



DEFINING RETIREMENT READINESS

Enjoying a comfortable retirement depends on having adequate income. While about half of the baby boomers appear to be financially ready, the other half face an uncertain future.

In "Who Is Ready for Retirement, How Ready, and How Can We Know?" Sophie Korczyk, in a research report for AARP, evaluates the findings of a number of research studies that look at the issues baby boomers face as they approach retirement in every-increasing numbers. She focuses on research that addresses three specific areas:

- Measuring the adequacy of retirement income
- Groups at particular risk of financial insecurity
- Links between home equity and retirement income

EVALUATING THE FINDINGS

The underlying studies have some good news. At least half of boomers, both early (born between 1946 and 1954) and late (born 1955-1964), are on track to enjoy a financially secure retirement. The remainder, however, are at risk of outliving their assets.

One reason some boomers are unprepared may be that they're approaching retirement with no idea about the amount of income they'll need to live comfortably and inadequate savings on which they can draw. Further, evidence suggests that the gap between those who will have adequate income and those who will not is growing. This helps to explain the finding that 25% of boomers probably can't afford to stop working as they reach retirement age, and nearly 19% could find themselves in serious financial difficulty.

The research also identifies several factors that will impact the amount of retirement income that baby boomers will have, and which are likely to contribute to the shortfall they may not be anticipating. First, Social Security replacement rates are dropping, both because of the increase in full retirement age (also called normal retirement age), and the steeper penalty for taking early benefits.

→ A QUICK LOOK

- 19% of baby boomers could face serious financial problems in retirement
- 25% of baby boomers may be forced to continue working after 66 to maintain an adequate income
- Singles and those with less than a high-school education face the bleakest long-term outlook, despite a reduction in the overall poverty rate
- Boomers may have no choice but to tap their home equity as a source of retirement income

In addition, pensions, which make a major difference in retirement income levels, have shifted from defined benefit to defined contribution plans during boomers' working lives, adding a potential risk for less retirement income. Finally, employers have reduced or eliminated healthcare coverage for retired workers at a time when those costs are escalating.

ADEQUATE RETIREMENT INCOME

In her analysis, Korczyk compares the findings of a number of studies that attempt to define what an adequate retirement income is. She points out that while the researchers have different perspectives and use different methodologies, they seek to "resolve the same or similar questions." These questions address whether or not retiring boomers will have enough income to be self-sufficient once they leave the workforce.

Some of these researchers focus on replacement rates -- or percentages of pre-retirement income -- as the primary indicator of whether retired people will be able to maintain their standard of living. While this is the most straight-forward approach, and the most widely used, Korczyk notes that it's of somewhat limited value because it's a static number, and doesn't account for changes in personal circumstances or the overall economy.

Other of these researchers assess workers' savings patterns and wealth accumulation as the main indicator of their future financial security. This approach, which looks at savings patterns over time, can be an effective tool in identifying who is likely to be at risk and who is not. Still a third group of researchers compares baby boomers' financial standing with that of their parents' generation. While their research tends to show that boomers will, in general, be better off, the findings are the least actionable in terms of taking measures to ensure greater financial security.

Korczyk concludes that each of these approaches, while not totally satisfactory in assessing income adequacy, contributes to our understanding of what she calls a potentially "crushing" economic burden for the next, and smaller, generation of boomers' children.

AT RISK GROUPS

The research on the adequacy of retirement income that Korczyk reviews identifies two groups at greater-than-average risk of outliving their resources: those who are single when they retire, and those who have not completed high school.

Singles include those who have never married, are widowed, or divorced -- a group that includes more women than men in the over-65 demographic. Women in this group are already at risk of long-term financial problems because they are less likely to have a substantial pension or be eligible for the highest Social Security benefits.

In 2004, just 4.5% of elderly married people were poor, based on federal poverty levels. But for the unmarried, poverty rates ranged from a low of 14.5% for the widowed to a high of 21.9% for those who never married.

Similarly, those without a high school diploma face a much greater-than-average likelihood of not having adequate retirement income. While a number of factors contribute to this situation, including lower lifetime earnings, higher

pre-retirement poverty rates, and the reduced likelihood of being eligible for a pension, Korczyk also comments on what she sees as a deficit in this group's "ability – and possibly willingness to plan ahead for retirement."

HOMES AS INCOME SOURCES

In the final section of her analysis, Korczyk examines attitudes toward one's home as a source of retirement income. Although several studies include equity-based income through a reverse mortgage as a key component of the income boomers can expect to count on in retirement, the research is clear that this approach is at odds with the way people feel about owning their homes and passing them on to their heirs.

However, she concludes, baby boomers may not have this "luxury," and may have to change their view of using their home equity. At the same time, she acknowledges the widespread perception that reverse mortgages, which would be the primary vehicle for turning equity into income, have serious drawbacks.

PUBLIC POLICY IMPLICATIONS

The retirement experience of the baby boomers will have a significant impact on society as a whole. To help ease their transition and mitigate some of the potential consequences, Korczyk suggests adopting three initiatives:

- Improved financial education for older workers, including emphasis on the roles of Social Security and workplace benefits
- An education campaign aimed at encouraging employers to retain their older workers, hire other older workers, and create attractive employment opportunities for them
- An across-the-board government commitment to encourage older workers to remain in the workforce, taking advantage of phased retirement, bridge jobs, and part-time opportunities

The study, "Who Is Ready for Retirement, How Ready, and How Can We Know?" was written by Sophie Korczyk as an AARP Public Policy Institute Research Report. It was published in January 2008, and based on an analysis of a number of studies of retirement readiness. It includes a number of helpful tables and charts, and an extensive bibliography.