Planning for Retirement?  
Web Calculators Weak on Health Costs

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AARP’s Public Policy Institute informs and stimulates public debate on the issues we face as we age. Through research, analysis and dialogue with the nation’s leading experts, PPI promotes development of sound, creative policies to address our common need for economic security, health care, and quality of life.

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# TABLE OF CONTENTS

Foreword.......................................................................................................................... v

Executive Summary ...................................................................................................... vii

Personal Savings and Retirement Planning in the United States ............................. 1
  Introduction................................................................................................................... 1
  Findings from the Literature on Retirement Savings............................................ 1

Comparing Popular Retirement Planning Calculators ................................. 4
  Introduction................................................................................................................... 4
  The Calculators............................................................................................................. 4
  Results........................................................................................................................... 5
  Conclusions................................................................................................................... 8

References..................................................................................................................... 10

Links to the Selected Calculators................................................................................ 12
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FOREWORD

Economic and health security in retirement years are topics of central interest to AARP and of growing interest as the baby boomers begin to retire. Social Security and Medicare provide important financial underpinnings for economic and health security; yet, on their own, they are not sufficient to ensure freedom from financial worry in later years. There is a general expectation that people will need savings, pensions, and other financial resources to maintain their standard of living after leaving the workforce. Consumers face the problem of estimating savings needed for retirement, and one piece of this puzzle is anticipating postretirement spending on health insurance and health care services. The challenge is estimating postretirement health care spending and factoring that into retirement savings plans.

Retirement planning can take various forms, but one way people may start thinking about retirement is to use one of the online retirement planning calculators that are available. The goal of this project was to look at a number of popular online planning tools to see how they treated the issue of health costs in retirement planning. This question takes on importance because changes in spending on health can be expected during retirement. Not only does health coverage commonly change after leaving the workforce, but new health problems and a need for long-term care services may occur in later life. Likewise, health care inflation is higher than general inflation. Together, these factors suggest that it is important that health costs be part of retirement planning if people are to be prepared for potential shifts in spending in their later years.

The findings indicate that online calculators may help people estimate what they need to save to reach a targeted level of resources for retirement. But, they generally do not help people plan specifically for health and long-term care expenditures in retirement.

Gerry Smolka
Project Officer
Public Policy Institute
EXECUTIVE SUMMARY

As the baby-boom generation begins to retire, retirement saving has become a topic of increasing interest to policymakers and individuals. Social Security and Medicare are cornerstones of financial and health security in retirement. Yet, by themselves, they are not enough to ensure retirement security. People need additional resources to pay for their living expenses in retirement—thus, personal savings, pensions and planning for retirement are important. People tackle the challenge of estimating the savings they need to support themselves in retirement in different ways. Online retirement planning calculators are one way people can begin to assess both their retirement saving needs, and the adequacy of their resources. This research looked at ten popular online calculators to see how they help consumers estimate savings needed for retirement and, in particular, how they treat the issue of health care costs. All the calculators have the same underlying purpose: to provide guidance on how much savings are needed for retirement.

Existing calculators allow for many considerations in their calculations of the level of savings required to support a given level of spending. Users can test many different scenarios with varying interest rates, inflation rates, mixes of stocks and bonds, life expectancies, and tax rates. Estimates can be provided for bequests, living on interest, or consuming all of one’s assets. There are, of course, many areas of spending that will go down in retirement. Children are usually grown and living independently; expenses like tuition and mortgage payments often are no longer in play; taxes are lower and there is no need for work-related expenses like clothing and commuting. Other expenses, however, like leisure and health care will increase.

The calculators provide different estimates of how much savings are needed, which highlights differences in the variables used in their calculations. But the estimates are valuable only if the user’s own estimates of post-retirement spending are accurate.

The calculators provide little assistance to ensure that accuracy. The first ten calculators simply take a percentage of the user’s preretirement income as the target for postretirement income level. None of these calculators incorporate information on health care spending in retirement into their analyses. However, two calculators provided worksheets to estimate monthly spending by adding up current monthly expenses such as housing, transport, debt payment, medical expenses, and insurance.

Two additional calculators do provide some information regarding postretirement health care spending, although these two calculators give very different results. The Fidelity Investments calculator (only available to Fidelity customers) is designed to help consumers save specifically for health care expenses. It uses a series of inputs including gender to estimate likely lifetime spending, including the key inputs of age of death and the future real health care inflation rate. The calculator provides information on sources of health care spending, including Part B and Medigap premiums, out of pocket spending and expenses associated with Part D. The Mind Your Finances calculator focuses on long-term care expenses. Both calculators provide valuable information on potential liabilities for retirees and can serve to educate the users on the significance of health-related spending. For example, for a 55-year-old male retiring in ten years at age 65, dying at age 92, and assuming a 6 percent health care inflation rate, the Fidelity calculator estimates total lifetime health care costs of $211,030. For a female dying at age 94, total lifetime health
care costs are estimated to be $230,853. If long-term care costs are included (assuming the 6 percent inflation rate again), the estimates are increased by $76,622 for males and $78,303 for females. In contrast, the Mind Your Finances calculator suggests $154,713 (assuming a per day cost of $137, three years of care, and a 3.1 percent inflation rate). These last two calculators provide some information on health-related spending, but supplying accurate input data will be challenging for the consumer.

These calculators easily could be improved by providing consumers with—

- a simple but improved estimate of their life expectancies
- the likely annual or monthly health care spending associated with Medicare medical and drug coverage, retiree health benefits, Medicare supplemental insurance, and private Medicare plans
- the likely need for long-term care services and the out-of-pocket costs associated with different long-term care services

Creating significantly better postretirement financial planning tools would not be a difficult task. Minimally, estimates could be adjusted for age and gender. More sophisticated estimates based on health and family history would be even more valuable and would provide a significant improvement in retirement savings planning.

The published literature on the adequacy of retirement savings, while mixed in some areas, is in agreement that at least 20 percent of U.S. households are not meeting savings targets for retirement. Yet, few studies focus explicitly on the role of health care spending in assessing retirement security. While two found that most people would have enough resources to meet the health expenses in retirement, another study suggests that once health care costs are explicitly taken into account, the percent of people “at risk” for not being able to maintain their preretirement spending for things other than health care increases dramatically. This points to the importance of educating people about the significance health related spending may have in their retirement years so that they can incorporate that into their thinking about retirement savings and planning for retirement.

Calculators are one of many ways to improve consumer education about the resources they may need to be financially secure in retirement. Calculators could contribute more to consumer financial education if they included information that helped consumers educate themselves about how their health coverage and health needs might change in their later years. Financial and health security depend on having the ability to absorb changes in health spending that can come in retirement. Improving people’s understanding of this ability is important, whether through calculators or other financial education efforts.
PERSONAL SAVINGS AND RETIREMENT PLANNING IN THE UNITED STATES

INTRODUCTION
As the baby-boom generation begins to retire, retirement saving has become a topic of increasing interest in both the private and public sectors. Public programs for the elderly, such as Social Security and Medicare, are under growing financial pressure as the number of retirees becoming eligible increases and the relative number of tax-paying workers supporting the program declines.

Medicare, in particular, faces an uncertain future, as its relative tax base declines and the cost of health care continues to increase. Currently, Medicare covers approximately half of Medicare beneficiaries’ total health care spending (Caplan 2002), with beneficiaries themselves responsible for a quarter of spending. The Part B premium doubled from 2000 to 2007, and beginning in 2007, means testing is being phased in for Part B premiums, ultimately resulting in significantly higher premiums for higher income beneficiaries.

In addition to increasing out-of-pocket costs under public insurance programs, older Americans face substantial financial risk from the costs associated with services not covered by typical health insurance policies, especially long-term care. While a great variety of different long-term care arrangements have been developed (nursing homes, assisted living facilities, home care, and others), all of these options are expensive. Many Medicare beneficiaries not only underestimate the probability that they will need long-term care, but they also mistakenly believe that Medicare pays for long-term care (Barrett 2006). The government does fund long-term care through the Medicaid program, but Medicaid requires beneficiaries to “spend down” their assets to gain eligibility.

Increased needs for health care, health care inflation (which is higher than general inflation), changes in Medicare and Medicaid, and a need for long-term care all present risks for individuals in their later years, and individuals need to understand the impact of these risks on their postretirement financial security. This paper explores the extent to which the risks related to health costs figure in efforts to assess adequacy of retirement resources in the literature and in online calculators designed to help individuals assess their own situation.

In this paper, we focus on the consumer’s problem of estimating the savings required for retirement and the extent to which the risks related to health costs figure in available research and tools for assessing adequacy of retirement resources. The next section summarizes findings from the literature on retirement savings, followed by a presentation of results from some popular calculators that are designed to assist individuals with their retirement plans. The concluding section provides additional information that could help consumers better understand how health spending may change in retirement and how to factor that information into their retirement planning.

FINDINGS FROM THE LITERATURE ON RETIREMENT SAVINGS
The adequacy of current workers’ savings for retirement has been a topic of long-standing policy interest (AARP 1994). Postretirement cash income streams can be broken down into three sources: Social Security, employer-sponsored retirement plans, and personal wealth.
Personal financial wealth that is capable of producing an income stream includes cash savings, financial instruments (e.g., stocks, mutual funds, and bonds), and other income-generating assets (e.g., rental properties, small businesses, and farms). Other assets, including home ownership, produce “imputed” income because they eliminate the need for some types of expenditures (e.g., rent). For the least well-off individuals, Social Security accounts for virtually all of their postretirement revenue, while personal financial wealth and pensions account for the largest proportion among individuals in the top 10 percent of the population by wealth (Moore and Mitchell 1997).

Many categories of spending decline in retirement. Retirees no longer need to save for retirement as they already are in that state; children typically are grown and living independently; large expenses like tuition and mortgage payments often are no longer required; their taxes are lower; and they no longer have to incur work-related expenses such as clothing and commuting. However, other types of expenditures, including leisure activities and out-of-pocket spending on health care, are likely to increase with age (Caplan and Brangan 2004). Average out-of-pocket health care spending and out-of-pocket spending as a percentage of income can vary dramatically with the beneficiary’s type of insurance coverage. Beneficiaries with private supplementary coverage have both the highest level of out-of-pocket health care spending and the highest proportion of their income devoted to out-of-pocket health care spending, while beneficiaries in private Medicare health plans and beneficiaries with Medicaid coverage have the lowest (Gold and Achman 2003).

Two components make up any calculation of the adequacy of retirement savings. The first component is an estimate of the amount of wealth individuals need when they enter retirement. The second is an estimate of the actual wealth that future retirees are likely to accumulate before they retire. Disentangling the many sources of household wealth from the available data, determining how much wealth is adequate, and thereby measuring the adequacy of savings is challenging. The results of “adequacy of retirement resources” estimates depend upon how they are calculated.

The published literature on the adequacy of retirement savings in the United States is somewhat mixed in its findings. The Congressional Budget Office (CBO) provided a comprehensive review of the literature in 2003. The analyses included in that review suggested that 50 to 80 percent of Americans are saving adequately for retirement; that is, the majority of Americans are financially well prepared for retirement and will be able to pay for their out-of-pocket medical expenditures without becoming destitute (Engen, Gale, and Uccello 1999; Gustman and Steinmeirer 1999; Scholz, Seshadri, and Khitatrakun 2006).

Scholz, Seshadri, and Khitatrakun (2006) use detailed information on earning histories, asset accumulation information, and importantly, expected out-of-pocket medical expenditures to calculate the optimal wealth for each person in their sample. They find that more than 80 percent of households have more wealth than their optimal targets. Furthermore, for those households that have accumulated less than optimal savings, the wealth deficit is modest—averaging less than $6,000. However, these conclusions are based on a model that treats the house as a fully liquid asset. When housing assets are treated as only half-liquid, the number of households that are saving more than their optimal target drops to 75 percent and the average wealth deficit (conditional on saving
less than their desired target) increases by a modest $2,000. Their findings include the possibility of large nursing home expenditures.

The conclusions of these studies are broadly consistent with survey information on individual beliefs about retirement planning. The Employee Benefit Research Institute (2007) reports that 70 percent of all workers feel “very confident” or “somewhat confident” that they are saving enough for retirement. However, the survey also finds that the proportion of their retirement income that current workers believe will come from personal savings is much higher than the actual proportion of current retirees, and the estimated proportion of income from Social Security is much lower than the actual proportion for current retirees.

Few studies focus explicitly on the role of health care expenditures in assessing retirement security. Knickman et al. (2003) find that the future elderly will, on average, have sufficient resources to cover their health care expenses. Similarly, Totten and Blewett (2005) find that majority of Minnesotans (approximately 75 percent) will have enough resources to meet retirement health care expenses. However, Munnell et al. (2008) find that once health care costs are explicitly taken into account, the percentage of people “at risk” for not being able to maintain their preretirement nonhealth spending increases from 44 percent to 61 percent.

Several papers are less sanguine in their assessment of retirement savings adequacy. For example, VanDerhei and Copeland (2003) argue that the elderly face an income shortfall of at least $400 billion between 2020 and 2030 in their ability to cover basic expenses. Using a rule of thumb analysis, Moore and Mitchell (1997) find that the median household faces significant shortfalls in wealth to finance retirement. This conclusion differs significantly from that of Scholz, Seshadri, and Khitatrakun (2006).

The literature is in agreement that at least 20 percent of U.S. households are not meeting savings targets for retirement. Not surprisingly, the households that are most at risk for facing shortfalls in retirement income are the currently poor. Fortunately for these households, the Medicaid program will absorb most of their health care expenditures, and thus their health status entering retirement likely will have less of an effect on consumption than for their more well-off counterparts.

The conclusion that most Americans are well positioned for retirement is contingent upon the Social Security, Medicare, and Medicaid programs maintaining at least their current level of generosity. For many low-income Americans, postretirement income is tied largely to the current level of benefits of these programs. If those benefits are jeopardized in any way, then the conclusion that most Americans are well positioned for retirement would no longer hold.
COMPARING POPULAR RETIREMENT PLANNING CALCULATORS

INTRODUCTION

There are many sources of information for Americans planning for retirement. One of the key tools produced by retirement planners are “calculators” designed to help consumers estimate their postretirement financial needs. Most retirement planning calculators are designed to help individuals who have not yet retired determine how much money they will need to save each year in order to be able to produce a given income stream in the years when they are no longer working.

The first step is to determine the desired annual postretirement income stream. Although factors such as health status and life expectancy have a significant effect on health care spending in the future and thus the need for saving, the calculators we examined usually set the target income stream as a simple percentage of current income, rather than taking into account individual-specific factors that might indicate a high risk of serious medical illness, which can affect spending for health and long-term care. This is a step where information about illness probabilities and associated health expenditures would be very helpful and where much better information is needed.

The second step is to estimate life expectancy, that is, how many years the income stream must be maintained. Although life expectancy is not a major determinant of lifetime health care costs, it is an important determinant of total required income. Data on life expectancy are readily available, and it would be particularly helpful to retirees to have those estimates tailored to individual characteristics.

THE CALCULATORS

We examined twelve retirement planning calculators that have the same underlying purpose: to provide guidance on how much savings are needed for retirement. Our focus was on the role that potential health care costs play in those calculators.

All of the calculators help users assess different types of retirement income, although the precise details vary. Most of the calculators ask about current private investments and savings such as pensions, individual retirement accounts (IRAs) and 401(k) plans, postretirement wages, and Social Security income.

The first ten calculators were chosen based on the ease with which they can be accessed and used by consumers. Two of these calculators are free and available on well-known Web sites: CNN Money and the T. Rowe Price Retirement Income Calculator, which is recommended by Forbes Magazine. Two are free, relatively straightforward to use, and are found on financial or retirement Web sites: one by Principal Financial Group and one by Pacific Life. A third, more sophisticated calculator is distributed by First American Bank. We included two calculators that are recommended by experts: the Ballpark E$timate, which is recommended by the Securities and Exchange Commission (SEC) and distributed by the Employee Benefits Research Institute (EBRI), and the AARP Retirement Calculator, provided by AARP.

Three of the first ten calculators were chosen because while they are not free, they are relatively inexpensive: The Retirement Calculator ($9.95), which was demonstrated on CBS’s The Saturday Early Show; Simple Planning.com ($9.95); and Simple Joe ($25.00).
Because none of the first ten calculators provide information about expected health care spending per se, we added two calculators. The first is offered by Fidelity Investments and is designed to estimate postretirement health care spending. The second is the *Mind Your Finances* calculator distributed by the InCharge Education Foundation, which focuses specifically on long-term care expenditures.

## RESULTS

We focus first on general retirement calculators. Table 1 shows the “input” variables that the user must provide. A strength of most of the calculators lies in the methods used to evaluate the income streams produced by different levels of savings and investments. Most of the calculators consider the number of years the individual plans to live (by asking either for “life expectancy” or “length of time expected to spend in retirement”), and several ask about desired bequests. Unfortunately, consumers may have difficulty estimating their life expectancy. Many of the calculators could be improved simply by adding a pull-down screen with standard tables of life expectancy at age 65 for given years of birth (Centers for Disease Control and Prevention 2003a). Even in the absence of those data, however, the calculators still provide a valuable service, as many consumers would have difficulty replicating the programs’ calculations on their own.

### Table 1: Input Variables for the Calculators

<table>
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</thead>
<tbody>
<tr>
<td>Retirement age</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<td>X</td>
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<tr>
<td>Expected age of death</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Tax rate</td>
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<td>X</td>
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<tr>
<td>Assumed inflation</td>
<td>X</td>
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<td>Current salary</td>
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<td>X</td>
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<td>Income growth rate</td>
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<tr>
<td>Desired income in retirement</td>
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<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Social Security income (age/amount)</td>
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<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Postretirement income (pension/other)</td>
<td>X</td>
<td>X</td>
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<td>X</td>
<td>X</td>
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<td>Desired estate</td>
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<tr>
<td>Living expenses</td>
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<tr>
<td>IRA</td>
<td>X</td>
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<tr>
<td>401(k)</td>
<td>X</td>
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<tr>
<td>Savings</td>
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<tr>
<td>Investments</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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</tbody>
</table>

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5
Based on these data, the calculators estimate the amount of savings required to produce the desired outcome (see Table 2). However, the precise output varies. The calculators provide either an estimate of how long savings will last, given assumptions about life expectancy and savings; estimates of how much the retiree should spend annually, given a fixed amount of savings and income; or estimates of assets throughout retirement.

The calculators vary in their ability to show the effects of different levels of spending on the number of years the savings will last, the effect of inflation and different rates of return on needed savings, and, in some cases, the effect of different tax rates. The ease with which consumers can conduct these sorts of sensitivity analyses is a great advantage of these calculators.

If an individual has an idea of how much retirement income per month (or year) he or she needs and a rough idea of how long he or she will live, many of the calculators provide scenarios detailing how long an accumulated amount of savings will last or, alternatively, how much savings would be required to achieve the retiree’s goal. Some calculators allow the user to input different inflation rates and different rates of return on investments.

<table>
<thead>
<tr>
<th>Calculator</th>
<th>How Long Savings Last</th>
<th>What You Should Spend Annually</th>
<th>Estimated Assets throughout Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Retirement Calculator</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Ballpark E$timate</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>AARP Retirement Calculator</td>
<td>X</td>
<td></td>
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<tr>
<td>CNN Money</td>
<td>X</td>
<td></td>
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<tr>
<td>Principal Financial Group</td>
<td>X</td>
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<tr>
<td>Pacific Life</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>First American Bank</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Simple Planning.com</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Simple Joe</td>
<td>X</td>
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<td></td>
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<tr>
<td>T. Rowe Price</td>
<td>X</td>
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</tbody>
</table>

The comparison of estimates shown in Table 3 is based on a standardized individual: a 50-year-old female who wishes to retire at 65 and expects to live to age 85. The estimates assume a 3 percent inflation rate and a 5 percent rate of nominal return on investments, unless the calculator provides default values, which we used in lieu of our assumptions. Although some the input variables differ across the different calculators and cannot be manipulated by the user, we strove to be as consistent as possible. Two different scenarios

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1 We did not include all calculators in this analysis because some did not provide estimates of savings needed to achieve given retirement income targets.
were evaluated: one in which the woman has a current annual income of $50,000 and another with an annual income of $100,000. In both cases, the target retirement income is set at 70 percent of current income.

The calculators provided different estimates of how much savings are needed. The CNN Money calculator had the lowest estimate of required savings, at $215,757 for the lower income woman and $690,521 for the higher income woman. The AARP calculator was in the middle, with the Pacific Life and Simple Joe calculators having the highest estimates of needed savings. The estimates from the latter calculator were nearly five times higher than those provided by the CNN Money calculator for the woman whose current income is $50,000.

<table>
<thead>
<tr>
<th>Table 3: Savings Needed for Retirement from Several Calculators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Calculator</strong></td>
</tr>
<tr>
<td>Assumption</td>
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<tr>
<td>AARP Retirement Calculator</td>
</tr>
<tr>
<td>CNN Money</td>
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<tr>
<td>Simple Joe</td>
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<tr>
<td>Pacific Life</td>
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<tr>
<td>Principal Financial Group</td>
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</tbody>
</table>

The key focus of this analysis is on how the different planners addressed potential health care financial liabilities. None of the first ten calculators incorporated health care spending into their analyses. In general, the calculators estimated postretirement income needs simply by asking for a percentage of current income (typically assumed to be between 65 and 80 percent) or for an estimate of postretirement monthly spending. However, both the First American Bank and the Simple Planning.com calculators provide worksheets to estimate monthly spending by adding up current monthly expenses such as housing, transport, debt payment, medical expenses, and insurance. The AARP calculator reminds users to consider the costs of long-term care insurance. However, none of these ten calculators help the retiree estimate postretirement health care spending.

Next, we analyzed two calculators that do provide some information regarding postretirement health care spending. The Fidelity Investments calculator is designed to help consumers save specifically for health care expenses. This calculator is available only to Fidelity customers. The calculator uses a series of inputs, including gender, to estimate likely lifetime spending, but the key inputs are age of death and future real health care inflation rate—both of which consumers are unlikely to know. Although gender is included, it changes only the default age of death, rather than the amount of spending for a particular age of death. The calculator does not allow estimated spending to vary with current or projected health status or any other individual characteristics. The calculator provides information regarding the main sources of health care spending, including Part B and Medigap premiums, out-of-pocket spending, and spending associated with Part D. The calculator assumes that the consumer purchases long-term care insurance.
The *Mind Your Finances* calculator focuses on long-term care expenses. Consumers input their estimated cost of long-term care per day (the calculator suggests a default value, $137 per day), an estimate of the long-term care inflation rate (default value of 3.1 percent), and the number of years of long-term care needed. Based on those inputs, the calculator provides an estimate of savings required for long-term care expenses. Unfortunately, consumers have difficulty estimating the out-of-pocket cost of long-term care (as well as the need for long-term care services) (Barrett 2006). The *Mind Your Finances* calculator also is somewhat odd in that it purports to offer information useful in planning for long-term care expenses, but the program appears to assume that consumption of long-term care begins immediately.

Both of these calculators provide valuable information on potential liabilities for retirees and can serve to educate the users on the significance of health-related spending. For example, for a 55-year-old male retiring in ten years at age 65, dying at age 92, and assuming a 6 percent health care inflation rate, the *Fidelity* calculator estimates total lifetime health care costs of $211,030. For a female dying at age 94, it estimates total lifetime health care costs of $230,853. If the inflation rate is increased to 8 percent (the highest available), the estimates become $338,755 and $379,463, respectively. If long-term care costs are included (assuming the 6 percent inflation rate again), the estimates are increased by $76,622 for males and $78,303 for females. In contrast, the *Mind Your Finances* calculator suggests $154,713 (assuming cost of $137 a per day, three years of care, and a 3.1 percent inflation rate).

**CONCLUSIONS**

For many preretirement consumers, retirement planning is an important activity, because they do not have the level of wealth that guarantees a comfortable standard of living in the postretirement years. Those consumers require reasonably accurate estimates of the expenses they are likely to incur, as well as other information such as estimated rates of increase in inflation, taxes, and return on investments.

Estimating postretirement spending on health care poses unique challenges for current workers because they often have little information on which to base those estimates. To make accurate estimates of postretirement health care spending, preretirement consumers need estimates of the likelihood that they will contract specific health conditions (or remain relatively healthy); their likely years of survival with those conditions; and their annual out-of-pocket spending on health care, including the costs and effects of health insurance.

Out-of-pocket spending will be a function of the health plan choices consumers make after they retire. Most current workers will transition to a new type of health insurance (Medicare) upon retirement. Under Medicare, they will face a variety of choices, including Medicare Advantage (MA) plans, traditional fee-for-service Medicare, Medigap supplementary insurance, and Part D drug benefits offered through either MA plans or private stand-alone plans. Benefits and premiums vary significantly among these choices. Premiums and out-of-pocket cost-sharing will vary considerably. Most current workers have never purchased a supplemental insurance plan and have little idea regarding the options or cost of the different plans. They may have little experience with the cost of long-term care. This lack of information and experience makes health care different from other “big ticket” items, such as food, housing, and transportation, with which retirees have long experience and for which there is less change in the nature of the product upon retirement.
Planning for Retirement? Web Calculators Weak on Health Costs

The good news for consumers who are thinking about retirement planning is that there is a variety of free or low-cost calculators to help with the general problem of financial planning. The bad news is that accurate values for much of the input data required by the calculators are unlikely to be readily available to consumers.

These calculators differ in their required input variables, type of output, and underlying assumptions. They also differ in their approaches to modeling inflation, taxes, and investment rates of return.

In some respects, the retirement calculators are sophisticated. They allow for many considerations in their calculations of the level of savings required to support a given level of spending. Users can test many different scenarios with varying interest rates, inflation rates, mixes of stocks and bonds, life expectancies, and tax rates. The calculators can provide estimates for bequests, living on interest, or consuming all of one’s assets. However, calculators are rudimentary in the sense that their estimates are valuable only if the user’s own estimates of annual (or monthly) postretirement spending are accurate, and the calculators provide little assistance to ensure that accuracy. If users systematically over- or underestimate their spending needs, including health care costs, all of the sophisticated scenarios will be inaccurate. The first ten calculators we examined simply take a percentage of the user’s current preretirement monthly income as the target postretirement income level. The last two calculators provide some information on health-related spending, but again, determining the input data will be challenging for the consumer.

These calculators easily could be improved by providing consumers with:

- simple but improved estimates of their life expectancy
- the likely annual or monthly health care spending associated with Medicare medical and drug coverage, retiree health benefits, Medicare supplemental insurance, and private Medicare plans
- the likely need for long-term care services and the out-of-pocket costs associated with different long-term care services

Creating significantly better postretirement financial planning tools would not be a difficult task. These estimates, minimally, could be adjusted for age and gender. Estimates would account for health care inflation. Incidence data exist for some diseases (Centers for Disease Control and Prevention 2003b; Lloyd-Jones et al. 1999, 2002; Narayan et al. 2003; Vasan et al. 2002). More sophisticated estimates based on health and family history would be even more valuable and would provide a significant improvement in retirement savings planning. The methods and data required to produce these estimates are readily available and have been used to estimate health care spending (Lubitz et al. 2003) and the effects of Part D coverage on out-of-pocket drug costs (Atherly and Dowd 2007) among the elderly.

Calculators are one of many ways to improve consumer education about the resources consumers may need to be financially secure in retirement. Calculators could contribute more to consumer financial education if they included information that helped consumers educate themselves about how their health coverage and health needs might change in their later years. Financial and health security depend on having the ability to absorb changes in
health spending that can come in retirement. Improving people’s understanding of this ability, whether through calculators or other financial education efforts, is important.

REFERENCES


LINKS TO THE SELECTED CALCULATORS

The Web sites were all visited between 11/1/06 and 12/31/06.

1. **Calculator:** The Retirement Calculator  
   Link: [http://www.retirementcalc.com/download.cfm](http://www.retirementcalc.com/download.cfm)

2. **Calculator:** Ballpark E$timate  
   Link: [http://www.choosetosave.org/ballpark/](http://www.choosetosave.org/ballpark/)

3. **Calculator:** AARP Retirement Calculator  

4. **Calculator:** CNN Money  

5. **Calculator:** Principal Financial Group  
   Link: [http://partners.leadfusion.com/tools/principal/retire02a/tool.fcs](http://partners.leadfusion.com/tools/principal/retire02a/tool.fcs)

6. **Calculator:** Pacific Life  

7. **Calculator:** First American Bank  
   Link: [http://partners.financenter.com/firstambank/plan/retplan01.fcs](http://partners.financenter.com/firstambank/plan/retplan01.fcs)

8. **Calculator:** Simple Planning.com  
   Link: [http://www.simpleplanning.net/Financial%20Calculators/Retirement%20Calculator.html](http://www.simpleplanning.net/Financial%20Calculators/Retirement%20Calculator.html)

9. **Calculator:** Simple Joe  

10. **Calculator:** T. Rowe Price Retirement Income Calculator  
    Link: [http://www.troweprice.com/common/indexHtml3/0,0,htmlid=17,00.html](http://www.troweprice.com/common/indexHtml3/0,0,htmlid=17,00.html) or [http://www3.troweprice.com/ric/RIC/](http://www3.troweprice.com/ric/RIC/)

11. **Calculator:** Fidelity Investments (available only to Fidelity customers)  

12. **Calculator:** Mind Your Finances  