

Views of Retirement Income

The 3 - Legged Stool and Retirement Pyramid

Often in retirement planning, Investment Advisors use the analogy of a three-legged stool to explain the main sources of retirement income with Social Security, employer-sponsored retirement plans, and personal savings being the three legs of a supposedly perfectly balanced stool.



The three-legged stool of retirement saving is not a new concept. This metaphor dates back to the late 1940's and has evolved over time with the changing retirement landscape. Originally, the legs of the three-legged stool represented private insurance, group insurance, and Social Security. The metaphor was originally introduced by Reinhard A. Hohaus, an actuary for Metropolitan Life Insurance Company, at a forum on Social Security in 1949, however, the basic concept behind the three-legged stool was implied by the creators of the Social Security program at an even earlier date. In a message to Congress recommending certain improvements to the Social Security program, President Franklin D. Roosevelt makes the following statement.¹

“We shall make the most orderly progress if we look upon social security as a development toward a goal rather than a finished product. We shall make the most lasting progress if we recognize that social security can furnish only a base upon which each one of our citizens may build his individual security through his own individual efforts.”

A New View of Retirement Income

While this analogy has served its' purpose for many years, the old three-legged stool may be a bit wobbly. Today's working class cannot rely as heavily on future Social Security payments. Over time, we have seen a shift from traditional pension plans to participants taking on more of the investment risk with profit sharing and 401(k) plans. With the new retirement landscape, many have proposed changing the traditional thinking of retirement savings as a three-legged stool.

¹ DeWitt, L. Origins of the Three-Legged Stool Metaphor for Social Security. Research Notes & Special Studies by the Historian's Office. Agency History. Social Security Administration. May 1996. <http://www.ssa.gov/history/stool.html>

One suggestion, introduced by the Investment Company Institute, ICI, utilizes the idea of a five layer pyramid to represent five basic components of the United States retirement system. The pyramid includes the three sources of income represented by the stool and adds homeownership and individual retirement accounts, or IRAs, into the mix. Peter Brady, ICI Senior Economist, explains, “The composition of the retirement resource pyramid varies to reflect the resources available to an individual household. Social Security provides resources to nearly all retirees, but provides a higher replacement rate to retirees with low lifetime earnings. Because Social Security benefits typically replace a smaller share of earnings for higher-income households, these households rely more on other retirement resources, such as employer-provided retirement benefits and IRAs.”

Visibly, the multilevel pyramid conveys that retirement assets will not likely be perfectly balanced, as suggested by a proper three-legged stool. Because the sectors do not need to be equal, the pyramid can be customized to depict individual retirement scenarios, as shown in Figure 1.²

Figure 1:
Estimates of the Components of the Retirement Resource Pyramid for Households Approaching Retirement

Percentage of augmented wealth by augmented wealth quintile in 2006 for households with at least one member born between 1948 and 1953



* Approximate average level of augmented wealth in 2006 for augmented wealth quintile, which includes estimates of Social Security and DB benefits as assets.
 Source: Investment Company Institute tabulation derived from Gustman, Steinmeier, and Tabatabai 2009 using Health and Retirement Study (HRS) data

² Brady, P., Burham, K., & Holden, S. ICI Analysis of U.S. Retirement System: It is Working and Serving Each Generation Better Than Previous. Investment Company Institute. 5 December 2012.

The Real Focus

Regardless of the analogy we use, stool or pyramid, the bottom line is that we, as working Americans, need to save for retirement. Now more than ever, the responsibility for ensuring we have adequate savings falls squarely on our shoulders. With the impending depletion of Social Security benefits, we must rely heavily on our employer-sponsored plans and personal savings.