You Have to Oversave

One of the key questions to consider when planning for retirement is: "How long will I live"? It's a pretty obvious consideration. After all, one needs to know how long they're likely to need the money.

Actually, it is totally the wrong question.

The reality is that you need to provide for an income however long you live. If you plan to live to age 90 and manage to survive to age 91, then (assuming you planned carefully and exactly and your plans worked out) you'll have nothing for that last year of your life.

Of course, you don't think you're planning to run out of money right at age 90 (or whatever age you pick). But that's what all the retirement planning software does, in fact, assume.

If you've done any thinking about retirement saving, you've heard about the "magic" of compound interest. The sooner you start saving, the better it is, because your money works for you and makes more money. Very true.

The problem is that when you turn to spending, then compound interest starts working against you. Your savings dwindle more and more rapidly as you spend them down, making it harder and harder to spread them further if you (perversely) find yourself alive and well and not dead at the right time.

My conclusion: You have to oversave. If you want to have money right up until the day you die, you will die with money left to someone else.

I suppose this sounds rather morbid. However, I can't see any way around it. Unless …

Well, there are two ways of maybe avoiding oversaving:

1. Get hired by an employer with a defined benefit pension and work for them for 30-40 years – i.e., long enough to earn a pension that will actually cover all your needs and wants in retirement. (And, of course, take the pension option, not the lump sum commuted value!)
2. Take your retirement savings and purchase a guaranteed income from a life insurance company. The insurance company will guarantee the payments and you can spend happily, knowing the income will keep coming as long as you are alive. The only downside of this plan is that annuities are expensive, so you have to save up a lot of money to be able to afford the amount of income you need … probably about the same as you would have to oversave if you decided to manage the money yourself.

Oversaving isn't that bad. You can take comfort in being reasonably sure you won't run out of money. And if it bugs you to leave money to others, you may find some comfort in the thought that your heirs will need more than you can leave them, since they'll have to oversave for their retirement.

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