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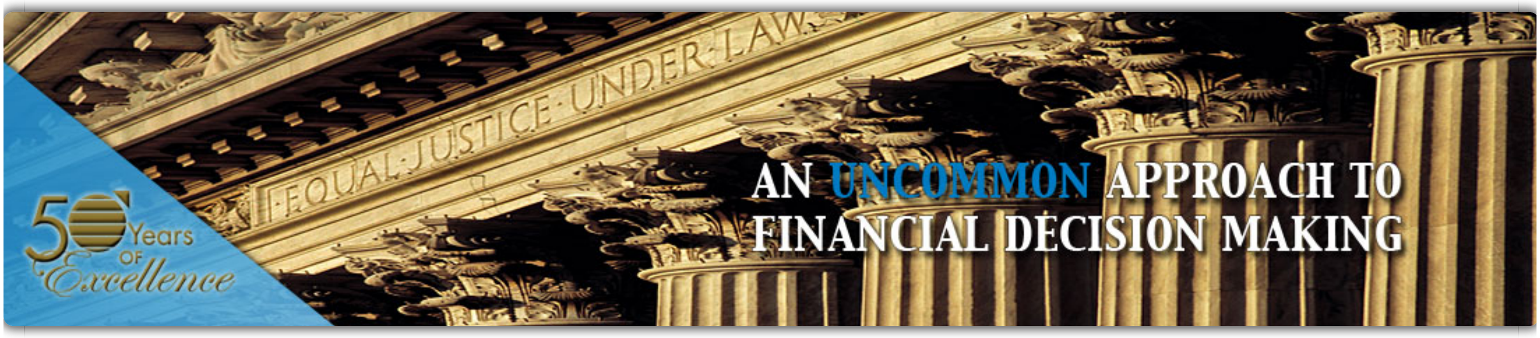


## The Rule of 22 (or 21.47):

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**"Don't have a pension? Don't worry. Most people don't. They will get to retire, and so will you."**

This is the optimistic opening statement from a 20-page white paper titled "A Pension Promise to Oneself" by Stephen Sexauer and Laurence Seigel, published in the November-December 2013 issue of the *Financial Analysts Journal*. The stated goal of the paper: To give Americans a simple model for retirement planning that "compresses 40-80 years of dynamic complexity into something that they can manage and understand" with a simple formula that "reduces the retirement calculation to a multiplication problem that a fifth grader can solve."

From a fifth grader's perspective, here's the bottom line: Your number is 22 (actually 21.47), and you need to save a lot of money.

The number 21.47 is a Retirement Multiple (RM). The RM determines the retirement account accumulation required for a "risk-free" retirement income. For instance, if you want to receive an income of $100,000 annually at age 65, your retirement account should be almost $2.2 million ($100,000 x 21.47).

The RM metric makes it fairly simple to self-assess your retirement progress. Besides giving you an accumulation target, you can also calculate the value of your current retirement savings. For example, if you currently have $300,000 in retirement assets, dividing the amount by 21.47 results in an annual income of $13,972.

Simple? Yes. But is it accurate?

**What are the underlying assumptions? And are they realistic?**

The main premise of the white paper is: individuals should see themselves as sponsors of a traditional defined benefit (DB) pension plan, one that delivers a guaranteed income "from the moment you retire until the end of your life or your spouse's life, whichever comes later."

**The authors make certainty a priority**. "We start by assuming that the investor wants to ***guarantee*** the desired income level, not merely have a high probability of achieving it." This means "investing with as little risk as possible, both before and after retirement." Meeting this objective requires very conservative assumptions about projected rates of return and consequently higher levels of saving, but offers the near-certainty of hitting your target.

Besides emphasizing guarantees, the article offers several practical arguments from human behavior for low-risk simplicity in retirement planning. Most individuals aren't financially savvy – "they do not fully grasp the difference between a stock and a bond, much less the difference between an expected return and a return one can count on." Even experienced investment professionals "suffer from an illusion of precision regarding return expectations," and complex plans "will simply not be widely adopted or [will be] adopted incorrectly in a way that hurts investors." Further, our cognitive skills decline with age. Retirees "do not want to couple this almost assured fall in clear thinking with a retirement plan full of complexity and risk taking."

The Retirement Multiple is derived from the performance of a hypothetical portfolio consisting of Treasury Inflation-Protected Securities (TIPS). Per Investopedia, "TIPS are considered an extremely low-risk investment," backed by the U.S. government, with values that rise with inflation. A website, www.dcdbbenchmark.com, updates the current RM (21.47 was used in the white paper; it was 21.85 for December 2013).

The authors state in their introduction, "Well-run DB pension plans provided retirement income for generations. When plans failed, it is because they broke the rules." The Rule of 22 distills the funding requirements of a compliant pension plan. If someone adheres to these no-risk guidelines for retirement planning, success depends on only one factor: **you just have to save money.**

#### Select a savings target, then figure out how to hit it.

In their retirement planning process, Sexauer and Seigel estimate an income stream that will be needed, and a target retirement age. These numbers are educated guesses. (In examples accompanying the article, the authors use 70% of projected earnings at age 65 as their annual retirement target.) The RM is applied to the target income, resulting in a lump-sum, and a savings plan is constructed to reach the goal. In order to meet their projections, most households will have to increase their saving over time – both at greater amounts, and a higher percentage of income. One recommended strategy is automatically allocating half of any pay increase to savings. Because life changes, the plan must be updated. But each adjustment uses the same items: the target income, the current RM, and a revised saving plan.

In three hypothetical examples (a teacher, a sanitation worker, and a software developer), the white paper applied this process to show how different career arcs and earning levels could achieve a risk-free, guaranteed retirement. Some common factors: Every future retiree started by saving at least 10% of their annual income in their first year of employment. In their final working years, they all were saving at least 20%, and in one case, more than 30%. When Sexauer and Seigel say a risk-free retirement "involves a lot of saving," they aren't kidding.

But the authors insist these scenarios are achievable. They cite large-scale studies showing saving rates of over 30% for the 55-60 age group for the top three quartiles in the United States. "We have shown that individuals saving for retirement are not facing a hopeless task. Far from it."

#### Optimistic, Sobering, Doable.

"A Pension Promise to Oneself" makes several thought-provoking statements about retirement planning. Instead of massaging projected rates of return and historical probabilities, the focus is on guaranteed results. In their words, "Assets must be accumulated according to an economically sound plan, and wishful thinking about markets must not be allowed to substitute for rational savings rates." This is a reality check about the costs of providing a truly secure retirement.

The simplicity of the calculations and the insistence on low-risk investing addresses key behavioral aspects in personal finance. In a vacuum, sophisticated retirement models may deliver superior results. In the real world, many savers would likely do just as well with a fifth-grade calculation and saving a large percentage of one's income. This planning process takes less time, and the results are less likely to disappoint.

Indirectly, Sexauer and Seigel imply that current retirement theories have somehow made a distinction between building an individual and corporate retirement plan. They insist the processes – and the funds required – are equivalent. In their words, "individuals can provide pensions for themselves almost as easily as employers can. It requires saving a lot of money – almost exactly the same amount…" And since this is true, they ask

"Why aren't these words spoken to every employee who begins to work at a company, government agency, or nonprofit organization? Why aren't they taught in schools? Why aren't they part of the advice lovingly given by parents to their children as adulthood looms?"

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