PLANNING FOR RETIREMENT: THE IMPACT OF MARKET RECOVERIES ON RETIREMENT PREPAREDNESS

The National Retirement Risk Index (NRRI) is published by the Center for Retirement Research (CRR) at Boston College, and measures the percentage of working-age households at risk of being unable to maintain their pre-retirement standard of living during retirement. The last update to the NRRI, published in October 2012 and based on 2010 data, indicated that 53 percent of households are at risk. These results represented a spike of 9 percentage points over a three-year period, signaling an increasing retirement security problem in the U.S. A number of factors drove the increase, including a sharp decline in equity values, a decrease in housing wealth, a decline in interest rates, and an increase in Social Security’s Full Retirement Age.

In June of 2013, the CRR examined the impact of interest rate levels on the NRRI. In new research, the CRR takes a closer look at the impact of the rebound in the equity and housing markets.

Findings
The CRR reports that, since 2010, both equity and housing prices have increased. The increase in the prices of equities, which are held primarily by the wealthy, has been dramatic. The increase in the price of housing, which is much more widely held, has been modest. Equity prices have increased by 45 percent after adjusting for inflation, whereas national house prices have increased by 6 percent in real terms. Because equities are not widely held and because the increase in housing prices has been small, the impact on the NRRI is modest. If 2010 equity and home prices had been at 2013 levels, the NRRI would have been 50 percent instead of 53 percent (see Exhibit 1).

Percentage of Households ‘At Risk’ at Age 65 by Income Group

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<tbody>
<tr>
<td>All</td>
<td>45%</td>
<td>44%</td>
<td>53%</td>
<td>50%</td>
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<tr>
<td>Low Income</td>
<td>52%</td>
<td>54%</td>
<td>61%</td>
<td>60%</td>
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<tr>
<td>Middle Income</td>
<td>44%</td>
<td>43%</td>
<td>54%</td>
<td>52%</td>
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<tr>
<td>High Income</td>
<td>39%</td>
<td>35%</td>
<td>44%</td>
<td>40%</td>
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Note: Households are divided into thirds by income level, categorized as low, middle, and high. The income groups reflect the CRR’s classification based on the Federal Reserve’s “Survey of Consumer Finances” and vary by age group (e.g., for ages 48-50, lowest third is less than $45,500, middle third is $45,500-$98,500, and highest third is more than $98,500).

Source: Center for Retirement Research.
The somewhat larger improvement in the index among high-income households is due to the much higher percentage of overall wealth held in equities. Lower- and middle-income households hold only small portions of their total wealth in equities. (See Exhibit 2)

**Equities as a Percentage of Total Wealth for Households 30-59, by Income Group**

Exhibit 2

![Equities as a Percentage of Total Wealth for Households 30-59, by Income Group](image)

Note: Households are divided into thirds by income level, categorized as low, middle, and high. The income groups reflect the CRR’s classification based on the Federal Reserve’s “Survey of Consumer Finances” and vary by age group (e.g., for ages 48-50, lowest third is less than $45,500, middle third is $45,500-$98,500, and highest third is more than $98,500).

Source: Center for Retirement Research based on the 2010 Survey of Consumer Finances.

The CRR concludes that while fluctuations in the markets will have some impact on the NRRI, half of today’s working households remain at risk and will need to work longer and/or save more to improve their retirement prospects.

**Prudential’s Perspective**

The latest analysis by the CRR indicates that, despite a strong rebound in the stock market and a modest rebound in housing, Americans’ retirement prospects have not meaningfully improved. Recent research sponsored by Prudential found that employers share the concerns raised by the NRRI. Sixty-five percent of finance executives believe that a significant portion of employees will have to delay retirement due to inadequate savings. As seen in Exhibit 3, companies are worried about the impact of workers’ delayed retirements on workforce costs, employee morale, and talent retention.

**Senior executives are concerned that their company’s ability to accomplish the following objectives will be impacted by employee decisions to delay retirement.**

Exhibit 3

![Senior executives are concerned that their company’s ability to accomplish the following objectives will be impacted by employee decisions to delay retirement.](image)

Source: Prudential Financial and CFO Research.
There are three important ways to improve the retirement prospects of Americans:

• Savings: making sure individuals save enough for retirement

• Coverage: making sure individuals have access to a workplace retirement plan

• Retirement Income: making sure individuals can efficiently and prudently convert their retirement savings to retirement income

**Savings**
Defined contribution (DC) plans, such as 401(k)s, have a lot going for them. In 2009, workers in their 60s who had participated in their 401(k) plans for at least six years had increased their savings, on average, to $144,000, up from $100,000 in 2003. Still, there is need for improvement. A survey by Prudential of workers eligible to participate in a defined contribution plan found that only one in five felt “very” confident they would be able to save enough to retire when they want.

The passage of the Pension Protection Act has encouraged the use of automatic features in DC plans to improve savings behavior. These features have proven successful in the short time they have been utilized. DC plans that use Prudential as a recordkeeper have a 90 percent plan participation rate when an automatic enrollment feature is used, but only a 62 percent participation rate when it is not. Plans that have had automatic escalation of participant contributions for five or more years had average deferral rates that were 21 percent higher than plans without automatic escalation; over the three-year period between March 2010 and March 2013, these plans’ average account balances grew by 78 percent compared to 57 percent for plans that don’t offer the feature.

**Coverage**
The most effective way to get individuals to save is through the workplace. Yet today, approximately half of U.S. private sector workers do not have access to a workplace retirement plan of any kind. Key reasons include the costs and long-term liabilities employers associate with defined benefit (DB) plans, as well as the perception among small employers that DC plans are costly and complex. To improve plan coverage, Prudential developed a proposal to allow for Multiple Small Employer Plans (MSEPs). As generally envisioned, the plans would allow companies employing fewer than 100 people to participate in a single plan, thereby achieving economies of scale. Canada started offering a variation of MSEPs—called Pooled Registered Pension Plans—earlier this year. Prudential is working with policymakers in an effort to achieve the needed regulatory and legislative changes in the U.S. to allow for MSEPs.

**Retirement Income**
Among private sector workers who were in a retirement plan in 1979, 84 percent had a DB plan and 38 percent had a DC plan. By 2008, just 33 percent of U.S. workers participating in a workplace plan had a DB plan, while 93 percent had a DC plan. Although DC plans have many positive attributes, most lack the guaranteed income feature provided by DB plans. For that reason, many plan sponsors are considering adding guaranteed lifetime income features to their DC plans to help improve retirement outcomes. In a recent study, 45 percent of companies were at least somewhat likely to add guaranteed lifetime income products over the next two years, and 11 percent had already done so. Individuals who do not have access to such a feature in their DC plan or who prefer to work with their financial advisor can choose from a range of guaranteed income solutions that are available to individual investors.
Social Security continues to be the primary source of retirement income for most Americans, and underpins Americans’ financial security in retirement. Delaying Social Security benefits to Full Retirement Age and beyond can significantly increase Social Security benefits. Strategies available to married, divorced, and widowed individuals can further increase Social Security payouts. Working with a financial advisor to understand and optimize Social Security claiming options is an important and foundational component of retirement planning.

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Prudential is the exclusive sponsor of the National Retirement Risk Index.

5 Ibid, p. 4.

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