

Americans' Retirement Preparedness

Discussion of: *Are Retirees Falling Short? Reconciling the Conflicting Evidence* (Munnell, Rutledge, and Webb, Boston College) at the 16th Annual Meeting of the Retirement Research Consortium
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Discussion Outline

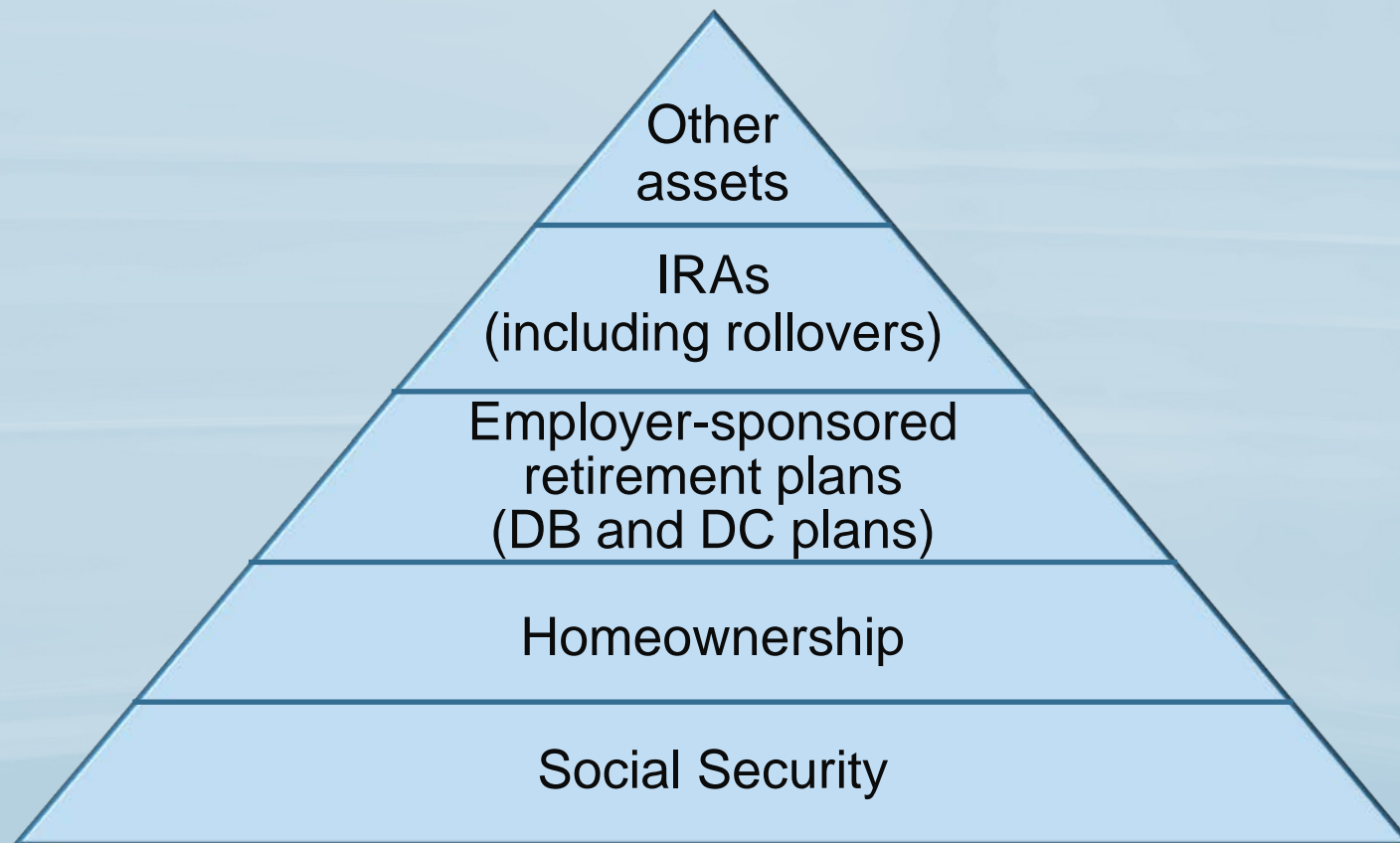
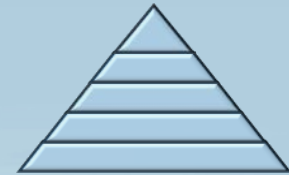
- Approaching the Question of Americans' Retirement Preparedness
 - Taking Stock and Tracking Flows
- Risks to Retirement Security
- Thinking About Future Retirement Preparedness: The Inner Workings of the NRRI
- Policy Considerations: Weighing the Range of Assessments
- Appendix
- References

Approaching the Question of Americans' Retirement Preparedness—Taking Stock

- Taking Stock of What We've Got
 - Analyzing data from SCF, HRS, other household survey efforts
 - Recognizing all resources households will have to draw upon in retirement
 - Putting Social Security and defined benefit (DB) plan benefits onto the household balance sheet
—Gustman, Steinmeier, and Tabatabai (2009)*

*See slide 25 in the appendix.

A Retirement Resource Pyramid



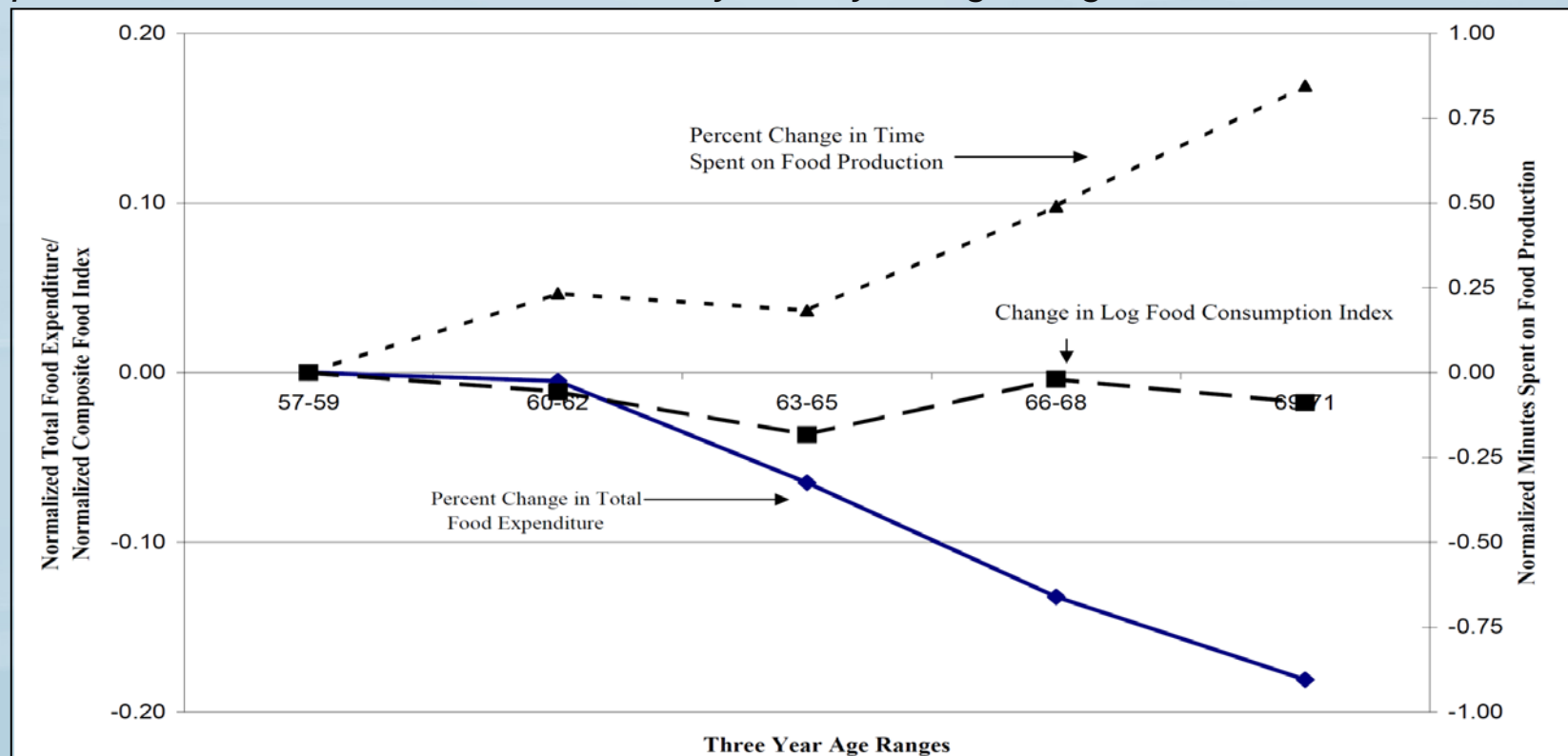
Source: Investment Company Institute; see Brady, Burham, and Holden, *The Success of the U.S. Retirement System* (December 2012)

Approaching the Question of Americans' Retirement Preparedness—Tracking Flows

- Understanding changes in income over the life cycle, especially during transition into retirement
 - SCF, HRS
 - CPS (although understates retirement income)
 - IRS SOI data (reveals survey underreporting)
 - SSA earnings records
- Understanding changes in spending over the life cycle, especially through retirement
 - CEX, CAMS, other survey efforts that gather income/spending information
- Synthetic cohorts or longitudinal analyses

“Consumption vs. Expenditure”: Retirees Use Less Money and More Time When Making Meals

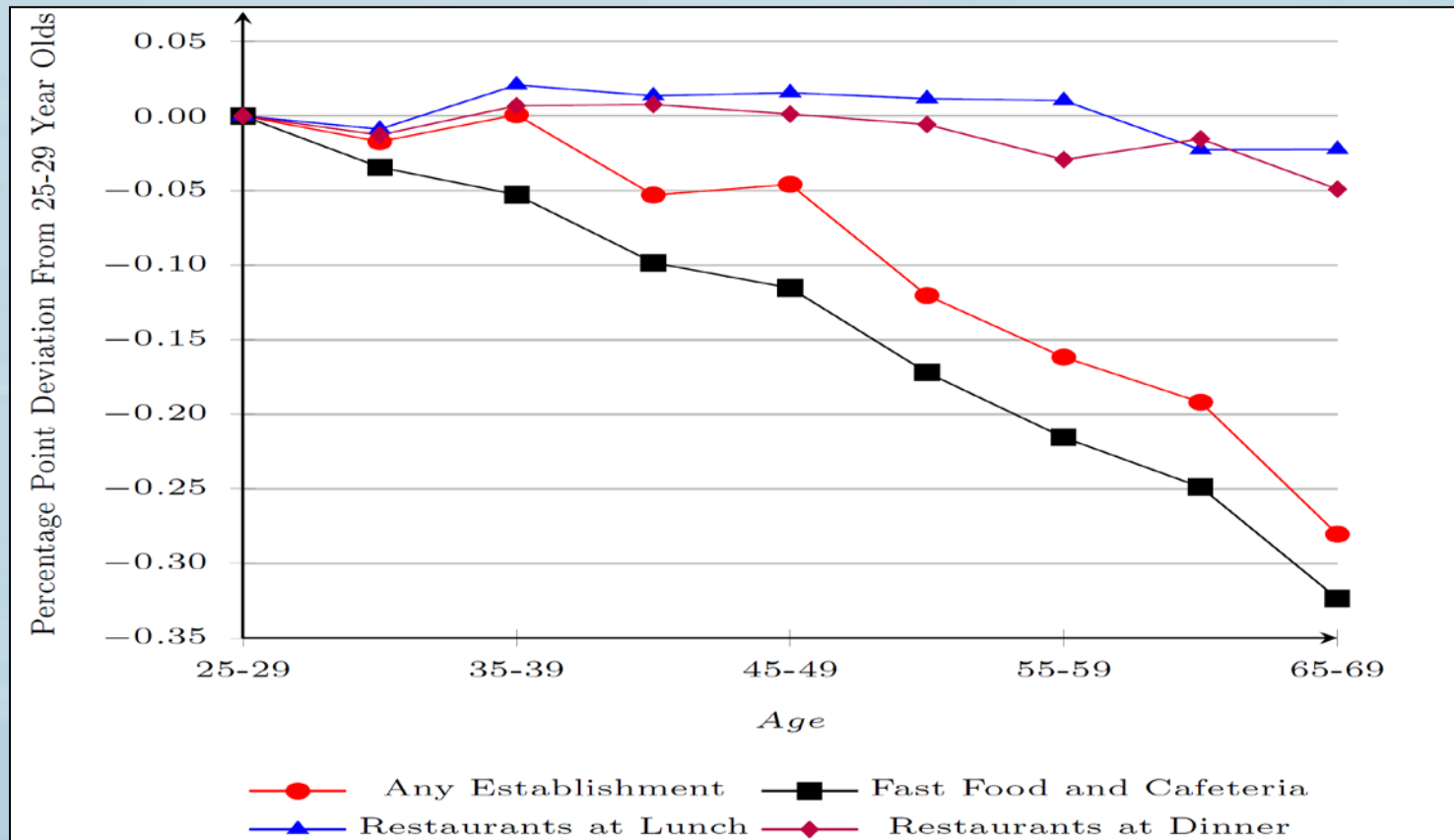
Percentage change in food expenditure, composite food index, and time spent on food production for male household heads by three-year age ranges



Source: Hurst, “Consumption During Retirement” (April 2014) based on Aguiar and Hurst (2005)

“Deconstructing Lifecycle Expenditure”: Propensity to Eat at “Restaurants” Steady with Age

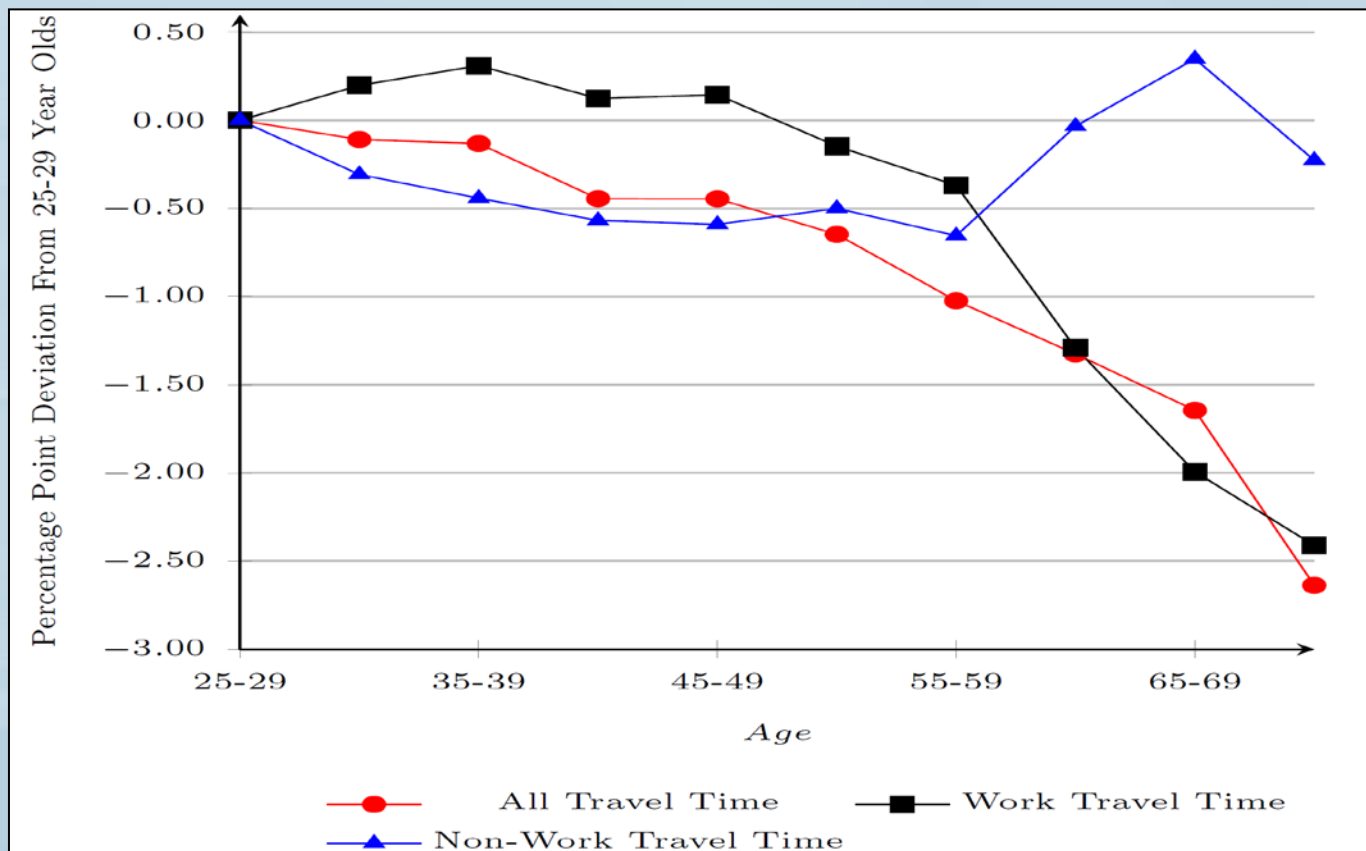
Propensity to eat away from home by establishment



Source: Hurst, “Consumption During Retirement” (April 2014) based on Aguiar and Hurst (2013)

“Deconstructing Lifecycle Expenditure”: Work Travel Time Declines but Other Travel Time Increases

Travel times over the life cycle



Source: Hurst, “Consumption During Retirement” (April 2014) based on Aguiar and Hurst (2013)

What's Happening in Retirement Now?

- Social Security benefits have grown more generous over time; Social Security tax rates and tax base also have grown.*
- ERISA 1974 and subsequent legislation put protections around pension plan assets and ensured more workers vested in pensions; now more retirees are collecting more from private-sector pensions.**
- Poverty rates among people aged 65 or older have fallen over time and are lower than other age groups.***
- Assets specifically earmarked for retirement have risen; to date, successive generations have entered retirement better off than previous generations.*

*See slides 22 and 23 in the appendix. **See Brady and Bogdan (2010 and 2013). ***See Brady, Burham, and Holden (2012).

Risks to Retirement Security

- There are macro risks:
 - Changes to Medicare and Medicaid
 - Changes to Social Security (e.g., projected benefit cuts when trust fund is depleted)
 - Changes to retirement saving incentives
 - Low interest rate environment makes prefunding of DB or DC difficult; also have uncertainty of future investment returns
- And, risks specific to individuals:
 - Early retirement due to poor health
 - Limited work history
 - Changes in marital status
 - Underfunded DB plan changes to benefits*

*See slide 26 in the appendix for unfunded pension liabilities; and Brady, Burham, and Holden (2012).

The Inner Workings of the NRRI: Replacement Rate

- NRRI pre-retirement income includes investment returns (including on retirement accounts) and imputed rent, which means that NRRI replacement rates are not comparable to typical calculations.
- It would be helpful also to report alternative measures:
 - Using pre-retirement earnings rather than pre-retirement income
 - Inflation-indexed rather than wage-indexed

A Simple Numerical Example

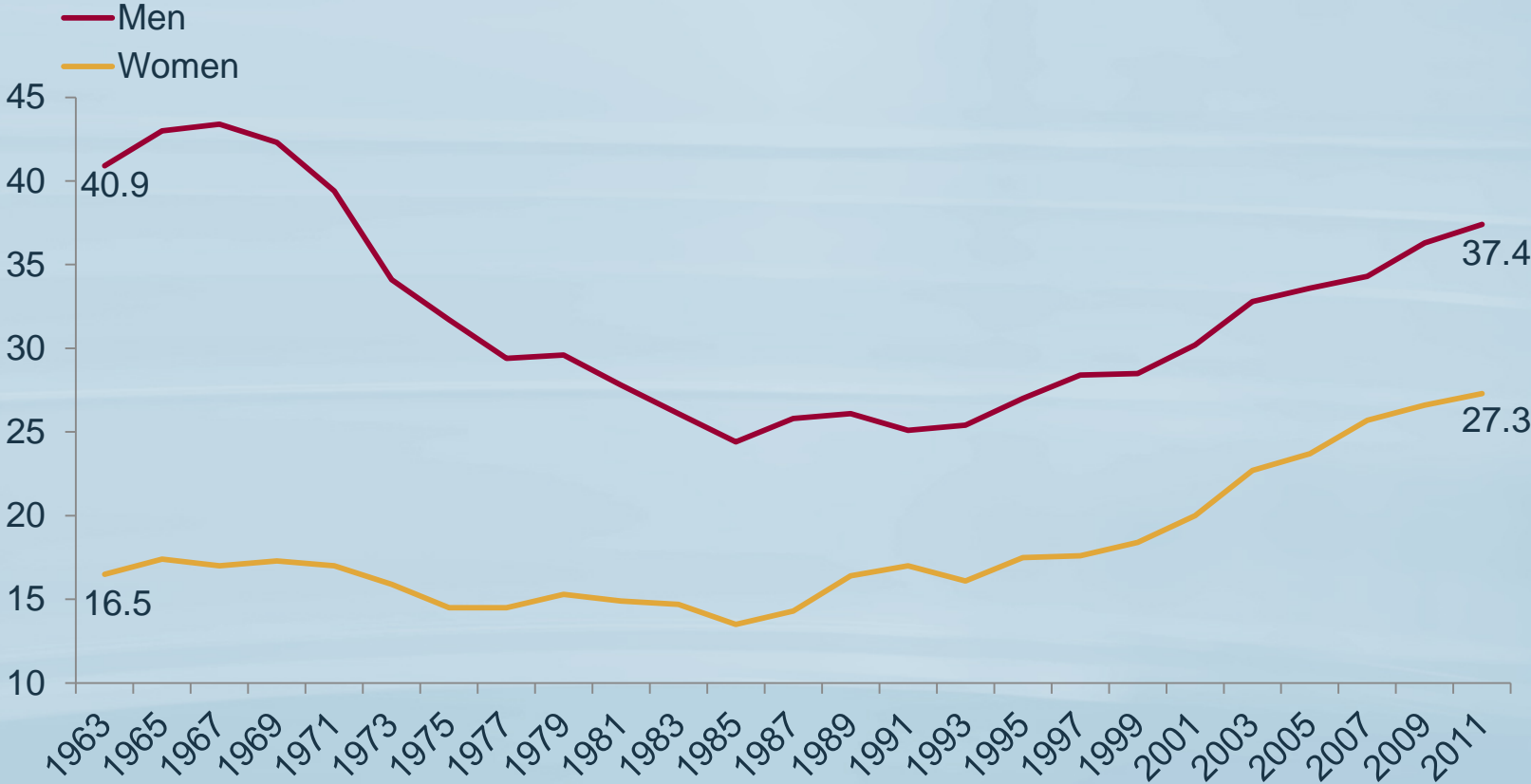
	Year prior to retirement	First year in retirement	Replacement rate
Person with DB plan			
Earnings	\$50,000	\$0	
Pension*	\$0	\$7,725	
Social Security	\$0	(45% of \$50,000)= \$22,500	
Total	\$50,000	\$30,225	60%
Person with DC plan			
Earnings	\$50,000	\$0	
Pension*	(4.6% of \$150,000)= \$6,900	(5.15% of \$150,000)= \$7,725	
Social Security	\$0	(45% of \$50,000)= \$22,500	
Total	\$56,900	\$30,225	53%

*Assumes the DC plan and DB plan produce the same benefit.

The Inner Workings of the NRRI: Rates of Return and Social Security

- NRRI has 4.6% real rate of return, which appears to impact the target, but not the projected growth in assets. It would be helpful to see the impact of different real rates of return.
 - How would a 3.0% real rate of return change the target replacement rates? A 2.0% real rate of return? Would lower rates of return decrease the percentage of households at risk?
- NRRI assumes Social Security cuts benefits and individuals retire before their normal retirement age, making it harder for households to reach the target.
 - How would success rates change if there were not across-the-board benefit cuts?
 - If people retired at normal retirement age? Or later? In the earliest NRRI report (using 2004 SCF data), households at risk fell by 11 percentage points when they worked two more years (to age 67).
 - How would these two different effects vary across households?

Labor Force Participation Rates 65–69 Year-Olds, 1963–2011



Source: Federal Inter-Agency Forum on Aging-Related Statistics (2012) presented in Poterba (2014)

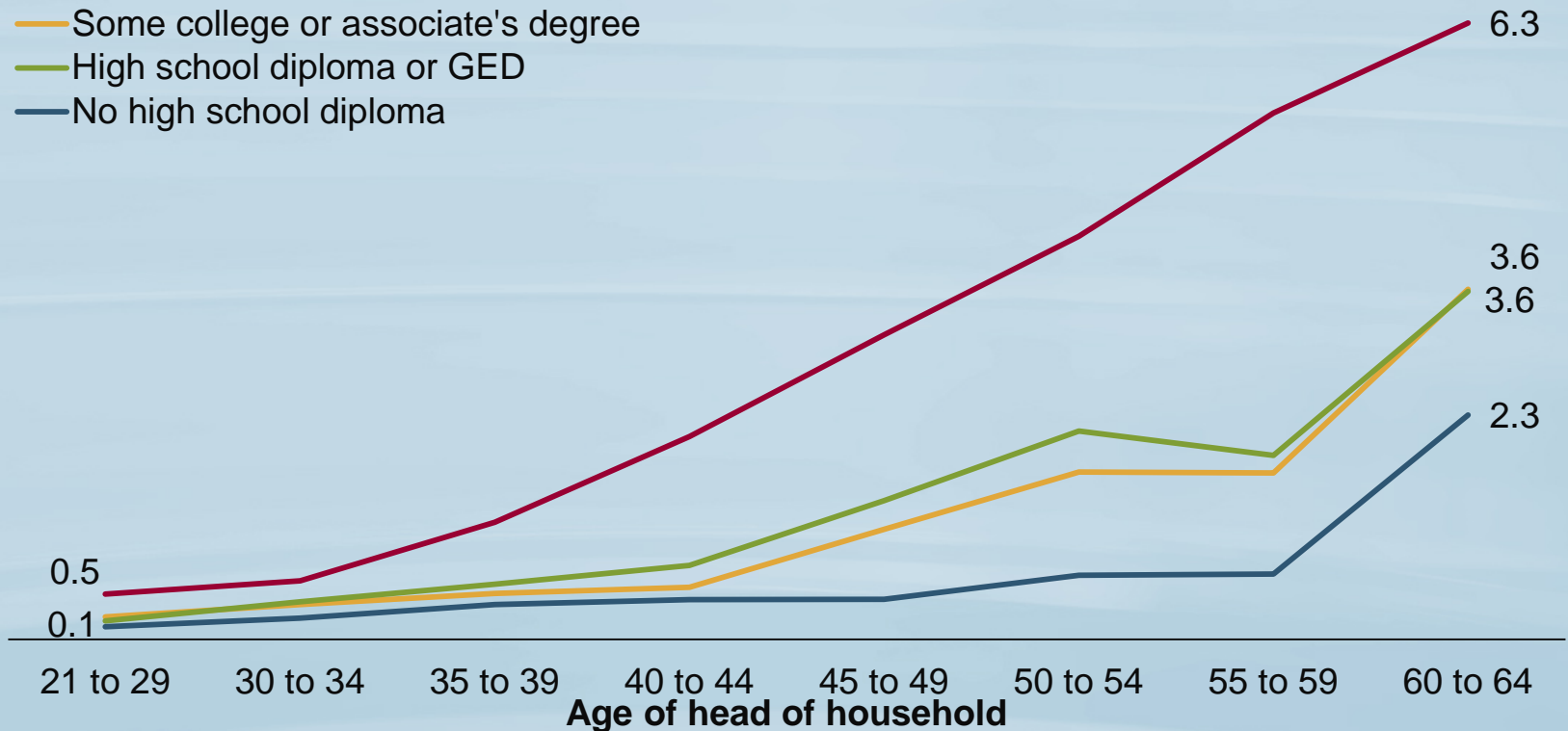
The Inner Workings of the NRRI: Averages of Wealth to Income Ratios

- What is the impact of using averages to construct many of the paths?
 - Given the rising and changing role of DC plans, do the existing averages capture the evolving DC system?
 - Given that a young individual with high education could have low financial assets/wealth, but should have a different trajectory than a low financial assets/wealth individual with less education, does the forecasting allow for such heterogeneity in people's income and wealth accrual paths?

Median Ratio of Wealth to Income Varies by Age and Education

Highest level of education:

- 4 year college degree or more
- Some college or associate's degree
- High school diploma or GED
- No high school diploma



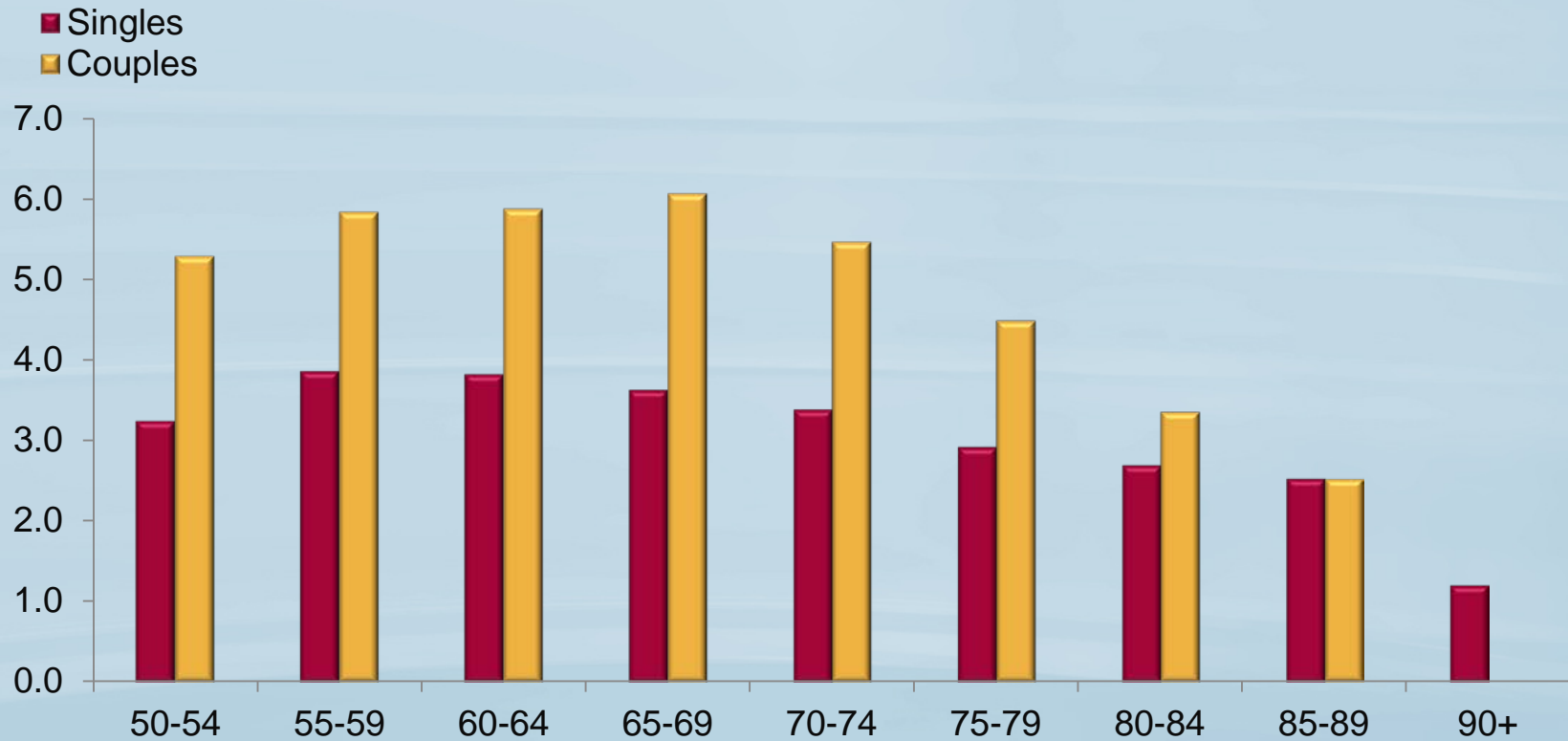
Source: ICI tabulations of the 2010 Survey of Consumer Finances

The Inner Workings of the NRRI: Children and Consumption

- Incorporating data-based spending patterns into the NRRI improves the assessment.
 - Ignoring the cost of children raises the target. A source of heterogeneity across households is the presence of children.
 - Assuming consumption must persist at the same level throughout retirement (whether or not you agree on the level) raises the target and does not reflect observed behavior.
 - Hurst and Aguiar find expenditures fall at retirement due to increased home production, more time researching and shopping for food, and not having work-related fast food and travel costs.
 - Hurd and Rohwedder note declining spending in a number of categories where health would be an input. Budget shares on donations and gifts increase with age, indicating that people have resources that they could spend on trips and vacations should they so desire, suggesting people are not forced to reduce spending.

Health Limits Travel at Older Ages

Budget shares, percentage due to trips and vacations

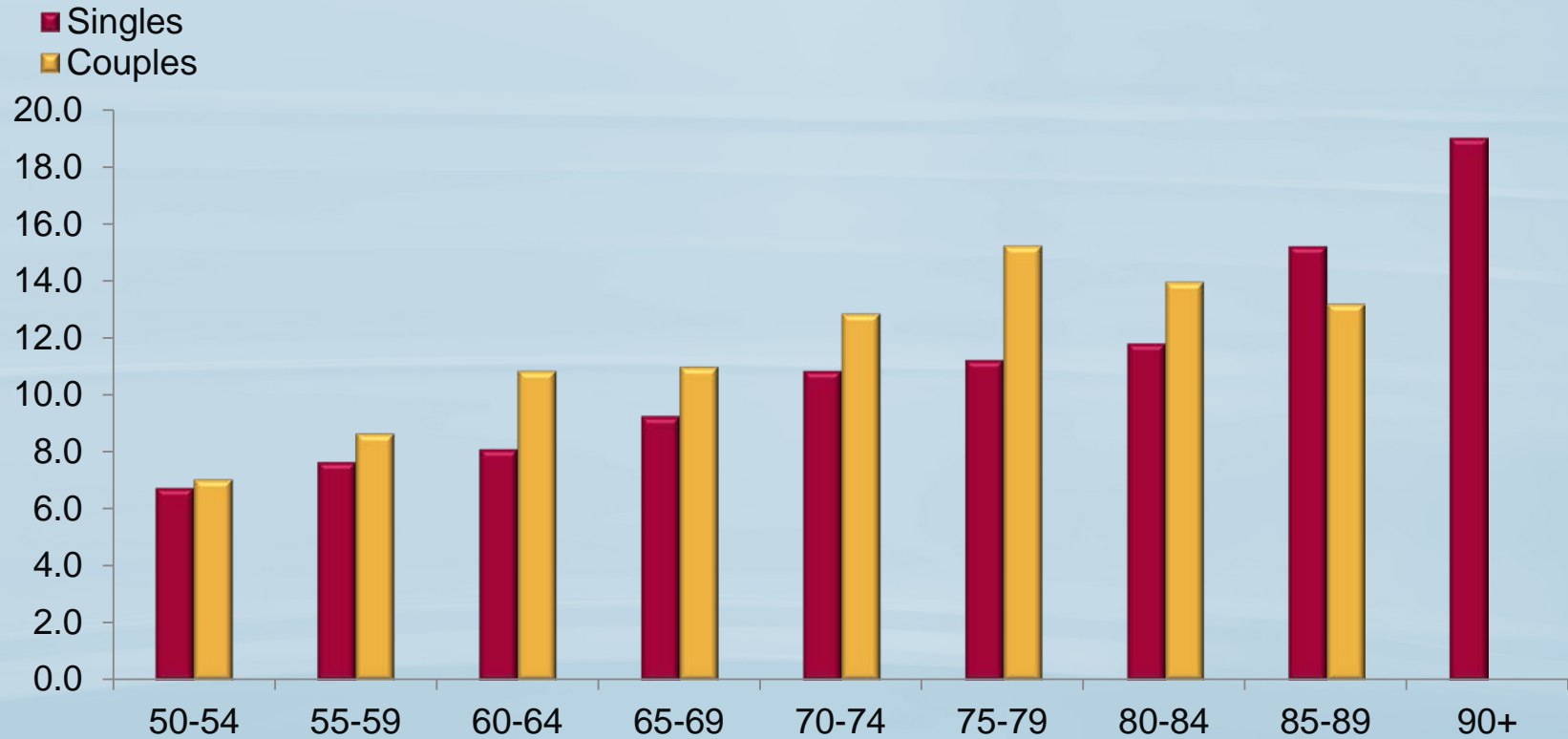


Note: Data are a subsample from the HRS of about 5,000 households interviewed every two years, filling out the Consumption and Activities Mail Survey (CAMS). Households were asked about 36 categories of spending.

Source: Hurd and Rohwedder (2010)

Considerable Discretionary Spending in Old Age

Budget shares, percentage due to donations and gifts



Note: Data are a subsample from the HRS of about 5,000 households interviewed every two years, filling out the Consumption and Activities Mail Survey (CAMS). Households were asked about 36 categories of spending.

Source: Hurd and Rohwedder (2010)

Policy Considerations

Weighing the Range of Assessments

- It is important to take stock and track flows.
- Many decisions to make when determining adequacy, and assessment tools should have:
 - up-to-date data;
 - an internally consistent framework;
 - transparency; and
 - sensitivity analyses.
- How much is enough varies by household, and focus on one “ready or not” number diverts attention from a more nuanced and detailed analysis of who’s not prepared and why.

Policy Considerations, cont.

- Analyses should separate out:
 - whether current near-retirees have prepared for retirement; vs.
 - whether current workers appear to be on track.
- The longer the time horizon being projected, the harder it is to judge.
- The research community should continue to update, clarify, refine, and build on analyses of retirement preparedness.

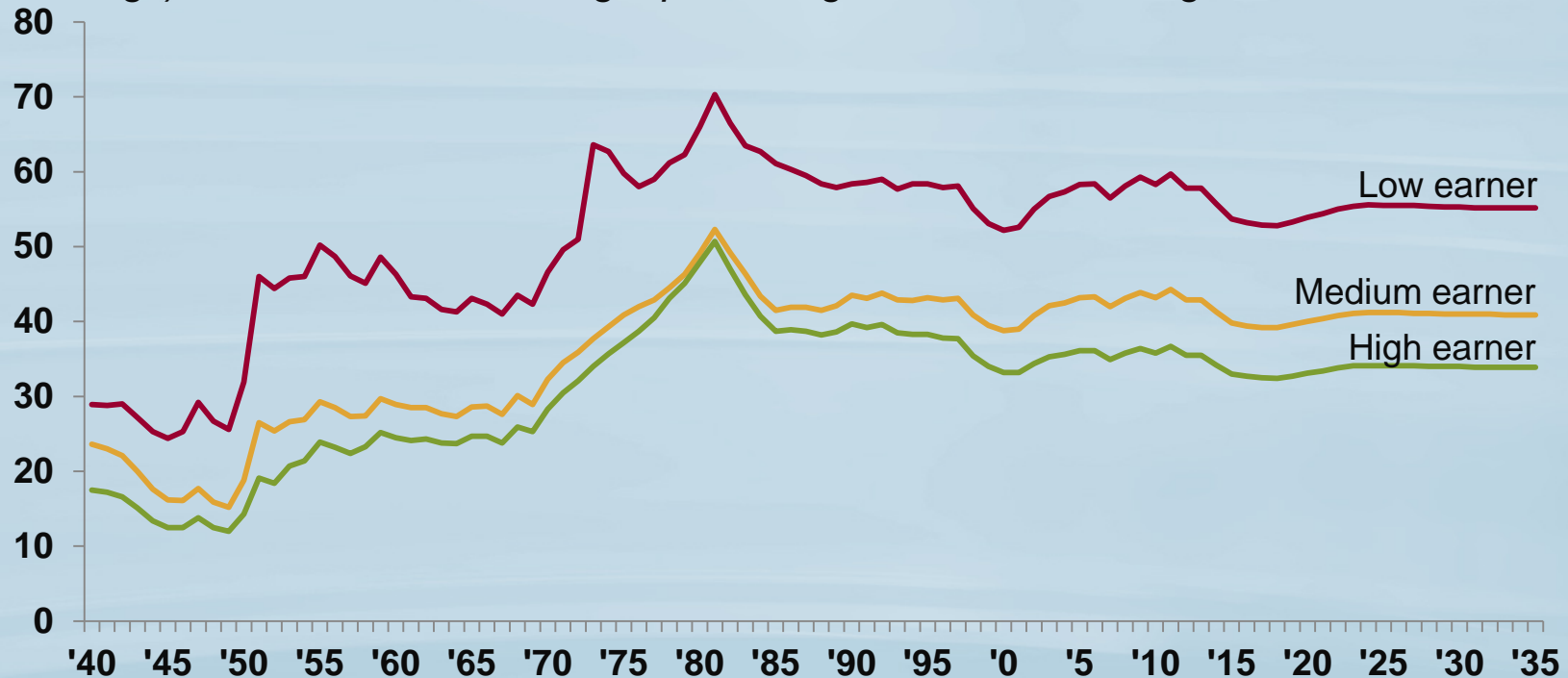
Appendix

- Social Security benefits have grown more generous over time
- Assets earmarked for retirement have grown
- Share of near-retirees with retirement accumulations is steady, but the composition has shifted (higher percentage with DC plans or IRAs, lower percentage with DB plan accumulations)
- The retirement resource pyramid varies across households
- U.S. retirement assets and unfunded pension liabilities
- Median ratio of financial assets to income varies with age and education

Social Security Benefits Have Grown More Generous over Time



Estimates of replacement rates (first year benefits relative to average indexed earnings) at normal retirement age; percentage of lifetime earnings; 1940–2035



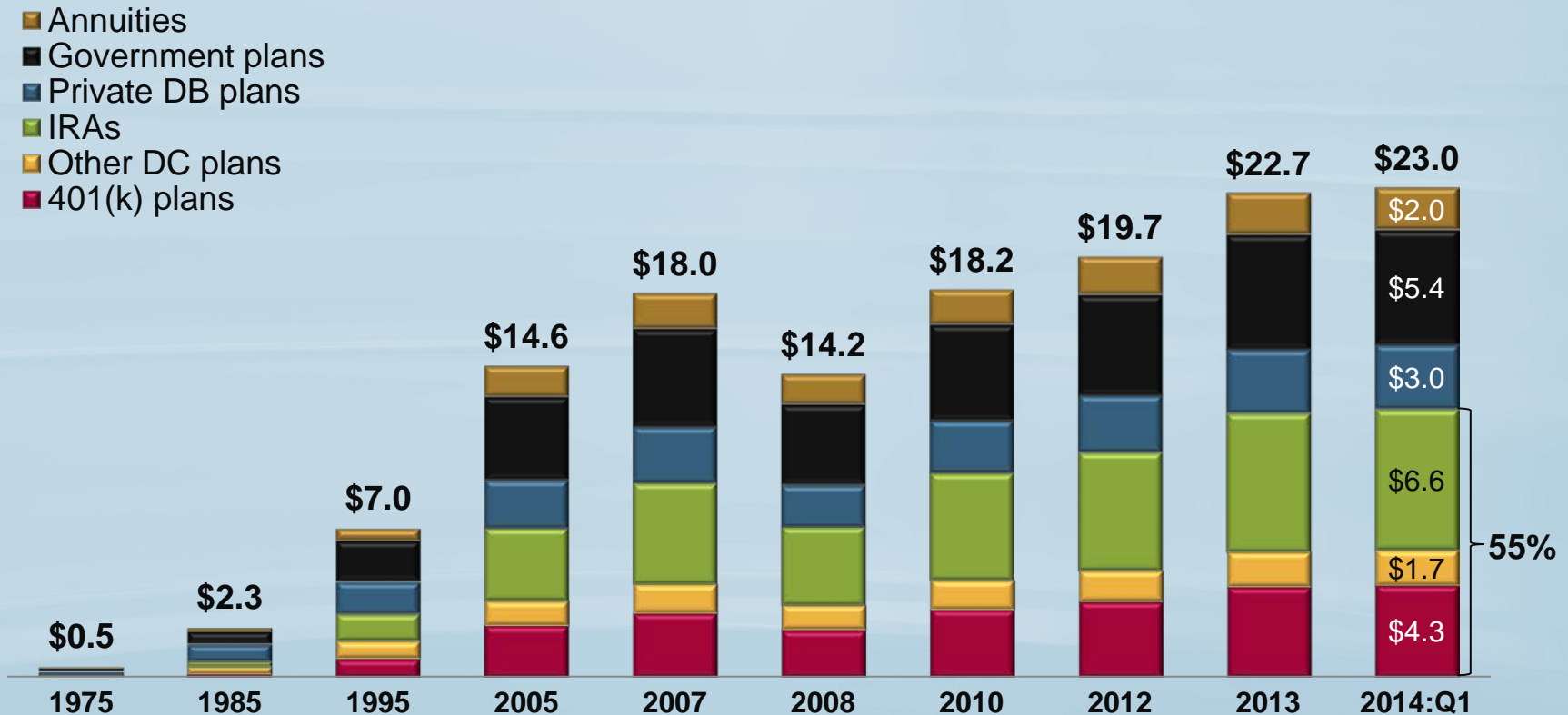
Note: Low, medium, and high earner refer to scaled earnings that reflect patterns of work and earnings for hypothetical workers over the course of a career. Projections assume no change in current policy.

Source: Social Security Administration, Office of the Chief Actuary; see Brady, Burham, and Holden, *The Success of the U.S. Retirement System* (December 2012)

Assets Earmarked for Retirement Have Grown



Trillions of dollars, end of period, selected dates



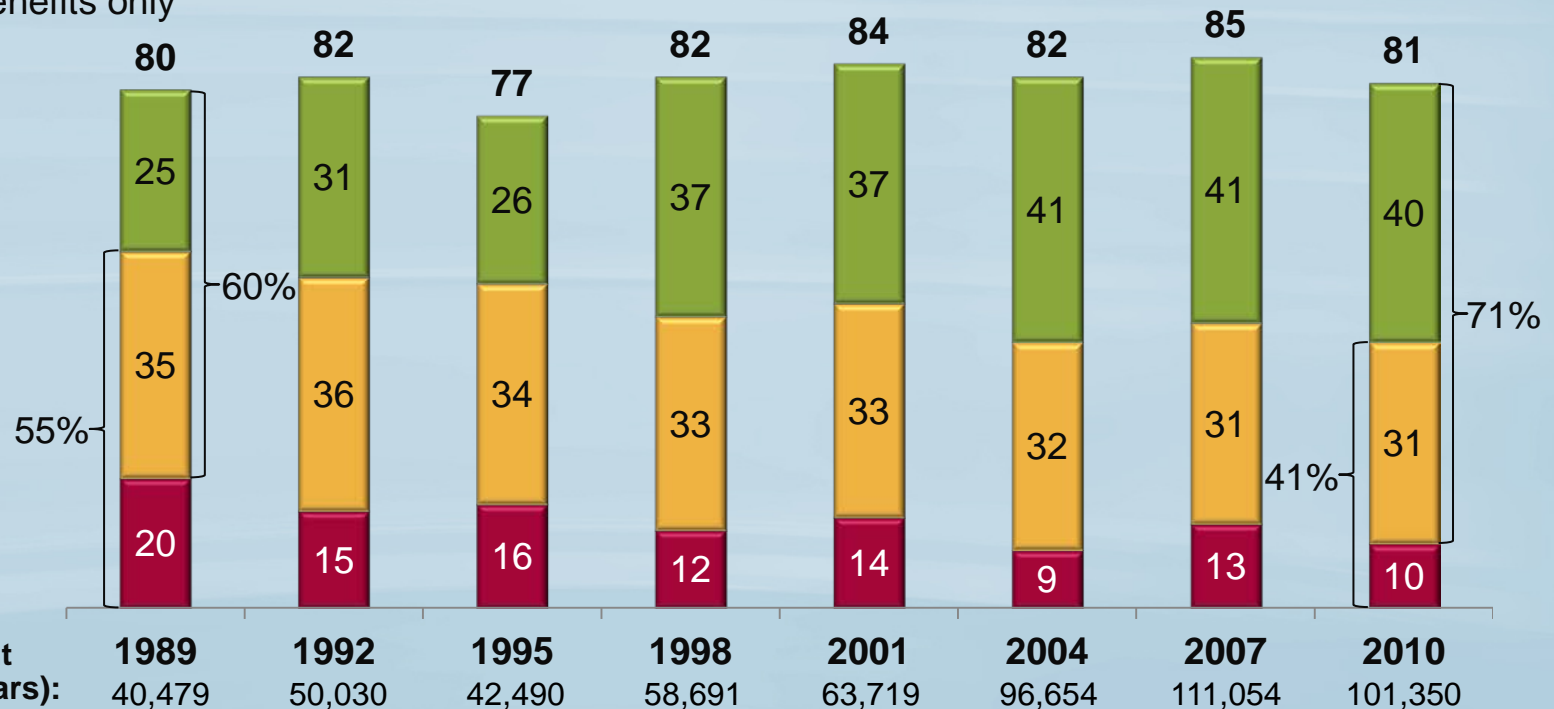
Note: For definitions of plan categories and a complete list of data sources, see Tables 1 and 4 in "The U.S. Retirement Market, First Quarter 2014." Some data are estimated.

Source: Investment Company Institute, *The U.S. Retirement Market, First Quarter 2014* (June 2014)

Share of Near-Retirees with Retirement Accumulations Steady, but the Composition Has Shifted

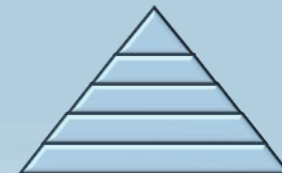
Households with working head age 55 to 64, 1989–2010

- Retirement assets only
- Both DB benefits and retirement assets
- DB benefits only

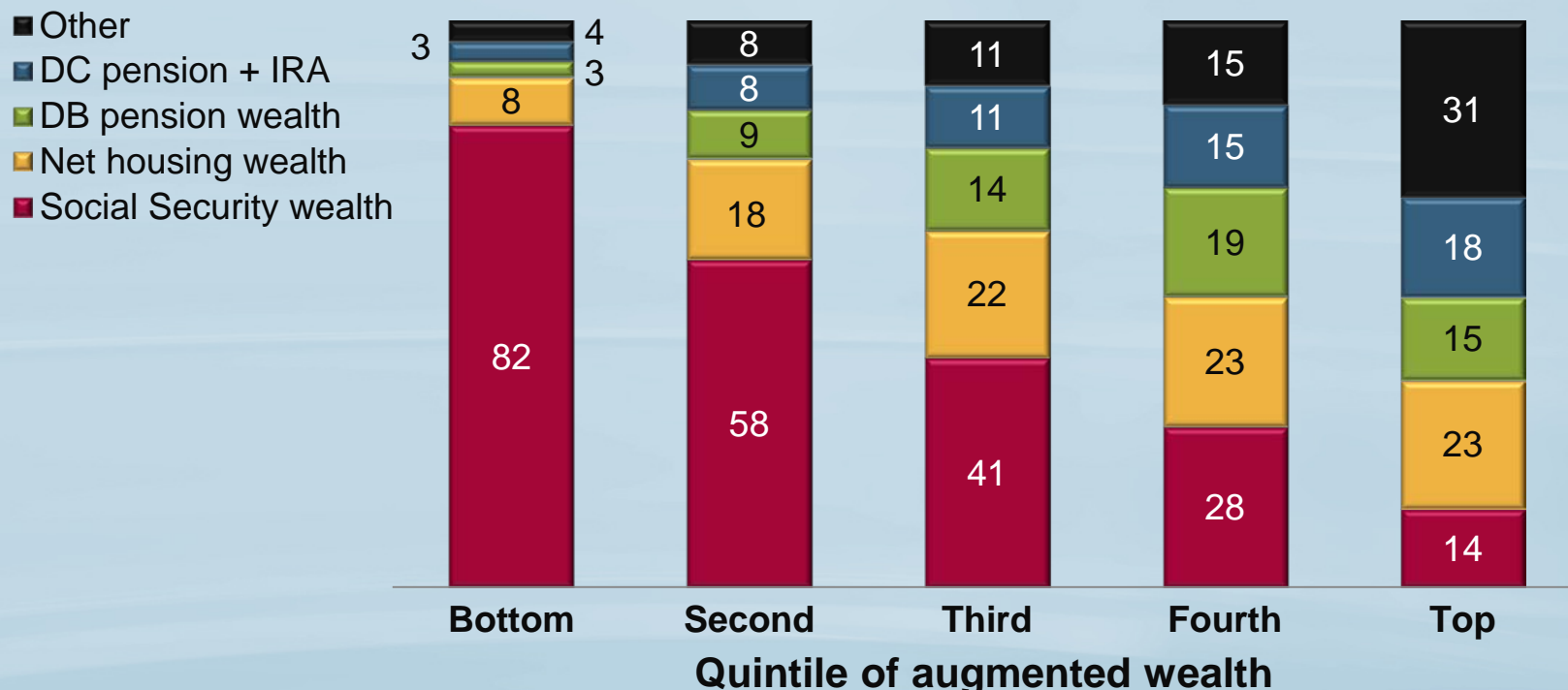


Source: ICI tabulations of the Survey of Consumer Finances; see Brady, Burham, and Holden, *The Success of the U.S. Retirement System* (December 2012)

The Retirement Resource Pyramid Varies Across Households



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

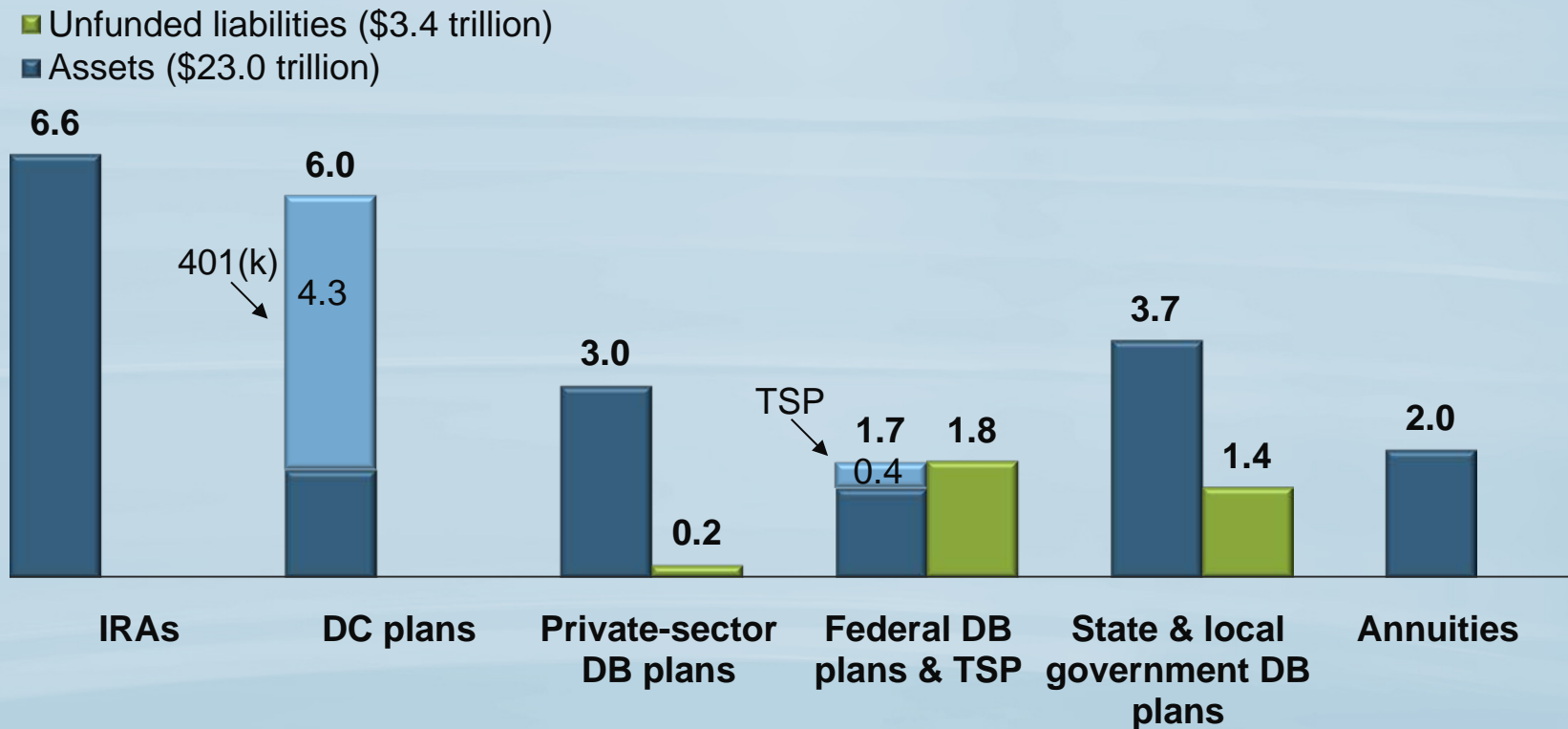


Note: Households with the top and bottom 1 percent of wealth are excluded. Social Security wealth is estimated as the present discounted value (PDV) of the stream of Social Security benefits. Net housing wealth is the value of the home less mortgages. DB pension wealth is estimated as the PDV of the stream of DB benefits. Retirement assets include DC plan assets (401(k), 403(b), 457, thrift, and other DC plans) and IRAs (traditional, Roth, SEP, SAR-SEP, and SIMPLE). DB pension and retirement assets are derived from work in both the private-sector and the government sector.

Source: Investment Company Institute tabulation derived from Gustman, Steinmeier, and Tabatabai (2009) using Health and Retirement Study (HRS) data

U.S. Retirement Assets and Unfunded Pension Liabilities

Trillions of dollars, end of period, 2014:Q1



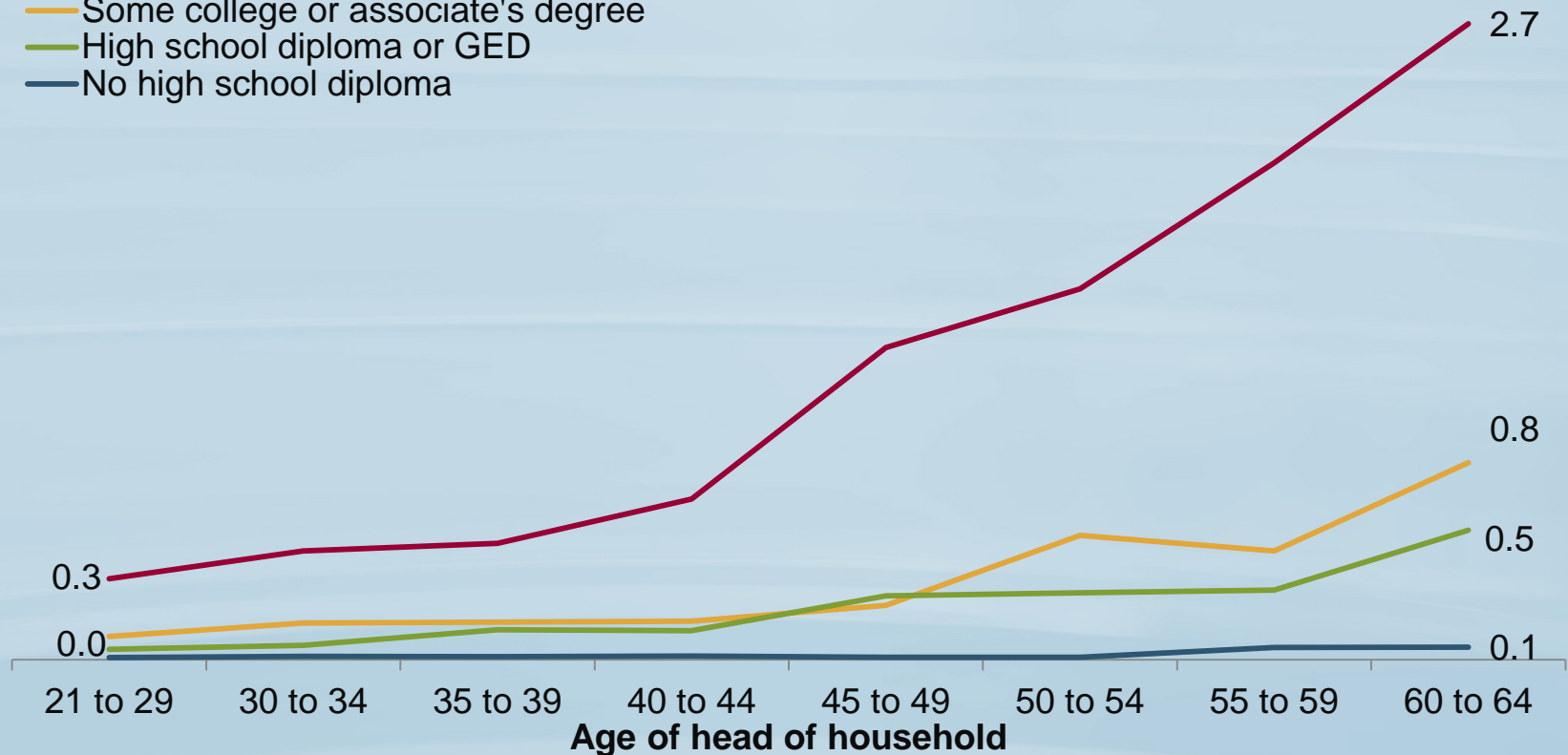
Note: For definitions of plan categories and a complete list of data sources, see Tables 1 and 4 in "The U.S. Retirement Market, First Quarter 2014." Some data are estimated.

Sources: Investment Company Institute, *The U.S. Retirement Market, First Quarter 2014* (June 2014) and U.S. Federal Reserve Board (2014)

Median Ratio of Financial Assets to Income Varies with Age and Education

Highest level of education:

- 4 year college degree or more
- Some college or associate's degree
- High school diploma or GED
- No high school diploma



Source: ICI tabulations of the 2010 Survey of Consumer Finances

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