



THE FINANCIAL CRISIS AND RETIREMENT READINESS

The economic meltdown had personal as well as national implications, as more people had to worry about running short of retirement income.

Did the crisis in the real estate and financial markets in 2008 and 2009 that threatened the stability of the US economy also increase the threat to the retirement readiness of the American workforce?

In research seeking to answer that question, Jack VanDerhei, in “A Post-Crisis Assessment of Retirement Income Adequacy for Baby Boomers and Gen Xers,” published by the Employee Benefit Research Institute (EBRI) in February 2011, focused on two specific issues:

- What percentage of US households who weren't at risk of running short of retirement income in 2007 were at risk after 2009?
- How much do these newly at-risk people have to save, over and above what they're already saving, between now and when they retire, to make up for their losses?

A RESEARCH OVERVIEW

To complete the first phase of his analysis, VanDerhei used two EBRI analytical tools—the Retirement Readiness Rating and the 2010 version of the Retirement Security Projection Model—to project the percentage of the population at risk of running out of money at some point after they retire. The projection was based on the outcomes of thousands of different hypothetical scenarios.

The sources of potential income the author included in these scenarios were Social Security, defined contribution plan balances, IRA balances, defined benefit

→ A QUICK LOOK

- Retirement readiness decreased across all age groups from 2008 to 2010
- Largest decrease in readiness hit the oldest workers
- Investment and real estate losses were primary reason for decrease
- Yet, overall retirement readiness improved from 2003 to 2010 thanks to participation in defined contribution plans

annuities, and net housing equity. (Housing was included since homeowners have the potential either to sell or to take a reverse mortgage, though previous research has shown that many people are reluctant to do either.)

His study assumed that all workers retire at 65 and begin withdrawing from their individual accounts (like employer-sponsored plans and IRAs) at that age. Further, he defined “running out of money” as the point at which those assets were exhausted and income from Social Security and defined benefit plans wasn't adequate to cover the retirees' needs.

To determine the impact of the financial crisis on retirement readiness, VanDerhei compared the percentage of households at risk on January 1, 2010, with those who would have been considered at risk on January 1, 2008, based on a similar statistical analysis. The difference in the calculations for 2008 and 2010 took into account two years of continued contributions to employer-sponsored retirement plans and potential for withdrawals or loans from those plans.

WHO WAS AFFECTED?

The actual percentage decrease in retirement readiness—those people who had enough assets to maintain their standard of living in retirement—within each of the three age groups (Early Baby Boomers, Late Baby Boomers, and Gen Xers) covered in the study was relatively small. The decrease ranged from a 2.3 percentage point drop for the oldest group to a 1.5 percentage point drop for the youngest group.

At the same time, what was revealing though not surprising in VanDerhei's findings was that the people most likely to have moved from the ready to the at-risk category between 2008 and 2010 were those with equity market exposure through employer plans and IRAs as well as real estate market exposure through home ownership. What put their retirement security in doubt was the diminished value of their assets.

TAKING A LONGER VIEW

But when VanDerhei compared the percentage of at-risk households in 2010 with the percentage that has been at risk in 2003, he discovered a significant drop in the at-risk category. This applied across all age groups and income levels, with two exceptions where the declines were smaller: the lowest income workers in the Early Boomer and Late Boomer categories. (Lowest income households are those earning less than \$32,500, according to the Bureau of Labor Statistics "Current Population Survey.") In these groups, the decrease in at-risk households was 2 percentage points and 6 percentage points respectively, rather than the double-digit percentage point decrease that was evident across the other groups.

Van Derhei explained that Late Boomers and Gen Xers who were eligible to participate in a defined contribution plan were at much less risk of running out of money in retirement than they had been seven years earlier—despite the impact of the financial crisis. In the case of Late Boomers, they were more likely to be at risk when they were not eligible to participate in the plan for an additional 10 to 19 years. In the case of Gen Xers, there was similarly a greater danger of being at risk if they were not eligible to participate in a defined contribution plan than if they were eligible to participate for 20 or more years.

Equally significant, the study also supports some of the author's earlier findings, which demonstrated not only the impact of participation in defined contribution plans on increased retirement savings for Late Boomers and Gen Xers, but also the particular value of both automatic enrollment in those plans and the subsequent automatic escalation of contribution rates.

ADDITIONAL SAVINGS NEEDED

The second part of VanDerhei's analysis deals with the issue of whether those who are likely to be at risk would be able to save enough more while they're still working to compensate for their losses in the crisis. His conclusion is not particularly reassuring.

To be reasonably sure of having as much income as a household needs, which VanDerhei described as a 90% probability, he estimated the need for additional savings at 6.7% of income annually—over and above what they are now saving—for all at-risk households across all age groups.

Jack VanDerhei, "A Post-Crisis Assessment of Retirement Income Adequacy for Baby Boomers and Gen Xers," EBRI Issue Brief no. 354, February 2011. This summary focuses on the issues of increased percentage of households at risk and additional savings needed that VanDerhei poses and provides an overview of his findings.