Will Inheritances Save Retirement?

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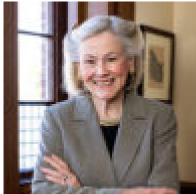
MarketWatch Blog by Alicia H. Munnell



Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

Inheritances already received have only a modest effect on the NRRI.

Today's working-age households, in aggregate, will inherit a substantial amount of wealth. The effect of inheritances on retirement readiness, however, is unclear. A recent study published by the Center uses the National Retirement Risk Index (NRRI), which is based on the Federal Reserve's *Survey of Consumer Finances* (SCF), plus additional questions from the latest (2013) SCF about inheritances to explore the extent to which inheritance receipts reduce the percentage of households "at risk."

The NRRI measures Americans' retirement preparedness by comparing projected replacement rates – retirement income as a percentage of pre-retirement income – with target rates and shows that today's workers face a major retirement income challenge. Even if households work to age 65 and annuitize all their financial assets, including the receipts from reverse mortgages on their homes, more than half are at risk in retirement. The question is the extent to which considering inheritances changes this story.

The SCF questionnaire asks people whether they have received an inheritance. Not surprisingly, the percentage of households receiving an

inheritance increases with income, rising from 14 percent for the households in the bottom third of the income distribution to 24 percent for those in the top third.

For those who received an inheritance, the SCF asks the value at the time received and when did they receive it. To update financial inheritances to 2013, we assume an annual real rate of 4 percent and inflation of 2.5 percent. If respondents' inheritances include their house, the questionnaire asks about the current value of the house. Combining house and financial inheritances, median inheritances had appreciated to $87,500 by 2013.

The central question is how much higher would the NRRI be if no households had received an inheritance. The methodology involves four steps. The first is to project the value of the inheritances received to age 65. The second is to calculate the annuity income at age 65 that is generated by the inherited wealth. The third step is to subtract that annuity income from the numerator of the original replacement rate to calculate a new replacement rate for households that received inheritances. The final step is to recalculate the NRRI with the reduced replacement rates for the households with inherited wealth. Taking inheritances out of the 2013 NRRI raises the Index from its current level of 51.6 percent to 52.4 percent, a statistically significant, but modest, change.

The modest impact is due to the fact that: 1) only about one-fifth of households have actually received an inheritance, so most are unaffected; 2) among those receiving an inheritance, the amounts are relatively small compared to the households' total retirement income; and 3) most households receiving an inheritance were already well above the NRRI's "at risk" cutoff, so removing the inheritance is not enough to put them at risk.

The bottom line is that, while anything that boosts households’ assets is beneficial to their financial situation, inheritances are not likely to be decisive in determining retirement preparedness for many households.