How Much Can I Afford To Spend In Retirement?

The Consequences of Saving Too Much for Retirement
David Ning (US News, May 29, 2013)

"The future is unknown, so it's always good to be conservative with your money, but you can go too far. Make a carefully thought out plan to make sure you're saving enough, but don't save too much. Money isn't just for hoarding, it's for spending too."

I agree with Mr. Ning. It is critical, however, to make sure that you are indeed on track to "save enough" before you decide that you have saved too much and you should be spending more.

The table below might help you determine whether you are on track or not. It shows the approximate multiple of final year's pay in accumulated savings needed to provide real dollar annual income during retirement that is expected to replace a specific percentage of your income prior to retirement (when added to income from Social Security). This table is based on the methodology set forth in the article in this website entitled How Much Accumulated Savings Will I Need To Replace My Pre-Retirement Standard of Living? and the following assumptions:

1. Social Security Normal Retirement Age 66
2. Social Security will replace 28% of final pay at assumed retirement age/benefit commencement age of 65 and 39.6% of final pay at assumed retirement age/benefit commencement age of 70 and will be increased by inflation of 3% per year after assumed retirement/benefit commencement
3. Investment return on accumulated savings of 5% per annum after retirement. Inflation increases of 3% per annum.
4. No other sources of retirement income (other than accumulated savings and Social Security)
5. Death occurs at age 95
6. No amounts intended to be left to heirs on death

These are just approximate amounts of accumulated savings needed based on the assumptions above. Changing any of these assumptions would change the multiples needed. For example, if a person had defined benefit income or had fixed annuity income, the amounts needed would be reduced. In addition, if a person decided to purchase a life annuity with some or all of her accumulated savings at retirement, multiples of pay needed may be less as insurance company pricing is based on an assumption of death
closer to average life expectancy. In addition, Social Security benefits may replace lower or higher percentages than assumed for this table.

But the bottom line is that if you don't have other significant pension income and you want to approximately maintain your standard of living in retirement, you probably don't need to be terribly concerned about the problem of "over-saving" until your accumulated savings start to exceed something like ten times your current compensation.

Ken Steiner, Fellow of the Society of Actuaries, Retired, is solely responsible for the opinions expressed in his website. He was a pension actuary for over 30 years, the last 10 of which serving as the Resource Actuary for Watson Wyatt Worldwide (now Towers Watson). He has no expertise in asset investing or financial planning. He has been advocating the actuarial approach for withdrawals from accumulated savings discussed in this website for over ten years. He receives no direct or indirect compensation from visits to his website.