Getting Past Retirement Crisis Denial

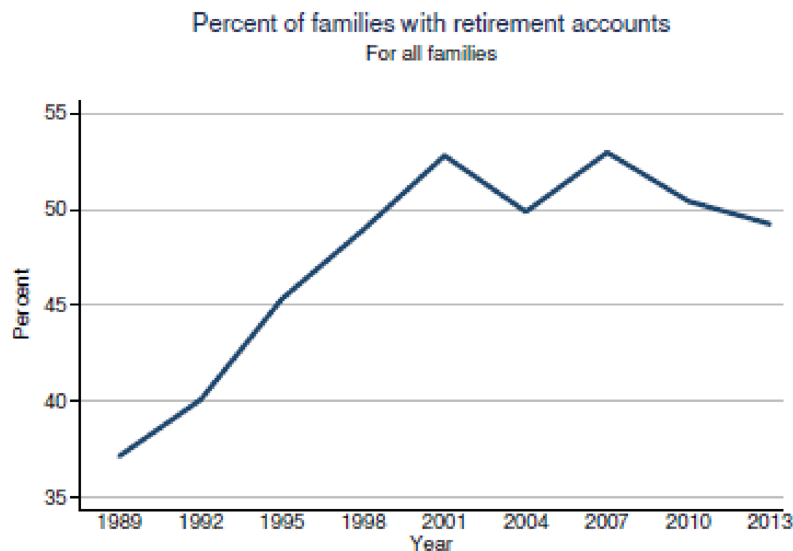
Nari Rhee, Ph.D., NIRS Manager of Research, September 2014

New data from the Federal Reserve's Survey of Consumer Finances (SCF) reveal that American households aren't making progress toward improving retirement security despite the stock market recovery—and it seems we're even losing ground.

U.S. household 401(k) and IRA retirement account assets increased to a combined record high of $11.3 trillion at the end of 2013.[1] Yet, according to the latest data from the Federal Reserve Board's SCF, the **median retirement account balance, counting all households regardless of whether they had a 401(k) or IRA, was zero in 2013. The data also reveal that**:

- The share of households with assets in retirement accounts **dropped** slightly, from 50.4 percent in 2010 to 49.2 percent in 2013, and farther away from the peaks of 2001 and 2007 (**Figure 1**).[2] This means that the typical American household right in the middle had no savings in **a 401(k) or IRA**.
- Among working-age households (age 25-64), the median retirement account balance **dropped** from $3,000 in 2010 to $2,500.[3]
- Account balances rose only minimally during the same period for the near-retirement age bracket, 55-64, from $12,000 to $14,500.[4] This is a trivial amount compared to retirees' lifetime income needs.

Figure 1
Household retirement account ownership is declining

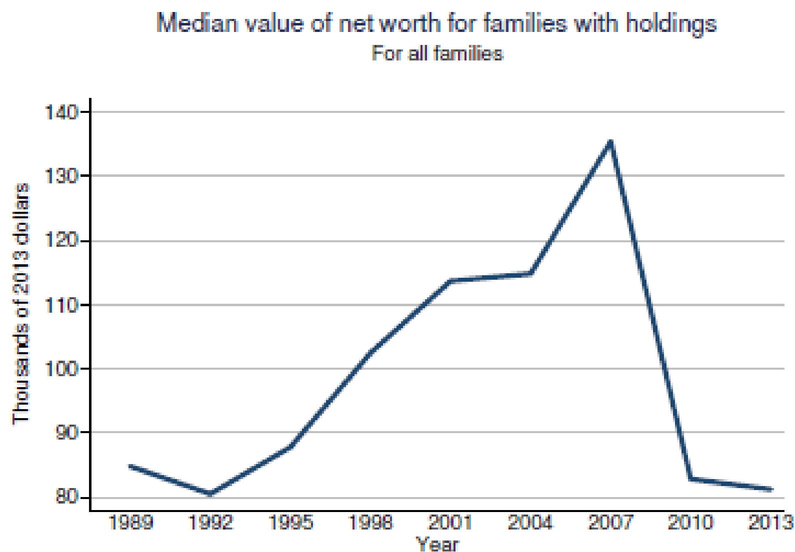


Source: Excerpted from Federal Reserve Board 2014.

The bottom half has been particularly hard hit by declining retirement security. According to the latest Federal Reserve survey data, among "prime-age" households with heads age 35-64, only 40.2 percent of households in the bottom half of the income distribution owned a retirement account or had coverage in a DB pension in 2013. This reflected a 20 percent decline from participation levels in 2007, caused mostly by the decline in IRAs and 401(k) ownership. Over the same period, the average account value for the bottom half also dropped 20 percent, from $50,600 to $39,500 in 2013 dollars.

These troubling numbers are consistent with overall trends in an economic recovery in which overall wealth has remained stagnant, and income and wealth at the bottom have dropped for most groups—especially those at the bottom. Net worth for the typical household dropped precipitously between 2007 and 2010, and then declined still further (**Figure 2**). Indeed, as other researchers have pointed out, the clearest sign of declining retirement income security is the fact that ratios of household net worth to income by age group have remained relatively flat over the past couple of decades, while Social Security and pension benefit cuts combined with longer life expectancy require greater personal savings just to keep up.[5]

Figure 2
The net worth of the typical household is declining



Source: Excerpted from Federal Reserve Board 2014. Universe includes all households.

Despite this hard data, we've seen a new emergence of retirement crisis deniers who argue that most working-age households are by-and-large on track to having sufficient income when they retire. Some of the deniers – such as economist Sylvester Schieber and Andrew Biggs

of the American Enterprise Institute – have released publications that take issue with research by NIRS and other organizations analyzing America's retirement savings shortfall.[6]

Unfortunately, these retirement crisis deniers choose to overlook key facts presented in our research and offer flimsy methodological critiques. In our 2013 report, "The Retirement Savings Crisis: Is It Worse than We Think?," we showed that half of working-age households do not have a 401(k) or IRA, and that the median retirement account balance of households approaching retirement was a mere $12,000 in 2010.[7] Moreover, two-thirds of near-retiree households had account balances worth less than one year of current income. Given growing reliance on these accounts to build retirement assets, such low account balances are very troubling. Ignoring these plain facts in their assessments, they choose to focus instead on NIRS's use of age-specific retirement savings benchmarks (adapted from the financial services company Fidelity) to assess working households' retirement wealth.

To put it simply, Schieber and Biggs argue that Fidelity's recommended retirement savings goal of 8 times income by age 67 is overly generous in terms of the retirement income it would provide, and that it should especially be ratcheted down for low-income households that will see a greater share of their pre-retirement income replaced by Social Security. In addition, the critics argue that retirement readiness studies should assume that younger households that are not saving much are still "on track" because it is reasonable to assume that they will be able to catch up later. Both are flimsy arguments at best.

1. The retirement savings benchmarks used by NIRS to evaluate U.S. household retirement readiness are conservative.

The NIRS research adapted a set of age-specific retirement saving targets recommended by Fidelity for the average worker.[8] However, it is important to clarify that NIRS does not interpret these targets as the definitive goal for every household. Rather, measuring how households measure up *on average* against these targets—using a range of asset measures, from retirement account balances to total household net worth—provides a transparent and easy-to-understand illustration of the collective retirement savings gap.

The final target under the Fidelity retirement savings guidelines is 8 times income saved by age 67. Combined with Social Security, this replaces 85 percent of pre-retirement income—somewhat in the high range among estimates of retirement income need. Nonetheless, the target is conservative in three key ways:

- ***This target implies a significantly longer career than is currently the norm, and thus produces a relatively low estimate of retirement savings need***. In contrast, a study by HR firm Aon Hewitt found that a typical large company employee would need 11 times income saved in order to retire at age 65.[9]

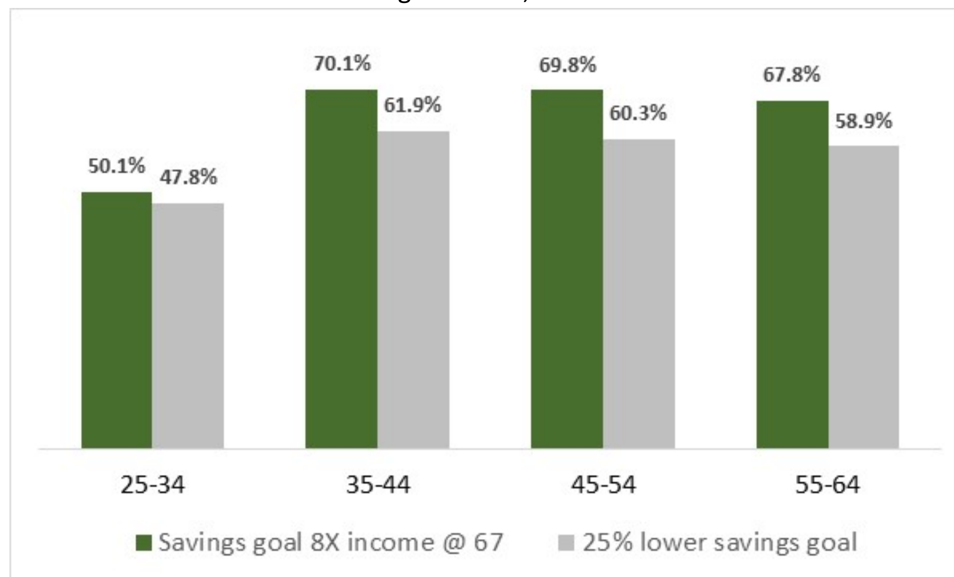
1612 K STREET, N.W. SUITE 500 • WASHINGTON, DC 20006
Tel: 202.457.8190 • Fax: 202.457.8191
www.nirsonline.org

- ***This target does not account for long-term care expenses***.
- ***This target does not fully protect against longevity risk.*** At age 65, one out of four people can expect to run out of money during retirement unless they save more.

2. **Most American households fall short, even with significantly reduced retirement savings targets and counting their entire net worth.**

- To begin, net worth is a generous measure of retirement wealth because not all household assets are available for use as retirement income.
- Our research found that among near-retirees, 67.8 percent of working households age 55-64 in 2010 had insufficient net worth to meet the Fidelity savings benchmark of 8x income by age 67.
- ***Even when the savings target is reduced a full 25 percent, to 6 times income by age 67, a large majority of near-retirement households – 58.9 percent – continue to fall short*** (**Figure 3**).

Figure 3
Large majority of households cannot even make a significantly reduced savings goal



Source: Author's analysis of SCF 2010 microdata. Universe is households with total earnings ≥ $5,000 and < $500,000 and total income < $1M.

1612 K STREET, N.W. SUITE 500 • WASHINGTON, DC 20006
Tel: 202.457.8190 • Fax: 202.457.8191
www.nirsonline.org

3. **Adjusting already-conservative savings benchmarks by income level is an interesting exercise, but most low-income households have so little wealth that almost any adequate retirement savings target is simply out of reach.**

- Low-income households ***need a greater share of their income replaced*** in order to maintain the same standard of living, because they are less likely to see taxes and other costs go down when they retire. This eats into the higher relative benefit they receive from Social Security.
- ***Among low-earning households (the bottom 25 percent), reducing the retirement savings goal by a full 25 percent has only a small effect.*** Based on net worth in 2010, the share of households that fall short of target retirement savings for their age ticks down from 70.1 percent to 65.5 percent. That's 4.6 percentage point decrease, translating to only a 6.5 percent reduction in the number of households that fall short.

4. Delaying saving for retirement is a very expensive proposition. It is simply unrealistic and misleading to say that younger households that are saving only a fraction of what they should can "catch up" in the last 15-20 years of their career.

- A 15 percent savings rate towards retirement is a high bar for most households. Accordingly, the Fidelity retirement savings benchmarks gradually move younger households to that level by incrementally ramping up the recommended savings rate from 6 percent of income at age 25 to 12 percent of income by age 31, with a 3 percent employer match. Thereafter, the worker continues to save 15 percent (including the match) for another 35 years. Accordingly, a smaller share of younger households fall short compared to older households in our study findings, and this is apparent in Figure 3.
- The downside underlying the power of compound interest is that ***putting off reaching the full retirement savings rate until even later will leave late career households facing unrealistically high savings rates*** if they want to have adequate retirement income.
  - Economist James Poterba calculates that to replace half of final earnings at age 65, a male would have to save 12.8 percent of earnings if he started at age 25—but if he waited until age 45, he would have to save 35.7 percent of earning for each of the next 20 years.[10]
  - The Center for Retirement Research at Boston College (CRR) found that households age 50-59 who were at risk of falling short in 2010 in CRR's National Retirement Risk Index would have to increase their savings rate by an extra 29-35 percentage points to catch up.[11]

So how do Schieber and Biggs arrive at an optimistic assessment of Americans' retirement readiness? One way is that they rely on a model of "optimal" retirement consumption in which older households accept a significant drop in retirement income as they age.[12] This is a questionable assumption at best, and—it's worth pointing out—one that is obscured in their writings.

So there you have it. Yes, the retirement crisis is real—and we're not improving. Let's move past denial and focus on creating responsible solutions so that Americans can have meaningful financial security after a lifetime of work.

---

[1] Board of Governors of the Federal Reserve System, 2014 (Jun. 5), "Z.1: Financial Accounts of the United States Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, First Quarter 2014," Table L.116.

[2] Board of Governors of the Federal Reserve System (Federal Reserve Board), 2014 (Sep.), Survey of Consumer Finances, "Bulletin Charts," Federal Reserve Board, Washington, DC.

[3] Author's analysis of SCF microdata.

[4] Author's analysis of SCF microdata.

[5] A.H. Munnell, M.S. Rutledge, and A. Webb, 2014, "Are Retirees Falling Short? Reconciling the Conflicting Evidence," PRC WP2014-05, Pension Research Council, The Wharton School, University of Pennsylvania, http://www.pensionresearchcouncil.org/publications/document.php?file=1206. C. Weller and D. Madland, 2014 (Aug.), "Keep Calm and Muddle Through: Ignoring the Retirement Crisis Leaves Middle-Class Americans with Little Economic Control in Their Golden Years," Center for American Progress, Washington, DC, http://cdn.americanprogress.org/wp-content/uploads/2014/08/RetirementCrisis.pdf.

[6] See for instance G. Pang and S. Schieber, 2014 (May 31), "Why American Workers' Retirement Income Security Prospects Look so Bleak: A Review of Recent Assessments," http://ssrn.com/abstract=2433193; and A.A. Biggs and S. Schieber, 2014, "Is There a Retirement Crisis?," *National Affairs* n20, http://www.nationalaffairs.com/publications/detail/is-there-a-retirement-crisis.

[7] N. Rhee, 2013 (Jun.), "The Retirement Savings Crisis: Is It Worse Than We Think?", National Institute on Retirement Security, Washington, DC.

[8] Fidelity, 2012 (Feb. 27), "How much do you need to retire?," https://www.fidelity.com/viewpoints/personal-finance/8X-retirementsavings. Financial firms like Fidelity put out such "rules of thumb" to help savers easily gauge if they are on track, probably in large part because most Americans spend little time on retirement planning. In fact, a recent Federal Reserve Bank survey reported that 7 out of 10 households had given no, little, or just some thought to this. Board of Governors of the Federal Reserve System (Federal Reserve Board), 2014 (Jul.), "Report on the Economic Well-Being of U.S. Households in 2013," Federal Reserve Board, Washington, DC.

[9] Aon Hewitt, 2012, "The Real Deal: 2012 - Retirement Income Adequacy at Large Companies," http://www.aon.com/attachments/human-capital-consulting/The_2012_Real_Deal_Highlights.pdf.

[10] Table 16 "Annual Saving Rate Required" in J. Poterba, 2013, "Retirement Security in an Aging Society," Working Paper 19930, National Bureau of Economic Research, http://www.nber.org/papers/w19930.

[11] A.H. Munnell, A. Webb, and W. Hou, 2014 (Jul.), "How Much Should People Save?," IB#14-11, Center for Retirement Research at Boston College, Chestnut Hill, MA, http://crr.bc.edu/briefs/how-much-should-people-save/.

[12] I.e., J.K. Scholz, A. Seshadri, and S. Khitatrakun, 2006, "Are Americans Saving 'Optimally' for Retirement?," *Journal of Political Economy*, v114n4, pp. 607–643. For a detailed explanation of why this study arrives at optimistic estimates of retirement readiness, see A.H. Munnell, M.S. Rutledge, and A. Webb, 2014, "Are Retirees Falling Short? Reconciling the Conflicting Evidence," PRC WP2014-05, Pension Research Council, The Wharton School, University of Pennsylvania, http://www.pensionresearchcouncil.org/publications/document.php?file=1206.