THE CHANGING ECONOMY OF AGING

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POLICYNOTE

INADEQUATE RETIREMENT SAVINGS FOR WORKERS NEARING RETIREMENT

by **Teresa Ghilarducci,** Bernard L. and Irene Schwartz Professor of Economics at The New School for Social Research and Director of SCEPA's Retirement Equity Lab (ReLab); **Michael Papadopoulos,** ReLab Research Associate; and **Anthony Webb**, ReLab Research Director

ELEVATOR PITCH

Without a universal supplement to Social Security, many of the 24 million workers ages 55-64 will face declining living standards or poverty in just 10 years. One-third of older workers have neither retirement savings through a 401(k) or IRA, or a defined benefit (DB) pension. Overall, the median account balance of workers approaching retirement is just $15,000. The median account balance for those with retirement savings is just $92,000.

KEY FINDINGS

- 35% of all workers ages 55-64 have neither retirement savings in defined contribution (DC) or IRA accounts or defined benefit (DB) pension coverage from a current or past job.
- Because a third of older workers have no retirement savings, the median account balance of workers approaching retirement is just $15,000.
- 50% of low-income older workers (earning less than $40,000 annually), 20% of the middle class (between $40,000 and $115,000), and 15% of high-income workers ($115,000 plus) have neither retirement savings or a DB pension.

MEDIAN DEFINED CONTRIBUTION AND IRA ACCOUNT BALANCES OF WORKERS AGES 55-64

Older Workers	Median Account Balances, DC Plans and IRAs
All workers ages 55-64 (35% have neither retirement savings nor DB coverage)	$15,000
Workers ages 55-64 who have any retirement savings	$92,000

Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data
Notes: Account balances rounded to the nearest $1,000.

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- The median account balance of those with retirement savings is $92,000. Among account holders in the top 10% of earners, the median balance is just $250,000.
- Income from retirement savings will replace a median 14% of pre-retirement income of workers with accounts, which is insufficient to maintain pre-retirement living standards. The small minority that also has DB pension coverage is better prepared with a median 20% replacement rate from their retirement savings, plus DB income.

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MEASURING RETIREMENT SAVINGS

This policy brief analyzes the distribution and inadequacy of retirement wealth among workers nearing retirement. We report the share with retirement accounts, and median retirement savings and replacement rates by income (the bottom 50 percent of older earners making $40,000/year or less, the middle 40 percent making between $40,000 and $115,000, and those in the top 10 percent earning over $115,000).[1]

We classify workers as having a retirement plan if they report having retirement savings in an IRA or defined contribution (DC) account such as a 401(k), 403(b), or equivalent, or report DB pension coverage from a current or past job.[2] A worker's retirement savings is the sum of his or her IRA and DC account balances. We report medians rather than averages because averages are skewed by a small number of workers with very large balances (see Appendix for means).

Most of the wealth accumulated in DC plans is held in IRA accounts. While workers can make direct contributions to IRAs (and the self-employed can contribute to SEP-IRAs), the majority of savings held in IRA accounts have been rolled over from employer-sponsored 401(k) accounts following a job change. We therefore include IRA balances in our DC totals.

While previous studies use data from the 2013 Survey of Consumer Finances (SCF), this brief uses data from the recently released 2014 Survey of Income and Program Participation (SIPP). The SIPP's larger sample size compared to the SCF (5,621 vs. 522 workers ages 55-64) allows for cross tabulation by income and plan ownership that the SCF sample size does not permit.[3] The two studies yield similar estimates of aggregate DC and IRA wealth for workers ages 55-64: $2.405 trillion for the SIPP and $2.513 trillion for the SCF.

Although poverty is measured at the household level, this analysis is conducted at the individual level since retirement accounts are owned and controlled by individuals rather than households. This brief shows that most older workers do not have adequate savings for themselves, much less enough to share with a partner (see Appendix for household-level statistics).

MOST WORKERS EARNING INCOMES BELOW THE MEDIAN DO NOT HAVE RETIREMENT SAVINGS

Half of near-retirees earning below the median income of $40,000 have no pension plan – they have neither retirement savings nor a DB pension. Just 41 percent report having only a DC account or IRA, 4 percent only a DB pension, and 5 percent both. Smaller shares of earners in the middle 40 percent and the top 10 percent (earning over $115,000 per year) lack any pension plan (20 and 15 percent respectively). Most workers earning above the median of $40,000 a year have only a DC account or IRA, while a smaller group reports having a DB pension as well (see Table 1). Plan ownership rates are almost identical for men and women (see Appendix for rates by gender).

WORKERS AT ALL INCOME LEVELS HAVE INADEQUATE RETIREMENT SAVINGS

More than half of workers earning below median income ($40,000) have no retirement savings. Median retirement savings for this income group is zero. Workers earning less than median income who own an IRA or DC plan, but with no DB entitlement, have a median account balance of $32,000, the middle 40 percent of earners have $100,000, and the top 10 percent have $230,000. The median retirement savings of workers earning less than $40,000 with any retirement savings amount to about a year's earnings.

TABLE 1: SHARE OF WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64

Income Group (Annual Income)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/ DB
Bottom 50% (< $40,000)	50%	4%	41%	5%
Middle 40%	20%	5%	59%	16%
Top 10% (> $115,000)	15%	2%	63%	20%
All Older Workers	35%	4%	50%	11%

Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data

TABLE 2: MEDIAN DC PLAN BALANCES (INCLUDING IRAS) BY INCOME AND PLAN TYPE, WORKERS AGED 55-64

Income Group (Annual Income)	No Plan	DC or IRA Only	DC or IRA, w/ DB	All with DC	All
Bottom 50% (< $40,000)	$0	$32,000	$60,000	$35,000	$0
Middle 40%	$0	$100,000	$150,000	$109,000	$60,000
Top 10% (> $115,000)	$0	$230,000	$315,000	$250,000	$200,000
All Older Workers	$0	$80,000	$150,000	$92,000	$15,000

Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data
Notes: Account balances rounded to the nearest $1,000.

The small minority of workers with both retirement savings and a DB pension has somewhat more retirement savings than workers with only DC savings, regardless of income level (DB participants are often unionized and paid more than similar workers). Workers with DB and DC accounts for the three income groups have a median DC and IRA account balance of $60,000, $150,000, and $315,000 (see Table 2). Regardless of income level, workers with both a DB and DC plan are better positioned to maintain living standards in retirement, in part because they have larger account balances, but mainly because they can also look forward to income from their DB pension (the value of which is not calculated in this brief).

MOST WORKERS FACE DECLINING LIVING STANDARDS OR POVERTY IN RETIREMENT

This study determines the adequacy of retirement savings by comparing projected replacement rates (projected post-retirement income from retirement savings and Social Security divided by pre-retirement income) with targets that permit workers to maintain their standard of living in retirement.[4] We project income post-retirement from retirement savings with generous assumptions: (1) workers earn a 4.5 percent real return on investments (net of fees); (2) workers contribute 6 percent of pay to their 401(k) with an employer match of 3 percent; and (3) workers purchase an inflation-indexed annuity at age 65.[5] Income targets post-retirement are less than 100 percent of pre-retirement pay because retirees no longer pay Social Security taxes or need to save for retirement, often have lower taxes, and may face lower living expenses. Targets are typically lower for higher earners, because Social Security replaces less of their pre-retirement earnings.

The study assumes a replacement rate target of 85 percent for workers earning below $40,000, a 75 percent target for workers earning between $40,000 and $115,000, and a 65 percent target for workers earning more than $115,000.[6]

Assuming that Social Security will replace 43 percent of the pre-retirement income of workers earning less than median income, they would need to replace 42 percent of their earnings with income from retirement savings.[7] As the median retirement savings of this group is zero, their median replacement rate from retirement savings is zero percent. Without retirement savings, workers below median income will be almost entirely dependent on Social Security and will be at high risk of not only downward mobility in retirement, but also falling into poverty. The picture is not much different for the small minority that has retirement savings.

Bottom line: Retirement savings will replace 14 percent of pre-retirement income for workers with incomes below the median, leaving lower-income older workers 28 percentage points short. Likely to outlive their savings, these retirees are at a high risk of poverty.

For middle-income workers, Social Security replaces 29 percent of income, requiring they have enough retirement wealth to replace 46 percent of their pre-retirement income. However, the median replacement rate for middle-income older workers is 10 percent overall and 15 percent among those with retirement savings. Finally, Social Security replaces just 24 percent of income for those in the top 10 percent. These workers need a replacement rate of 41 percent from retirement savings, but the median replacement rate for this group is 11 percent overall and 12 percent among those with retirement savings (see Table 3). Thus, even the median high earner with retirement savings will face downward mobility in retirement.

TABLE 3: MEDIAN PROJECTED REPLACEMENT RATE FROM DC/IRA SAVINGS BY INCOME AND PLAN TYPE, WORKERS AGED 55-64					
Income Group (Annual Income)	No Plan	DC or IRA Only	DC or IRA, w/ DB	All with DC	All
Bottom 50% (< $40,000)	0%	14%	24%	15%	0%
Middle 40%	0%	15%	20%	16%	10%
Top 10% (> $115,000)	0%	12%	20%	14%	11%
All Older Workers	0%	14%	20%	13%	4%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

SYSTEMIC ISSUES CAUSE DEFINED CONTRIBUTION SAVING PLANS TO FAIL

Social Security provides the largest share of retirement income for most retirees, and the progressivity of the benefit formula ensures that Social Security replacement rates (Social Security benefits as a percent of preretirement income) are largest for low- to moderate-income workers. But Social Security alone is insufficient to allow any but the lowest paid workers to maintain their pre-retirement standards of living. Further, due to rising Medicare premiums and an increase in Social Security's Full Retirement Age from 65 to 67 – the equivalent of a 13.3 percent cut in benefits – Social Security replacement rates will fall for everyone.

Employer-sponsored retirement plans are intended to bridge the gap between Social Security and targeted retirement income. Unfortunately, at any point in time, less than half of all private sector workers have a workplace retirement plan, a share that has declined over the last 30 years.[8] Many of those who move in and out of covered employment cash out their benefits on job-change or quit before their benefits vest.

401(k) plans became widespread in the 1980s, and for most workers in the private sector they replaced rather than supplemented DB plans. Only a small number of workers participate in both a DB pension and a DC plan, and they are the only group prepared for retirement regardless of income level.[9]

In theory, DC plans could enable participants to accumulate adequate wealth by the time they retire. But in practice, account balances fall short, reflecting spotty eligibility histories, non-participation, inadequate contributions and employer matches, pre-retirement withdrawals, high fees, and subpar investment returns. These faults are inherent to the DC system and cannot be fixed by regulation.

POLICY RECOMMENDATIONS

The combined effects of cuts to Social Security benefits and the consequences of a broken DC-centric savings system has created a retirement crisis. Few workers without workplace retirement plans save for retirement. Without significant reform to the retirement system, many workers who reach retirement age will be forced to choose between working longer and suffering severe drops in their living standards in retirement. The far-reaching effects of an increase in downward mobility and old-age poverty include pressure on the social safety net and economic stagnation due to weaker consumer spending. Working longer is not a solution. Many older workers cannot work longer due to physical or mental impairment, and those that are capable of working face a labor market unfriendly to older workers.

Rather than worsening the retirement crisis by cutting Social Security benefits, policymakers should both strengthen Social Security and expand retirement plan coverage. Guaranteed Retirement Accounts (GRAs) are individual accounts requiring employers and employees to contribute with a fair and effective refundable tax credit provided by the government. GRAs provide a safe, effective vehicle for workers to accumulate personal retirement savings over their working lives.[10]

ENDNOTES

1. The 50/40/10 split follows the framework of Piketty (2014).

2. The SIPP data do not permit estimation of expected DB benefits or their expected present value.

3. The 522 exclude the SCF high wealth supplement. Including the high-income supplement, the 50/40/10 split is 2,993, 2,106, and 522 in the SIPP, compared with 313, 301 and 307 in the SCF.

4. Our preference for current rather than lifetime earnings as a replacement rate denominator reflects the Social Security Administration (2015) Technical Panel endorsement of a comparison of retirement income to the average of a person's last five years' significant earnings. This study uses current earnings as a proxy for the five-year average because SIPP lacks a full salary history. Many of these issues are discussed in Goss, et al. (2014).

5. We assume August 2017 annuity rates. Although people rarely purchase an inflation-indexed annuity, it provides a higher income than commonly used drawdown strategies and is the only financial product that provides an inflation-indexed lifetime income. Thus, the assumption yields a conservative estimate of the share of households financially unprepared for retirement.

6. The recommendations of financial planners and academic studies of financial preparedness for retirement are typically based on simplified versions of what economists call the "life cycle model." This model of household consumption over the life course assumes people want to smooth the satisfaction they obtain from consumption. But households differ in their circumstances, preferences, and attitudes towards risk. The amount a household should save to finance future consumption depends on age, planned retirement age, feelings about downsizing, plans to substitute home production for purchases of goods and services, the extent to which work- and child-related expenses will decline after retirement, anticipated health care costs, and other factors. Households also face the risks of job loss and worse than expected investment returns and may desire additional reserves as a precaution. The financial planner or economist cannot observe many of these parameters and must also make simplifying assumptions. Even in a simplified model, different assumptions can yield widely different wealth targets (see Skinner 2007). Relative to earnings immediately prior to retirement, targets will also be lower for those whose earnings peak at older ages. While recognizing this is an uncertain and sometimes controversial issue, our assessment of the academic and practitioner literature leads us to conclude that plausible replacement rate targets for the bottom 50 percent, middle 40 percent, and top 10 percent are 85 percent, 75 percent, and 65 percent, respectively.

7. Our estimates of Social Security replacement rates use data from Clingman and Burkhalter (2016) and Clingman, Burkhalter, and Chaplain (2017). We interpolate their numbers to obtain estimates of replacement rates at the 25th, 70th, and 95th percentile of the earnings distribution, but do not adjust for lower labor force participation rates of low earners at older ages. We adjust the denominator to reflect the earnings at age 60 of those still in the labor force at that age.

8. Munnell and Bleckman (2014).

9. Having two types of plan may indicate that the worker desires to save for retirement more than others in like circumstances or DB and DC dual coverage may indicate that an employer competes on the basis of secure retirement plans – identifying the reasons is beyond the scope of this brief.

10. Ghilarducci and James (forthcoming).

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APPENDIX

APPENDIX TABLE 1: SHARE OF MALE WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64

Annual Income (Income Group)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/DB
< $40,000 (34% of men)	55%	3%	37%	5%
$40,000-$115,000 (46% of men)	23%	5%	56%	16%
> $115,000 (20% of men)	15%	3%	62%	20%
All Older Men	35%	4%	49%	12%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data				

APPENDIX TABLE 2: SHARE OF FEMALE WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64

Annual Income (Income Group)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/DB
< $40,000 (61% of women)	47%	4%	43%	6%
$40,000-$115,000 (35% of women)	17%	5%	62%	16%
> $115,000 (4% of women)	13%	4%	65%	18%
All Older Women	35%	4%	51%	10%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data				

APPENDIX TABLE 3: MEAN DC PLAN BALANCES (INCLUDING IRAS) OF WORKERS BY INCOME AND PLAN TYPE, AGED 55-64

Income Group (Annual Income)	No Plan	DC or IRA Only	DC or IRA, w/DB	All with DC	All
Bottom 50% (< $40,000)	$-	$71,000	$114,000	$76,000	$35,000
Middle 40%	$-	$159,000	$206,000	$169,000	$126,000
Top 10% (> $115,000)	$-	$335,000	$433,000	$359,000	$296,000
All Older Workers	$-	$146,000	$226,000	$161,000	$99,000
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

APPENDIX TABLE 4: MEDIAN DC PLAN BALANCES (INCLUDING IRAS) MARRIED HOUSEHOLDS BY INCOME AND PLAN TYPE, AGED 55-64

Income Group (Annual Income)	No Plan	DC or IRA Only	DC or IRA, w/DB	All with DC	All
Bottom 50% (< $78,000)	$-	$76,000	$180,000	$100,000	$15,000
Middle 40%	$-	$166,000	$200,000	$188,000	$130,000
Top 10% (> $193,000)	$-	$260,000	$567,000	$324,000	$250,000
All Older Households	$-	$140,000	$230,000	$168,000	$80,000
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

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POLICY NOTE

40% OF OLDER WORKERS AND THEIR SPOUSES WILL EXPERIENCE DOWNWARD MOBILITY IN RETIREMENT

by **Teresa Ghilarducci**, Bernard L. and Irene Schwartz Professor of Economics at The New School for Social Research and Director of SCEPA's Retirement Equity Lab (ReLab); **Michael Papadopoulos**, ReLab Research Associate; and **Anthony Webb**, ReLab Research Director

ELEVATOR PITCH

Inadequate retirement accounts will cause 8.5 million middle-class older workers and their spouses – people who earn over twice the official poverty line of $23,340 (if single) or $31,260 (if coupled) – to be downwardly mobile, falling into poverty or near poverty in their old age.

KEY FINDINGS

- Two in five - or 40% - of older workers and their spouses will be downwardly mobile in retirement.
- If workers ages 50-60 retire at age 62, 8.5 million people are projected to fall below twice the Federal Poverty Level, with retirement incomes below $23,340 for singles and $31,260 for couples.
- 2.6 million of 8.5 downwardly mobile workers and their spouses will have incomes below the poverty level – $11,670 for an individual and $15,730 for a two-person household.
- A typical single worker in the middle 40% of earners (earning $25,000-$64,000) can expect an annual income of $18,000 if they retire at age 62, the most common age of retirement.
- Couples in the middle 40% of earnings (earning $44,000-$105,000) can expect an annual income of $29,500 if workers retire at age 62.

Table 1: Projected Downward Mobility in Retirement of Individuals in Older, Working Households

Sources: Authors' calculation using the 2014 Survey of Income and Program Participation.
Notes: The sample comprises workers ages 50-60 in 2014 and their spouses or partners. They are considered to be downwardly mobile if their household labor market earnings exceed 200% of the Federal Poverty Level (FPL),[1] but their household is projected to have income below 200% of FPL in retirement at age 62.

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PROJECTING DOWNWARD MOBILITY

Older workers - ages 50-60 and their spouses – are projected to be downwardly mobile in retirement if their household income is currently more than twice the Federal Poverty Level (more than $23,340 for a single individual, and more than $31,260 for a couple in 2014), but is projected to be less than twice the Federal Poverty Level in retirement.

This study treats claiming benefits as synonymous with retirement.[2] The projection assumes that workers retire at age 62 because more than half of workers claim benefits at that age.[3] Because working longer is often touted as a solution to the retirement savings crisis, we test the sensitivity of our findings to an alternative assumption that workers retire at age 65 (less than 10 percent retire after that age).

We assume that households contribute to their retirement plans until retirement and earn returns on their retirement savings and other financial assets. At retirement, households use their retirement and non-retirement financial wealth to purchase an inflation-indexed lifetime income. The appendix explains the projection's assumptions in detail.

8.5 MILLION MIDDLE-CLASS OLDER WORKERS ARE PROJECTED TO EXPERIENCE DOWNWARD MOBILITY IN RETIREMENT

We project two in five older workers and their spouses will be downwardly mobile in retirement. If workers currently ages 50-60 retire at age 62, 8.5 million people – or 40 percent of these workers and their spouses - are projected to become downwardly mobile, with incomes falling below twice the Federal Poverty Level ($23,340 for a single individual, and $31,260 for a couple) when they retire. Of these, 2.6 million will have incomes of less than the poverty level, or $11,670 for an individual and $15,730 for a two-person household.

Table 2: Projected Downward Mobility of Older Working Households in Retirement

Threshold	Assumed Retirement Age	Individuals (million)	Share
Poor	62	2.6	8%
	65	1.2	4%
Near Poor	62	8.5	40%
	65	5.0	19%

Source: Authors' calculation using the 2014 Survey of Income and Program Participation.
Notes: The sample comprises workers ages 50-60 in 2014 and their spouses or partners. They are considered to be downwardly mobile if their household labor market earnings exceed the given threshold, but their household is projected to have income below the threshold in retirement. Numbers of individuals are rounded to the nearest 50,000 and percentages to the nearest percentage point.

DOWNWARD MOBILITY IS CAUSED BY INADEQUATE RETIREMENT SAVINGS

If older workers retire at age 62, couples in the middle 40 percent of the income distribution will receive on average $29,500 in retirement income. Of this total, the largest share comes from Social Security, which contributes $23,000. In contrast, income from defined contribution (DC) and defined benefit (DB) retirement plans average $4,000 and $1,500, respectively, reflecting low levels of coverage and small account balances. Only 17 percent[4] of these couples own non-retirement financial assets, such as money market accounts, CDs, government securities, municipal and corporate bonds, stocks, or annuities. Averaged over all households in the middle 40 percent, yearly income from these sources is a mere $1,000 (Table 3).

Table 3: Projected Annual Retirement Income of Coupled Households Ages 50-60

Income Source	% with income	Income if retiring at 62	Income if retiring at 65
All sources	100%	$29,500	$38,000
Social Security	100%	$23,000	$29,500
DC Savings	66%	$4,000	$5,500
DB Pension	18%	$1,500	$2,000
Financial Assets	17%	$1,000	$1,000

Source: Authors' calculation using the 2014 Survey of Income and Program Participation
Notes: Dollar amounts are means (in 2014 dollars) for the middle 40 percent of earning households (coupled households earning $44,000-$105,000) rounded to the nearest $500. Means are not conditional on having income source. Percentages are rounded to the nearest percentage point.

WORKING LONGER WILL NOT PREVENT DOWNWARD MOBILITY

Due to poor health and lack of employment opportunities, many older workers are unable to delay retirement. However, even if workers delay retirement until age 65, 5 million people will be downwardly mobile and 1.2 million will fall below the Federal Poverty Level. Delaying couples' retirement to age 65 increases their projected average annual retirement income by just $8,500, to $38,000. Of the additional $8,500, $6,000 comes from Social Security, $500 from DB pensions, and $1,500 from DC pensions (Table 3). Working longer may help some, but it is not the solution to the retirement savings crisis.

SINGLE HOUSEHOLDS ARE EVEN WORSE OFF

We project the retirement income of single older workers because single households are a large (24 percent) and growing share of older households. Rising divorce rates among older couples often cause the less wealthy partner to be left in a precarious financial situation.

Single older workers in the middle 40 percent of earners will receive on average $18,500 in retirement income, $14,000 of which will come from Social Security. An additional $3,000 is expected from DC pensions, $1,000 from DB pensions and $500 from financial assets. Delaying retirement from age 62 to age 65 provides an additional $6,500 in retirement income, of which most ($4,000) comes from Social Security (Table 4).

Table 4: Projected Annual Retirement Income of Single Workers Ages 50-60

Income Source	% with income	Income if retiring at 62	Income if retiring at 65
All sources	100%	$18,500	$25,000
Social Security	100%	$14,000	$18,000
DC Savings	55%	$3,000	$5,000
DB Pension	12%	$1,000	$1,500
Financial Assets	11%	$500	$500

Source: Authors' calculation using the 2014 Survey of Income and Program Participation
Notes: Dollar amounts are means (in 2014 dollars) for the middle 40 percent of earning households (coupled households earning $44,000-$105,000) rounded to the nearest $500. Means are not conditional on having income source. Percentages are rounded to the nearest percentage point.

POLICY RECOMMENDATIONS

Insufficient savings in DC plans and low coverage by DB plans are among the main drivers of the projected downward mobility of today's older workers and their households. Working longer, tested here by delaying the assumed retirement age from 62 to 65, will still leave many people with insufficient income. Moreover, for many workers, delaying retirement is not possible. Some cannot handle the physical demands of work at older ages,[5] and some who can work have difficulty finding jobs offering decent pay. Workers forced to delay retirement due to inadequate savings will lose deserved retirement time, and some may die before they retire.

All workers deserve a dignified, financially secure retirement after a lifetime of work. Policymakers should strengthen Social Security – the most effective vehicle for preventing old-age poverty. But we also need a strong second tier.

Only 65 percent of workers nearing retirement have any retirement wealth (an IRA or 401(k) balance or a defined benefit pension from a current or past job), and the median balance of those with IRA or 401(k) plans is $92,000, which will provide a lifetime income of a mere $300 a month.[5] Guaranteed Retirement Accounts (GRAs) are individual accounts requiring employers and employees to contribute with a fair and effective refundable tax credit provided by the government. GRAs provide a safe, effective vehicle for workers to accumulate personal retirement savings over their working lives.[7]

ENDNOTES

1. The Federal Poverty Level for a single-person household in 2014 was $11,670, and $15,730 for a two-person household.
2. Labor market outcomes for those who work after claiming are typically modest and decline rapidly with age.
3. Munnell and Chen (2015).
4. Financial Assets do not include bank savings accounts. Although bank savings accounts are widespread, their balances are too low to alter retirement income.
5. Johnson (2017).
6. Ghilarducci, Papadopoulos, and Webb (2017).
7. Ghilarducci and James (2018).
8. Clingman and Burkhalter (2017).

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APPENDIX

This brief uses Wave 1 the 2014 Survey of Income and Program Participation (SIPP) and the supplemental questions in the Social Security module. Workers' individual retirement incomes are projected and summed into households. Retirement income is the sum of income from Social Security (including spousal benefits), defined benefit (DB) pensions, annuitized defined contribution (DC) savings, and annuitized wealth from other financial assets.

For households with two workers ages 50-60, for our age 62 scenario, we assume each spouse retires at age 62, project each spouse's income to that age, and sum. For our age 65 scenario, if the younger worker is age 62 or younger at this point, we use their projected retirement income for age 62. If the younger worker is ages 63-65, they receive their projected retirement income at that age. For spouses who have already retired, we take their current reported incomes from each income source. Only heads of household and their spouse (if any) are included as part of a household, and if there are multiple households living together they are treated as separate observations.

Because this survey only asks respondents to report their earnings from the most recent year, we must construct profiles of career earnings for each worker. The Social Security Administration constructs scaled earnings factors for ages 21-64, and we use these factors to construct age-earnings profiles for each worker.[8] The 35 highest-earning years in these synthetic age-earnings profiles are then used to project Social Security income in retirement.

We consider all DB plans from current and previous jobs to project DB pension income in retirement. For pensions from current jobs, we assume the worker stays at their current job until retirement, and receives benefits equal to 1.5 percent of the average of their last five years of earnings at the job (using the synthetic age-earnings profiles) per year of job tenure. For pensions from past jobs, we assume the same accrual rate of 1.5 percent. For the purposes of determining earnings when transitioning out of past jobs, workers are assumed to have left past jobs at the same age and same nominal pay as their starting pay on their current job.

A worker's DC savings is the sum of the balances in their savings in 401(k), 401(k)-equivalent accounts, and IRA savings, from current and past jobs. We project income post-retirement from retirement savings with generous assumptions: (1) workers earn a 4.5 percent real return on investments net of fees; (2) workers contribute 6 percent of earnings to their 401(k) with an employer match of 3 percent; and (3) workers purchase an inflation-indexed annuity when they retire. Although people rarely purchase an inflation-indexed annuity, it provides a higher income than commonly used drawdown strategies and is the only financial product that provides an inflation-indexed lifetime income. Thus, the assumption yields a conservative estimate of the share of households financially unprepared for retirement. We assume August 2017 annuity rates.

We make similar generous assumptions for income from other financial assets. A worker's financial assets include the value of money market accounts, CDs, government securities, municipal and corporate bonds, stocks, and equity in annuities. We assume workers earn a 4.5 percent real return on their investments, and purchase an inflation-indexed annuity when they retire.

We report the mean retirement income separately for the middle 40 percent of single earners (earning $25,000-$64,000) and for coupled households (earning $44,000 to $105,000). This provides estimates that are close to the median while allowing for individual components of retirement income to be additive.

THE NEW SCHOOL

SCHWARTZ CENTER FOR ECONOMIC POLICY ANALYSIS

CENTER for RETIREMENT RESEARCH at BOSTON COLLEGE

May 2016, Number 16-8

DO HOUSEHOLDS SAVE MORE WHEN THE KIDS LEAVE HOME?

By Irena Dushi, Alicia H. Munnell, Geoffrey T. Sanzenbacher, Anthony Webb, and Anqi Chen*

Introduction

Kids are expensive. As a result, when children become financially independent, parents often have a substantial amount of extra money on hand. In this case, they have two basic choices: spend more on themselves or increase their saving for retirement. What they actually do is an open question.

Answering this question is important – much of the debate on whether or not we face a retirement savings crisis comes down to what parents do when the kids leave. If they spend the extra money, they will arrive at retirement with fewer resources and a higher standard of living to maintain. In contrast, if they save the money, they will have more resources for retirement and a lower standard of living to maintain. This *brief*, based on a recent paper, uses tax data to analyze how saving behavior in 401(k) plans changes for married couples when their children leave.[1]

The discussion is organized as follows. The first section provides more detail on why households' response to the kids leaving is important. The second section describes the data and methodology. The third section summarizes the results. The final section concludes that households do increase their savings when the kids leave, but the increases are extremely small, suggesting that we do indeed face a retirement savings crisis.

Why Empty Nesters' Saving Affects Retirement Readiness

Researchers differ as to whether the United States faces a retirement savings crisis. Some argue that half of households are at risk of not being able to maintain their customary spending level in retirement.[2] Others contend that maintaining spending into retirement is an overly ambitious and indeed sub-optimal goal. These researchers find that less than one-fifth of households are saving below their "optimal" level.[3] One of the biggest reasons for these vastly different predictions is how the two groups of researchers treat households with children.

Studies that find many households are ill prepared for retirement assume that a household's goal is to maintain a constant level of consumption through-

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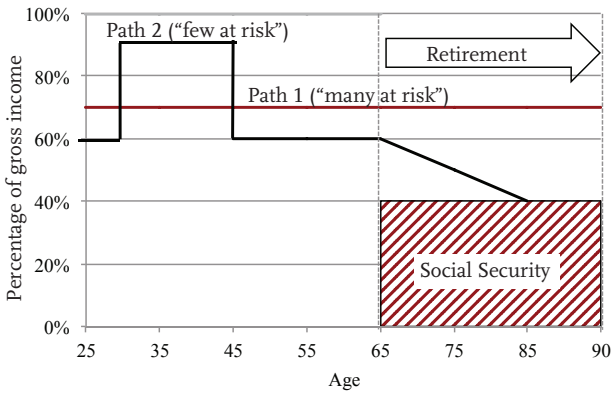
out their lives – regardless of whether the children are at home. This assumption means that, after the kids leave, the parents would maintain the same total consumption as before, shifting their spending away from child care, school supplies, and take-out food and towards restaurant meals, vacations, or new entertainment systems. The net effect is that households need to have enough income at retirement to maintain a consumption level similar to the level they had when the kids were at home. As consumption remains constant in this scenario, the departure of the kids does not trigger increased saving.

In contrast, studies that find that most households are saving enough assume that it is optimal for the household to vary consumption throughout the lifespan. In these models, households have four basic modes of consumption: 1) relatively low consumption before the kids are born; 2) high consumption when the kids are at home; 3) low consumption before retirement when the kids are gone; and 4) low and declining consumption in retirement, reflecting the lower probability the household is alive at older ages. This pattern means that, after the kids leave, parents save the money they used to spend on their children rather than spending more on themselves. These parents would, thus, arrive at retirement with both more savings and a lower level of consumption to maintain.

Figure 1 shows the percentage of gross income spent on consumption over time to illustrate the basic difference between these two views of the world. Parents following Path 1 ("many at risk") need to have enough money at retirement to finance the rectangle between the red line and Social Security benefits during retirement. Parents following Path 2 ("few at risk") need to have enough money to finance the triangle between the black line and Social Security – a far smaller amount. Which path people actually follow is an empirical question, but to date the scant evidence is mixed.[4]

Figure 1. Percentage of Gross Income Spent on Consumption, by Age, for Households with Children



Source: Authors' illustration.

Data and Methodology

Our primary analysis uses the *Health and Retirement Study* (HRS), a panel survey of households over age 50 that has been administered every two years since 1992. The survey collects in-depth information on income, education, pension eligibility, and children's residence and schooling. We then link these data to 1099 W-2 tax data to get an accurate measure of households' 401(k) saving. The analysis focuses only on households that are married throughout the sample to avoid changes in saving that may be due to family transitions.[5] The sample is further restricted to households where at least one member reported being eligible for a 401(k) plan at their employer.

The goal of the analysis is to see what happens to 401(k) saving when the kids leave home. Does it stay relatively constant, as suggested by Path 1, or does it increase, as suggested by Path 2?

To answer this question, the first step is to define what it means to have kids in the home. We consider three definitions. The first is having kids who physically live at home, regardless of age. However, this first definition omits kids residing at college. Since the purpose is to identify financially dependent kids, our second definition includes kids who moved out of the household but are still in school. This definition essentially assumes all children in college are financially dependent, even though some kids attending college may be financially independent. We therefore consider a third definition in which kids in college are excluded if, in a prior interview, they were neither physically resident nor attending college, i.e., in the past they were likely to have been financially independent.

One problem with the HRS is that it focuses only on older workers – what if younger workers behave differently? Thus, we augment the HRS analysis with a similar one using the *Survey of Income and Program Participation* (SIPP). The SIPP analysis uses the 1992-2008 panels, reflecting a similar time period as the HRS exercise. Again, we link the data on

education, race, and age available in the SIPP to administrative tax data on 401(k) contributions. Unfortunately, in the SIPP, this linkage requires sacrificing some detail on the resident and school enrollment status of children.[6] Instead, variables are created for couples who have a youngest child 18 and under (approximating children present), who have a youngest child between 19 and 22 (approximating children potentially in college), and those with a youngest child age 23 and over (approximating out of college). Although the approach used with the SIPP does not provide a perfect definition of the kids leaving home, the results serve as a useful check on the HRS.

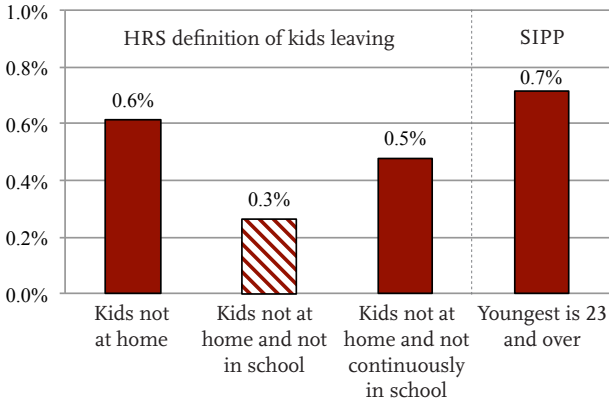
Using these data and definitions, the next step is to compare households that still have resident children to households where the kids are gone.[7] This analysis uses a regression approach, where the dependent variable is the share of the household's earnings contributed to a 401(k). The independent variable of interest is whether the household's children have left.[8] Other independent variables include the household's education, race, earnings, and financial wealth. The age of the male in the household is also included and is an especially important control, since older households tend to save more and are also more likely to have kids who have left. Finally, because homeowners who still have mortgages may be less apt to save through a 401(k) due to home payments, we also control for the presence of a mortgage as a dependent variable, as below:

$$\frac{401(k)contributions}{earnings} = f(kids\ left, education, race, age, earnings, wealth, mortgage)$$

Results

The results of the regressions are shown in Figure 2 for each of the three definitions of resident kids for the HRS and then for households with a youngest child 23 or older for the SIPP.[9] The bars show how much more a household saved when the kids were gone (or older) as compared to a similar household where the children were still there. The figure illustrates two facts. First, households do increase their 401(k) saving when the kids leave by 0.3 to 0.7 percentage points, depending on the definition and dataset being considered.

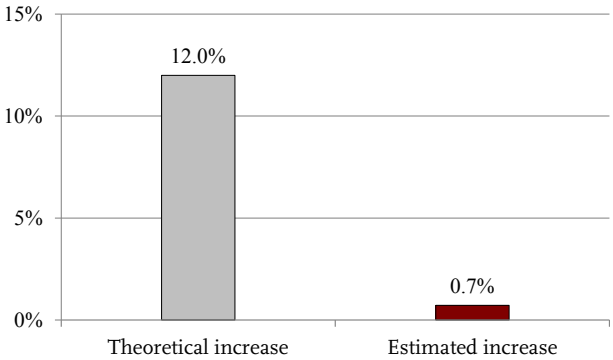
Figure 2. Percentage-Point Increase in 401(k) Saving for Households when Kids Leave



Sources: Authors' calculations from University of Michigan, *Health and Retirement Study* (HRS), 1992-2010; and U.S. Census Bureau, *Survey of Income and Program Participation* (SIPP), 1992-2008.

Second, the increase, while statistically significant, is very small compared to that suggested by theory. For example, consider a household with two adults and two kids at home making $100,000 and contributing 6 percent of salary to a 401(k). The research studies that assume households follow an "increase-saving" path would suggest that the couple move all the way to the 401(k) deferral limit of $18,000 in 2015 or 18 percent of earnings, a 12-percentage-point increase. Yet the results showed, at most, only a 0.7-percentage-point increase (see Figure 3). In other

Figure 3. Percentage-Point Increase in 401(k) Saving for Households when Kids Leave, Theoretical and Estimated



Note: The estimated increase is for the SIPP definition (youngest child is 23+), which is the highest estimate.
Sources: Authors' calculations from the 1992-2010 HRS and the 1992-2008 SIPP.

words, while saving does increase, the amount is tiny compared to that suggested by studies that find few households at risk of a poor retirement.[10]

Conclusion

Households' financial response to the kids leaving may seem like a matter of personal preference, but it has important implications for retirement preparedness. If households stand pat and maintain their total consumption when the kids leave, they will aim to keep that consumption level in retirement and will have less savings with which to do it. If, instead, they increase saving, they will have more retirement assets and a lower level of consumption to maintain. The results in this *brief* suggest that when the kids leave, households do increase their saving through their 401(k)s, but just slightly. The size of the increase is more consistent with research that suggests roughly half of households do not have enough savings for retirement than with the optimal savings research. Although this finding is not the last word on the subject – perhaps parents assist children financially even after they have left home – it does suggest that we should be concerned about households' preparedness for retirement.

Endnotes

1 Dushi et al. (2015).

2 For example, see Mitchell and Moore (1997) or Munnell, Orlova, and Webb (2013).

3 "Optimal" means that they are accumulating enough wealth to smooth the marginal utility of consumption over their life-cycle. For example, see Scholz and Seshadri (2008) and Scholz, Seshadri, and Khitatrakun (2006).

4 Coe and Webb (2010) examine this question using the *Health and Retirement Study*'s Consumption and Activities Mail Survey (CAMS) data. They find no evidence that households decrease total consumption when the kids leave home. On the other hand, Rottke and Klos (2013), using German data, find a moderate decrease in consumption but still only a small increase in saving when the kids leave home.

5 Households that started married but ultimately split up are kept in the sample until the point they split up. For more detail on the sample, see Dushi et al. (2015).

6 For details on how this linkage occurs and why it results in the loss of some detail, see the full paper (Dushi et al. 2015).

7 The full paper also contains an analysis that compares households to themselves before and after the kids leave. Since such an analysis is not possible in the SIPP, where households are observed just once, it is not shown here. In any case, the results of the two analyses are similar. See Dushi et al. (2015).

8 In addition, a control variable is used for households that never had any children, because these households are likely very different than those with children who have left.

9 For full results, see the Appendix.

10 In the full paper, we also examined whether non-401(k) financial wealth increased as well as whether households paid off their mortgage early. Neither of these measures showed a large enough increase to be consistent with models suggesting that few people are at risk of having insufficient retirement savings.

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APPENDIX

Table A1. HRS Regression of Share of Household Earnings Contributed to 401(k) Plans

	Definition 1		Definition 2		Definition 3	
Children not in home	0.614	***	0.264		0.479	**
	(0.234)		(0.232)		(0.233)	
Never had children	1.566	**	1.952	***	2.065	***
	(0.737)		(0.737)		(0.738)	
Demographics						
Black non-Hispanic	-2.335	***	-2.368	***	-2.349	***
	(0.314)		(0.315)		(0.315)	
Hispanic	-1.439	***	-1.497		-1.468	***
	(0.368)		(0.367)		(0.367)	
Age	1.264	***	1.272	***	1.272	***
	(0.191)		(0.191)		(0.191)	
Age^2	-0.012	***	-0.011	***	-0.012	***
	(0.002)		(0.002)		(0.002)	
Education						
Less than high school	-2.690	***	-2.688	***	-2.699	***
	(0.356)		(0.356)		(0.356)	
High school graduate	-2.369	***	(2.347)	***	(2.369)	***
	(0.303)		(0.304)		(0.304)	
Some college	-1.997	***	-1.974	***	-1.992	***
	(0.313)		(0.303)		(0.313)	
Earnings and Wealth						
Log of earnings	0.790	***	0.786	***	0.790	***
	(0.157)		(0.157)		(0.157)	
Log net financial wealth	0.244	***	0.247	***	0.245	***
	(0.024)		(0.024)		(0.024)	
Has mortgage	-0.241		-2.640		-0.256	
	(0.240)		(0.239)		(0.239)	
Constant	-38.099	***	-38.264	***	-38.284	***
	(5.961)		(5.964)		(5.958)	
Number of observations	10,843		10,843		10,843	

Notes: Significance is indicated at the 1-percent level (***), 5-percent level (**) and 10-percent level (*). All variables refer to the male member of the couple. Definition 1 is having kids who are physically living at home; Definition 2 is having kids who are physically living at home or in school; and Definition 3 is having kids who are physically living at home or in school and who never ceased living at home or school. All regressions also control for the HRS wave.
Source: Authors' calculations from the 1992-2010 HRS.

Table A2. SIPP Regression of Share of Household Earnings Contributed to 401(k) Plans

Youngest kid 19-22	0.030	
	(0.079)	
Youngest kid 23+	0.718	***
	(0.089)	
Never had kids	0.553	***
	(0.061)	
Demographics		
Black non-Hispanic	-0.750	***
	(0.088)	
Hispanic	-0.418	***
	(0.092)	
Age	0.054	***
	(0.003)	
Education		
High school graduate	0.420	***
	(0.123)	
Some college	0.839	***
	(0.109)	
College graduate	1.51	***
	(0.131)	
Earnings and Wealth		
Log of earnings	0.874	***
	(0.043)	
DB pension available	0.223	***
	(0.043)	
Individual owns residence	0.717	***
	(0.057)	
Constant	-10.672	***
	(0.044)	
Panel controls?	Yes	
Number of observations	40,388	

Notes: Significance is indicated at the 1-percent level (***), 5-percent level (**) and 10-percent level (*). All variables refer to the male member of the married couple.
Source: 1992-2008 SIPP.

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THE RETIREMENT SAVINGS CRISIS

ANTHONY WEBB

The New School for Social Research

Elder Law and Special Needs Meeting

Park Ridge, NJ

October 4, 2018

Will people have enough in retirement? Research offers conflicting answers.

Retirement preparedness is either:

- A big problem
  - Target replacement rate study using Survey of Consumer Finances (SCF)
  - Target replacement rate study using Health and Retirement Study (HRS)

OR

- A small problem
  - Optimal savings model
  - Initial retirement consumption

I plan to address two questions:

1. How big is the retirement savings crisis?
2. What should policymakers, advisors, and households do?

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How big is the retirement crisis?

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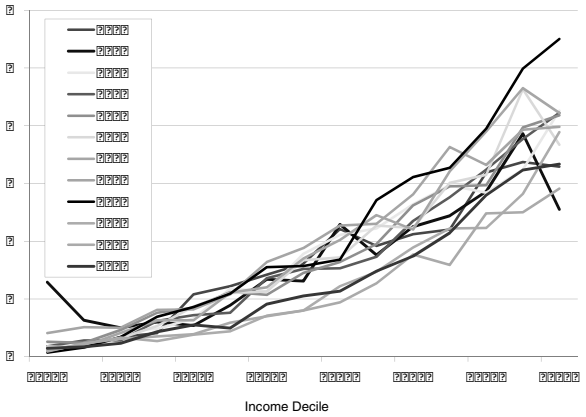
While preparedness is controversial, trends in wealth accumulation over time are not.

Ratio of Wealth to Income by Age from the *Survey of Consumer Finances*, 1983 - 2016



Income Decile

Source: Authors' calculations based on U.S. Board of Governors of the Federal Reserve System, *Survey of Consumer Finances* (1983-2016).

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Stable wealth-to-income ratios show declining preparedness because:

- Life expectancy has increased;
- Social Security replacement rates are declining;
- Plans have shifted from defined benefit (not in SCF) to defined contribution plans (included in SCF);
- Out-of-pocket health care costs are increasing; and
- Real interest rates are at record lows.

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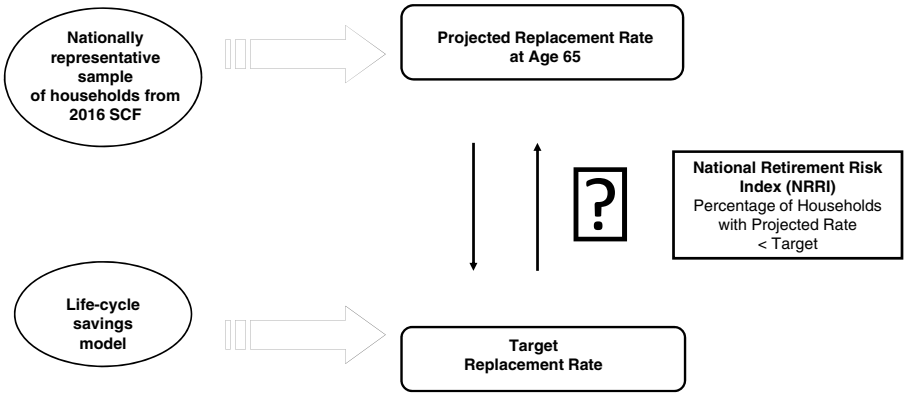
Let's look first at the "big problem" studies, which rely on target replacement rates.



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Are the NRRI target replacement rates appropriate?

- Financial planners think in terms of target replacement rates.
- But economists think in terms of smoothing the marginal utility of consumption.
  - Can households increase lifetime utility by shifting consumption from one period to another?
- The two approaches yield identical results only under restrictive assumptions – e.g.
  - Households do not face any kind of risk.
  - The marginal utility of consumption does not vary with age.

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Are the NRRI target replacement rates appropriate? (cont'd)

- Targets are arguably the better option.
  - Alternative involves too many simplifying assumptions.
- If there is a bias, targets are likely too low, because they assume zero precautionary savings.

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NRRI finds half of working-age households are "at risk" of falling short in retirement.

Percent of Households "At Risk" at Age 65 by Age Group, 2007, 2010, 2013, and 2016

Age group	2007	2010	2013	2016
All	44%	53%	52%	52%
30-39	53%	62%	59%	56%
40-49	47%	55%	54%	52%
50-59	32%	44%	44%	44%

Source: Authors' calculations.

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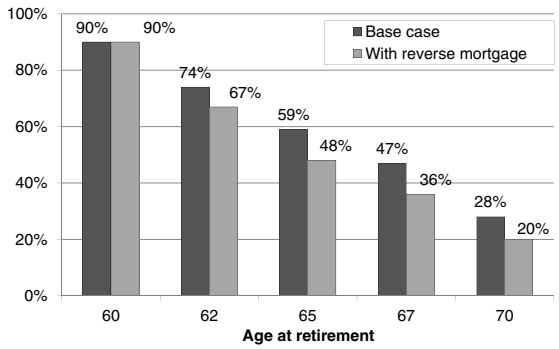
A similar analysis, using the HRS, arrived at the same conclusion.

Percent of All Households Falling Short of Target by Age at Retirement, Base Case and with a Reverse Mortgage



Source: Alicia H. Munnell, Natalia Orlova, and Anthony Webb. 2013. "How Important Is Asset Allocation to Financial Security in Retirement?" In *The Market for Retirement Financial Advice*, edited by Olivia S. Mitchell and Kent Smetters, 89-106. Oxford University Press.

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Research on optimal savings tells a similar story for those ages 51-61 in 1992…

Percent 'At Risk': NRRI versus 'Optimal Saving,' 1992

Age group	1992	
	NRRI	Optimal savings
All groups	36	--
51-61	19	16

Note: The NRRI result for 2004 is for households ages 50-58.
Source: Authors' calculations; and Scholz, Seshadri, and Khitatrakun (2006).

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…but a much different story for those ages 51-61 in 2004.

Percent 'At Risk': NRRI versus 'Optimal Saving,' 1992

Age group	1992		2004	
	NRRI	Optimal savings	NRRI	Optimal savings
All groups	36	--	43	--
51-61	19	16	35	5

Note: The NRRI result for 2004 is for households ages 50-58.
Source: Authors' calculations; Scholz, Seshadri, and Khitatrakun (2006); and Scholz and Seshadri (2007).

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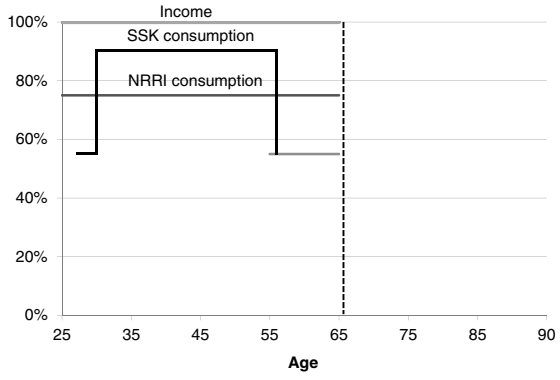
Differences are driven by two assumptions: (1) consumption when children leave…

Illustrative Consumption by Age, SSK and NRRI as Percent of Income



Source: Authors' illustration

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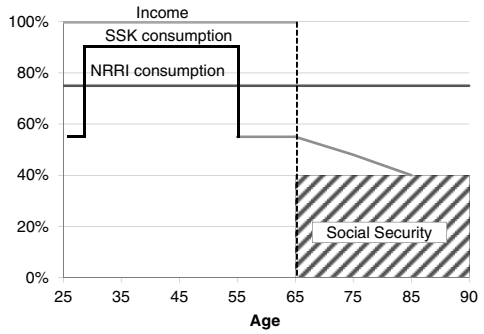
…and (2) consumption in retirement

Illustrative Consumption by Age, SSK and NRRI as Percent of Income



Source: Authors' illustration

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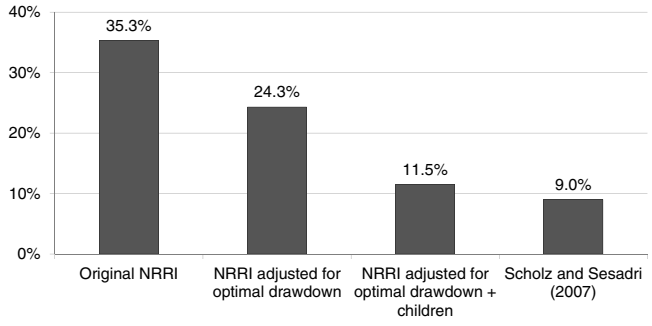
When the NRRI is adjusted to match these two assumptions, the results are very similar.

Percentage of Households Ages 51-61 At Risk, 2004



Source: Authors' calculations

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What does existing evidence tell us about the assumptions in the optimal savings model?

- Retirement consumption
  - Scholz, Seshadri, and Khitatrakun (2006), assume an intertemporal elasticity of substitution of 0.33. Financial planners generally assume 0, at least until advanced ages.
  - Under SSK model, households run out of money by around age 88. But mortality data indicate at least one member of an older married couple has a 40-percent chance of reaching age 90.

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What does existing evidence tell us about the assumptions in the optimal savings model? (cont'd)

- Children
  - Coe and Webb (2010) find evidence that married households increase their per capita consumption when their kids leave home.
  - And many parents of adult children say that they find the expenses associated with children don't ever actually stop.

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Do households prefer level or declining consumption in retirement?

- Research suggests that consumption declines during retirement. Could mean that:
  - households planned it that way; or
  - households belatedly realize they cannot spend what they don't have.
- We have yet to observe consumption trajectories at older ages of households with DC pensions.

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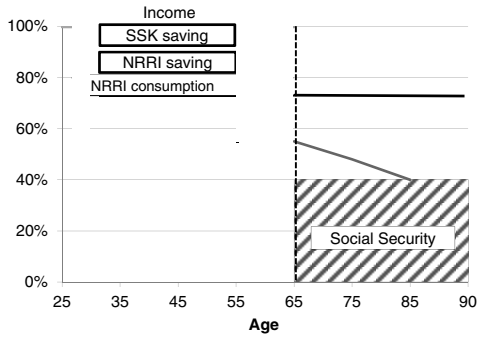
If consumption declines when the kids leave home, savings should increase.

Illustrative Consumption by Age, SSK and NRRI as Percent of Income



Source: Authors' illustration

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Does saving increase once the kids leave home?

- Most households save little outside their 401(k) plans.
- Can therefore investigate whether 401(k) deferrals increase once the kids leave home.
- Dushi, Munnell, Sanzenbacher, and Webb (2015) reveals no discernible trend, even controlling for other life events.

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Another way to see if retirees have enough is to look at household consumption.

Hurd and Rohwedder (2008) find that, right after retirement, household consumption declines by only 1-6 percent.

- Data source: HRS's *Consumption and Activities Mail Survey*
- Sample: panel data for 439 households in 2001, 2003, 2005, and 2007.

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A key question is whether households can sustain these initial levels of consumption.

Three tests:

1. Do the sample households have enough to maintain their spending in the first year of retirement throughout their lives?
2. What happens to their actual spending as they age?
3. Do the households with insufficient resources reduce their consumption more than those with sufficient resources?

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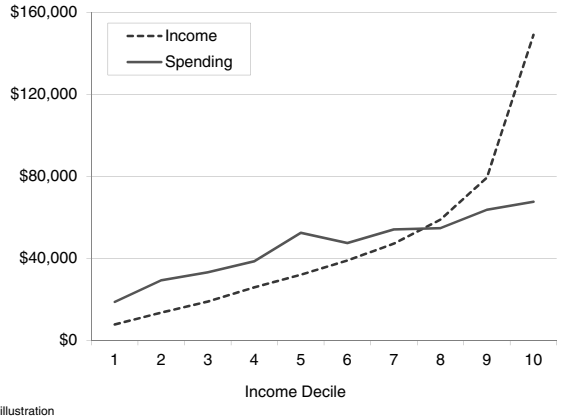
Only 30 percent can maintain consumption, even if they tap home equity.

Mean Income and Spending by Income Decile at Time of Retirement for Hurd-Rohwedder Sample of CAMS Households



Source: Authors' illustration

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As they age, retirees cut their consumption a lot, unlike older households not yet retired.

Median Respondent Spending by CAMS Retirement Status for Respondents Age 50 to 70

Observation period	Not retired at time *t*, retired at time *t+1*, and thereafter		Not retired throughout	
	Consumption	Sample size	Consumption	Sample size
t	24,600	279	28,300	1,442
t+1	25,300	279	27,400	1,442
t+2	21,000	208	26,500	902
t+3	21,000	194	26,700	682
t+4	19,500	123	26,700	291
t+5	18,000	71	27,900	148
Percent change				
From *t* to *t+1*	2.8			-3.2
From *t* to *t+5*	-26.8			-1.4

Source: Authors' calculations.

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Over time, those with a saving shortfall cut their consumption more than those without.

Median Respondent Spending by CAMS Retirement Status for Respondents Age 50 to 70

Observation period	Not retired at time *t*, retired at *t+1* and thereafter			
	Insufficient	Sample size	Sufficient	Sample size
t	25,600	147	23,500	128
t+1	28,500	147	21,000	128
t+2	21,000	115	20,800	93
t+3	20,900	95	21,300	98
t+4	18,700	60	19,700	63
t+5	18,000	33	19,200	38
Percent change				
From *t* to *t+1*	11.3			-10.6
From *t* to *t+5*	-29.7			-18.3

Source: Authors' calculations.

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What should policymakers, advisors, and households do?

- Managing wealth accumulation/decumulation over the life cycle is very (impossibly?) hard.
- Households face many types of unhedgeable risk:
  - labor market outcomes;
  - health outcomes; and
  - investment returns.
- Often, we don't even know the distributions from which the draws are made.
- A DIY system invites disaster

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What can we learn from an excel spreadsheet?

- Many households can't save their way out of the retirement crisis.

Required Increase in Saving Rates for Households Falling Short (Percentage Points)

Age	Household income (tercile)		
	Low	Middle	High
30 – 39	8	7	7
40 – 49	16	13	13
50 – 59	35	29	30

Source: Authors' calculations.

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In theory, working longer is a powerful antidote to inadequate retirement saving

- Higher Social Security benefits (at least 76% more if you delay from age 62 to 70).
- More years to contribute to your 401(k).
- When you eventually retire, can draw down wealth more aggressively.

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In practice, working longer may not be a solution for households with inadequate savings

- Many older households are unable to work due to ill health and lack of employment opportunities
- Many available jobs are low-paid and leave no margin for retirement savings.

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Increasing the Social Security Full Retirement Age will exacerbate the crisis

- An increase in the Full Retirement Age is equivalent to a cut in benefits
- Benefits at age 62 are already barely adequate to keep workers out of poverty. Any reduction will condemn retirees to poverty.
- An increase in the Early Retirement Age would leave many of those unable to work past age 62 without a source of income

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Conclusion

- The National Retirement Risk Index shows that half of households are “at risk” of falling short in retirement.
- In contrast, the optimal savings research finds no problem due to assumed consumption in retirement and when kids leave.
- Other research shows that retirees initially can keep their consumption up. But, they appear unable to maintain it.
- In the end, perhaps the most convincing evidence involves no modelling at all: a simple comparison of wealth-to-income ratios suggests we should be worried.

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Conclusion (cont'd)

- We need a universal and effective second tier
- Forget about DB plans coming back
- A reformed second tier would:
  - Include all workers
  - Prohibit leakages
  - Have low fees
  - Provide benefits in the form of a lifetime income

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THANK YOU

Practice Notes on the Topic: The Changing Economy of Aging

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INTRODUCTION

In reviewing the research studies presented in the enclosed materials by Dr. Anthony Webb , Research Director of the Schwartz Center for Economic Policy Analysis at the New School for Social Research in NYC, I was struck with the stark statistics that the upcoming retirement group are about to face a retirement crisis . His research demonstrates that 24 million soon to be retirees (ages 54 to 65) will be facing declining standards of living and risk retirement life on the fringes of poverty. This will be occurring in the next ten years. This decrease in available income will be a reality for almost 50% of the retirement population. This crisis will have an impact on the elder law practice. The impact can have two opposing effects. One aspect of this slide towards poverty will increase the retiree's need for our long term planning services as there will be a greater reliance of government support for these soon to be poorer retirees. Our advocacy in preserving these service supports, such as Medicaid, Social Security and other aging benefits will be increasingly important to our clients. An opposing aspect of this reality is that as this group of poorly funded retiree's age, they will be extremely cost sensitive and may not be able to afford our services and will look for low cost solutions. This is the challenge we face in positioning our practices in the next 10 years as the 54 to 65 years begin to retire.

REVIEW OF THE RETIRMENT STUDIES PRESENTED BY THE RESEARCH

The primary focus of Dr. Webb and his colleagues' research is that the next generation of retirees will be sorely under financed. Thirty-six percent (36%) of all retirees between 54 -65 have no retirement savings at all, no IRA's .no 401K's, no special annuities, no pensions…. Nothing. They will be exclusively

relying on Social Security benefits when they retire. It is well known that Social Security has been the most successful government program to address elder poverty. Social Security was never intended to be to sole source of financial support in the later years. Workers entering the work force in the 50's and 60's and even into the 80"s, could often rely on employer based defined benefit plans or pensions to supplement their social security income when they retired. This was and primarily still is a benefit government worker, union covered employees and large corporate entity employees rely on. This group is shrinking today as only 4% of workers have pensions. In the 80's the concept of employer run employee contribution plans emerged under the IRS approved /ERISA based 401K plans. About 50% of workers belong to or contribute to these employer offered plans. This is a positive concept, but unfortunately the amount of their voluntary contribution to these programs has proven to be inadequate even when the employer was contributing the recommended 3% match. The research shows that this is the result of low wages making it difficult to spare funds to contribute to the plans even with the income tax deferred advantages on the funds placed in the 401 K. In addition, many workers with erratic work histories, work interruptions, and unexpected preretirement withdrawals to fund to fund life emergencies or important family needs find it difficult to create the recommended balance in their retirement fund. Across the board nonparticipation and inadequate funding of retirement plans is a common flaw in the current system. Thus, replacing the defined benefit pensions with the employer /employee contributor strategies such as the 401K has failed nationally and has fallen very short of the necessary saving for a comfortable retirement.

When this "broken" retirement contribution system (IRA. 401K, etc.) is combined with the cuts in Social Security including the requirement to work to 66 and 67 to receive full benefits we are facing a retirement crisis. Older adults are working longer and well into their 70's as they find they do not have an enough funds to live on. Yet, not ever older person can continue to work past the traditional

retirement age of 65. These workers who cannot continue to work because of health deficits, family caregiving or other obligations may experience a severe drop in disposal income.

Dr. Webb and his colleagues are promoting the institution of a" pension like replacement" called a Guaranteed Retirement Account (GRA). It would have all the structure and benefits of an IRA except contributions by workers and employer would be mandatory similar to FICA contribution. The goal is to combat the haphazard way in which retirement savings is now conducted with a safer and more comprehensive plan. The challenge for all aging policy makers and retirement planners is to find ways to correct this trend toward poverty and economic decline projected for those retiring now and in the near future. With the increase in life expectancy, more elders will live to their 90's and 100's. These "old" elders risk running out of funds to supplement their modest Social Security benefit. Income supports and asset replacement does not now exist for those with inadequate Social Security benefits and little or nonexistent pensions or contributory retirement accounts in place. This is the basis of the retirement crisis for this next generation of retirees especially in light of the ever increasing cost of living.

ELDER LAW PRACTICE IMPLICATIONS:

Armed with the knowledge that many of the newly retired individuals in our county (50%) have inadequately saved for their later years, how can the elder law practitioner respond. Our client's question, "How do I prepare for the last stage of my retirement and do have enough money to retire and live comfortably?" Financial planner and advisors, CPA's and bankers and other financial consultants all jockey for positions to answer this question. Elaborate charts are created and distributed in an effort to win over the business of managing these retirees' assets and to capture this apparently lucrative market. Yet, underneath the upbeat sale pitch is the very real hidden story that almost 50% of retires will financially downwardly spiral. The sale of an annuity will not save them and no investment

strategy will create enough new income. Where will we, the elder law attorney, fit into this emerging picture: Practice approaches in planning with and for retirees can include the following:

1. Client Consultation on Retirement Planning:

   The Elder Law Attorneys must first understand and be able to help their clients understand the workings of the three basic prongs of retirement income:

   a. Social Security – Elder Law attorneys need to know how to maximize these benefits. When is the correct time to begin benefits, when to delay and how we build up the important and lifetime prong of income safety for the t later years? Our clients need to rely on us to help them plan best use of Social Security.

   b. IRA, 40IK and other Defined Contribution retirement Accounts – besides encouraging our clients to contribute the maximum allowable amounts to these accounts when possible. We also need to help them see the benefits that investing present income into these qualified retirement plans has income tax saving which often makes the fund contribution financially painless with the loss of current income is offset by the concurrent income tax deduction and lower tax due. We also can make sure their beneficiaries are updated while we review the investment strategies being used for their accounts. Are they monitoring these accounts and insuring they are invested for their fullest potential. Many clients with these plans have very hands off investment approach to their plans leaving it up to the custodian to maintain. Often their account has out date or underperforming investments. We need to help our clients be more active in these plans and recognize their importance to their future financial wellbeing.

   c. Defined Benefits/Pensions – Although, unfortunately, this is a shrinking part of the retirement pictures with on 5% of younger retirees with future pension, it is very common in municipal and government service employee's retirement benefits. Many of

these pensioners have lived with modest incomes in their work life in exchange for the promise of income security when they retire. This bargain has worked out for many, but in general even pensions have declined or have been curtailed. We may need to help our clients advocate for pensions which are their due and decipher their potential future pension benefit. Clients will also need guidance on whether to take full benefits or to defer income now to leave continuing benefits for their spouse or dependents. Many retirees are given the offer to take their pension as a lump sum and created their own self run IRA or to annuitize it into a guaranteed income. All of these questions, as well as the tax advantages/disadvantages of these offers are areas which the elder law attorney can provide guidance to clients and consult as either a billable service or as a value added on to our legal services and relationship building.

2. Marketing aspect of the retirement and the retirement crisis issues

The financial industry has made a large marketing push to attract this client to provide services. Our practice promotes this service as well. We have much to offer. We can assist our client in analyzing their assets, not to sell them a product or to capture their investment but in an objective approach. We can choose to provide this consultation service by teaming with a qualified financial planner and analyze the client's options while modulating the often sales driven approach of the financial advisor. The elder lawyer's clients will value us for our ability to explain and education and provide guidance grounded in more than the money but can overlay health care planning, access to other service programs needed in the later years.

In addition to working with a financial advisor or trusted CPA, another marketing approach could be to serve as a speaker at workshops and lectures on this retirement planning. Instead of using fear to

motivate action, we can and move the conversation from the fear approach to planning to include well thought out advance directives, realistic review of their assets relating it to their life style. We can help to answer questions like: Is it time to downsize my home and what are the capital gains tax implications? Elder Law attorneys in tandem with the other advisors can build a team which will create new or stronger professional relationships for future referrals. Our focus in addressing the retirement planning is to get our clients in earlier than we have in the past. We need to get ahead of the curve to more time to fix match and shore up the contributory plans. The Medicaid Planning part of our practices can be introduced to expose and alert new retirees to this need for special long term care planning as well. This is may be the first time the client is exposed to discussion about the risks of the later year's possible chronic health care costs. Often the attorney does not see the client until they are in their 80's when the health care issues have reached a crisis. At this advanced age the planning options are more limited while the needs for care or government benefits are often immediate and urgent, making planning more condensed and difficult. Presenting planning options, programs, consultations to the soon to be retirees are a vital marketing approach for the elder law.

Policy and Advocacy

As we recognize that the retirement crisis will be an integral part of the lives of our clients. We may wish to ramp up our advocacy work and participation in the discussion and dialogue about the inadequacy of the current retirement systems. Should we as elder law attorneys lobby for the expansion of the current Social Security program? Should we support the return of employer operated pensions even in the light of some pension funds currently report they are short on assets? Should we explore the Guaranteed Retirement account concept which is a hybrid type of guaranteed employer support like a pension with the 401K of administration? With either choice we as advocates for our clients need to support change to help advert the possibility of almost half of all retirees to

live their later years in poverty. This will strain the life of their families and create an even greater demand for the already oversubscribed government benefits such as Medicaid, senior subsidized services, housing and day care options, Dementia and memory care programs, and so many other programs need for the frail and aged retirees. This will also need to be the work of the elder law community's advocacy stance in the coming years.

# # #