2010.”

The GAO doesn’t calculate the present value of Social Security benefits for the average person. But its figures suggest that a new retiree would need about \$400,000 to purchase a retail income annuity that would produce an annual income equal to the average Social Security benefit.

Even then, the annuity income wouldn’t have the inflation-adjustments that Social Security has. If you consider that the average household saves only around \$100,000 by retirement, the value of Social Security to the average person looms large.

### **Defined benefit pensions and annuities**

Many Americans are still eligible for defined benefit pensions. The ones who aren’t are not making up for it by buying income annuities. About one in three American households still had a traditional defined benefit pension plan in 2007, according to Survey of Consumer Finances data cited by the GAO. In that year, according to the IRS, the average combined taxable pension and annuity income was \$19,500.

Of that amount, the portion attributable to annuity income would appear to be negligible. Few households—about 6% percent—owned individual annuities in 2007. Only 3% (\$8 billion) of the total amount of annuities sold in 2008 was fixed immediate annuities, designed solely to provide lifetime income.

The GAO indicated concern about the costs of variable annuities with lifetime income guarantees, noting, “one variable annuity prospectus we reviewed indicated that maximum expenses for a \$10,000 investment and a 5% annual rate of return could exceed \$7,000 over a 10-year period.”

### **Defined contribution plans and investments**

Of the people who have DC plans and taxable investments, few have balances large enough at retirement to buy an income annuity that pays as much as the average DB pension. In 2007, before the recent recession, half of the households with someone aged 55 to 64 had financial assets of \$72,400 or less.

An estimated 61% of households “at or nearing typical retirement age” have a defined contribution plan account or an IRA, as of 2007. The median account value was only \$98,000. At current rates, that would purchase a fixed income of less than \$6,500 a year for a 65-year-old couple, GAO figures showed.

About one in five households headed by someone ages 55 to 64 holds stocks directly, with a median value of \$24,000, while 14% hold pooled mutual funds, with a median value of \$112,000. Only 2% held bonds directly, which had a median value of \$91,000.

It might be inferred from those figures that wealthier people hold bonds, but it’s not clear. Certificates of deposit are held by 21% of near-retirement households, with a median total value of \$23,000. An estimated 35% of those households had cash value life insurance, with a median value of \$10,000.

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