PLANNING FOR RETIREMENT:
A GENERATIONAL PERSPECTIVE

INTRODUCTION

For the last several years, Prudential has served as the exclusive sponsor of the National Retirement Risk Index (NRRI) published by the Center for Retirement Research at Boston College. The NRRI measures the percentage of working-age households at risk of being unable to maintain their pre-retirement standard of living during retirement. It is updated every three years based on the triennial release of the Survey of Consumer Finances from the Federal Reserve, and has been recently updated to reflect 2016 data.

RESEARCH FINDINGS

From 2013 to 2016, the percentage of working-age households at risk of being unable to maintain their standard of living in retirement dropped by two percentage points, to 50 percent from 52 percent. This improvement is due largely to strong stock market growth and rising home prices.

PRUDENTIAL'S PERSPECTIVE

Generational retirement challenges for working-age households

The latest NRRI data indicate that exactly half of Americans are projected to be unable to maintain their standard of living in retirement, a slight improvement from three years earlier. Unfortunately, this also reveals a dramatic worsening of retirement readiness over the past 30 years. In 1986, only 31 percent of working-age households were at risk of not being able to maintain their standard of living in retirement. [1] Today, many of these households that were working in 1986 are, in fact, enjoying a secure retirement.

This dramatic worsening of prospects for current working-age households raises two important questions. First, what has changed to put so many more households at risk? Second, will those changes continue and be even more harmful to our youngest households?

To the first point, there has been a major shift in the types of workplace retirement plans available to households over the past 30 years. In 1986, many working-age households could count on traditional, employer-funded defined benefit pension plans to provide them with retirement income. Indeed, recently published research finds that 65 percent of retired households were receiving defined benefit plan income in 2012. [2]

That won't be the case for many people now in their 20s, 30s, and 40s, especially if they work in the private sector. There, the most common type of retirement program is now a defined contribution plan, typically funded at least in part, and often largely, by workers themselves. Unlike previous generations drawing traditional pension benefits, many of tomorrow's retirees will not be able to rely on employer-funded plans to bear longevity or investment risk. Nor are they as likely to be able to count on employer-funded health care benefits in retirement, another perk that has become increasingly rare over the past three decades.

It's also worth noting that many older current retirees—those born in 1937 or earlier—were eligible to retire at age 65, the so-called "full retirement age," with 100 percent of their Social Security benefit. For individuals born since then, the Social Security Administration has been

gradually raising the full retirement age, though, with those born in 1960 or later now eligible to receive 100 percent of their Social Security benefit only when they reach the age of 67. Relative to previous generations, this will result in reduced Social Security benefits for individuals retiring at any given age, including age 65, the age used in the NRRI formula.

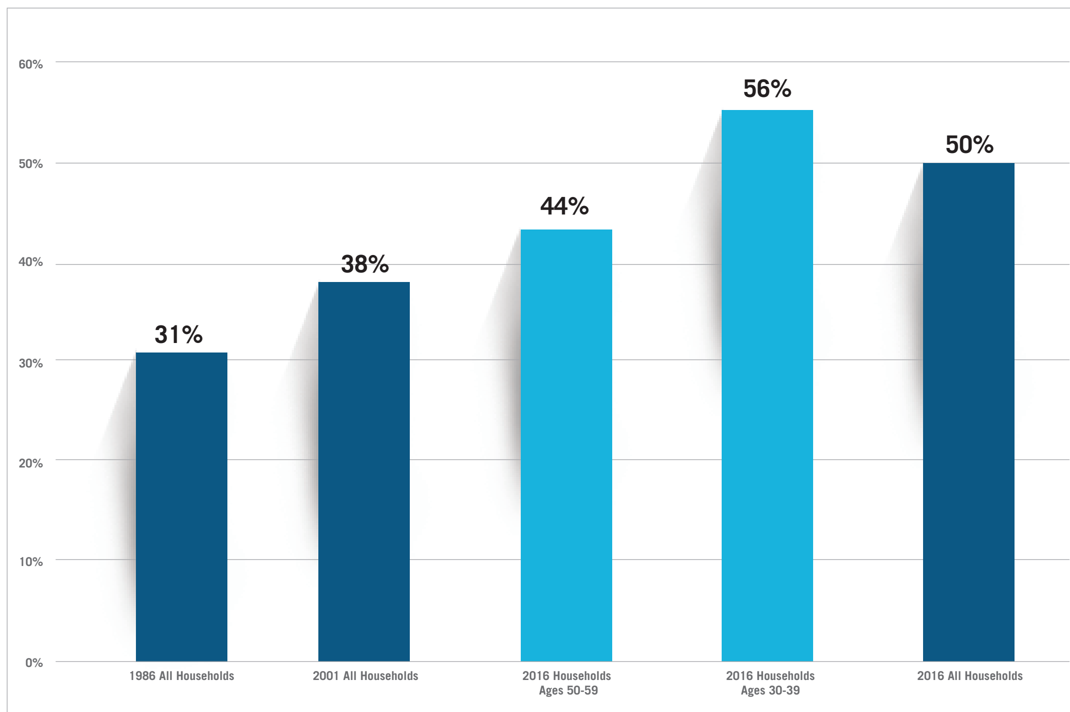
Further clouding the retirement outlook for younger generations are macroeconomic developments. During the working lives of many older Americans, wages, real estate values, and stock prices were all rising, for the most part, creating a positive environment to build housing wealth and personal savings. By contrast, wage growth has been trending down for nearly three decades now, and real estate values across much of the country remain skewed by losses sustained during the 2008 financial crisis.

The net result of all these factors is that today's working-age households cannot look to the experience of their retired parents and assume their own retirement will work out just as well financially. The rules of the game have changed in dramatic fashion.

As to whether these changes will likely continue and perhaps be even more harmful to today's youngest households, the unfortunate answer is "yes." They will have even less access to defined benefit plan income than previous generations, and their Social Security benefits will be even lower as a result of increases in the full retirement age. While only 44 percent of working-age households ages 50-59 are at risk in the latest NRRI, for example, 56 percent of those ages 30-39 are at risk. (See Figure 1)

For more households in their 30s to get on track, it will be critical that they save more for retirement. This won't be easy, as this generation carries much more student debt, on average, than earlier generations, pays more out-of-pocket for healthcare costs, and will have to cope with skyrocketing college tuition for their own children.

FIGURE 1



Source: The Center for Retirement Research at Boston College

The role of guaranteed lifetime income should be considered

While saving the proper amount for retirement is critical, households also need to ensure their savings last for as long as needed. Many current retirees need not worry about this; they are entitled to guaranteed lifetime income in the form of a defined benefit pension plan payment and Social Security benefits. Through these programs, longevity risk is pooled among many individuals and investment risk is borne by someone other than the individual retiree—by an employer, a government, or an insurer.

Current working-age households, by contrast, will need to generate more of their retirement income from personal savings, often a 401(k) plan. While the NRRI formula assumes individuals will annuitize their personal wealth upon retirement by purchasing an inflation-adjusted immediate annuity, historically only a small percentage of households have actually done that. Tomorrow's retirees may need to embrace annuities more fully. With a smaller stream of pension and Social Security money to fall back on should their savings run out, they may conclude that self-insuring against longevity and investment risk is simply too treacherous.

IMPLICATIONS

Individuals

Individuals can take several steps to help themselves along the path to retirement security:

- **Save at the appropriate rate.** Households should keep in mind that the primary function of a 401(k) plan will be to generate an adequate amount of retirement income. For help with this, they can make use of widely available retirement income calculators that can project future income based on a variety of contribution and investment return assumptions.
- **Consider insuring retirement income.** While fewer households tomorrow will have access to the guaranteed lifetime income benefits provided by a defined benefit pension plan, they can purchase an annuity, which can provide similar guarantees.

Employers

Employers can consider several measures that could help workers achieve retirement security:

- **Enhance defined contribution plans to help employees achieve more certain outcomes.** Where employers have not already done so, they should consider adding features such as automatic enrollment, automatic escalation of contributions, and in-plan guaranteed lifetime income products.
- **Encourage employees to track their savings progress in terms of an income goal,** rather than a savings goal, while targeting a realistic retirement age.

Policymakers

Recognizing that retirement security will be achieved in a much different way for working-age households compared to their parents, policymakers can:

- **Create safe harbors** that address any possible employer concerns regarding the addition of guaranteed lifetime income products to 401(k) plans and other types of defined contribution plans.
- Adopt regulations that **require defined contribution plans to project future monthly income** on participant statements.
- **Pass legislation that makes it feasible for more employers to offer a retirement savings plan** in the workplace.

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[1] The National Retirement Risk Index was launched in June 2006. In October 2012, the CRR published an NRRI calculation based on 1986 Survey of Consumer Finances data. Munnell, Alicia, Anthony Webb, and Francesca Golub-Sass, "The National Retirement Risk Index: An Update," p. 3, October 2012.

[2] Bee, Adam, and Joshua Mitchell, "Do Older Americans Have More Income Than We Think?," p. 22, July 2017.

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