PLANNING FOR RETIREMENT:
IMPROVING RETIREMENT PREPAREDNESS FOR THE NEXT GENERATION

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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. A household is deemed to be at risk if their projected retirement income falls short of the appropriate target.[1] The latest NRRI research explores the role of inheritances in retirement preparedness.

The NRRI utilizes data from the Survey of Consumer Finances, which indicates which households received an inheritance and the amounts of those inheritances. To determine their role in retirement preparedness, the values of these inheritances were projected forward to age 65, and the annuity income provided by these amounts was subtracted from the NRRI calculation. This allowed for comparison of NRRI results both with and without the retirement income inheritances are projected to provide.

The research found that, in aggregate, inheritances do not have a significant impact on the NRRI, in part because most households do not receive one. However, at an individual household level, inheritances notably improve retirement preparedness. Further, even if households that receive inheritances are still at risk as measured by the NRRI, these households are in a much improved position.

Past NRRI research has shown that younger households are at greater risk of not achieving a secure retirement as compared to older households. By leaving an inheritance to younger generations, retirement preparedness can be significantly improved. Even a relatively modest amount of wealth left to the next generation can have a meaningful impact, and solutions are available in the marketplace to help accomplish this.

Findings

The NRRI indicates that 52% of Americans are at risk of being unable to maintain their pre-retirement standard of living in retirement. The NRRI calculates statistics for the average household across all income groups, as well as for three categories of household income groups – low income (under $43,000), middle income ($43,000 - $83,000) and high income (over $83,000).[2]

According to the CRR, the overall NRRI is only modestly impacted by inheritances for the following reasons:

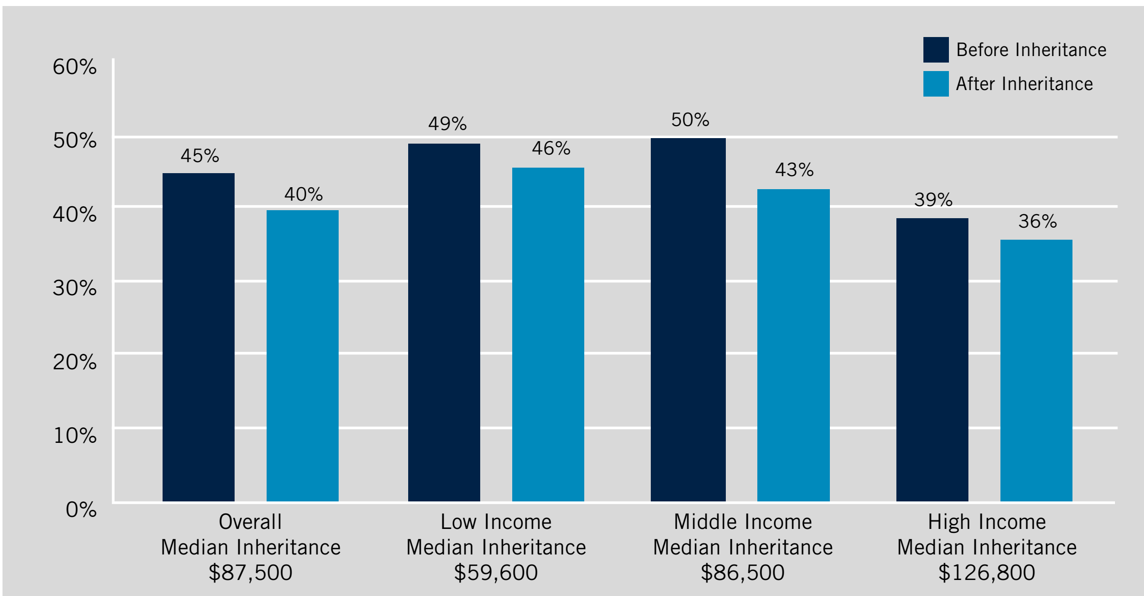
- Many inheritances go to households already prepared for retirement
- Most inheritances are relatively small
- Many households do not receive any inheritances at all

However, for those households that have received an inheritance, a notable improvement in retirement preparedness is apparent.

Among all households that received one, the median inheritance was $50,000; these inheritances grew in value to $87,500 by 2013,[3] and the percentage at risk improved from 45% to 40%. (See Figure 1.) Under the NRRI methodology, middle income households see the greatest improvement in retirement preparedness when inheritances are received. For these households, the median amount of inheritance is also $50,000 (which grew in value to $86,500 by 2013), and percentage at risk improves from 50% to 43% when inheritances are considered.

Figure 1
The graph below shows the improvement in the overall NRRI and for each income tercile when an inheritance was received.

Improvement in NRRI when inheritance received



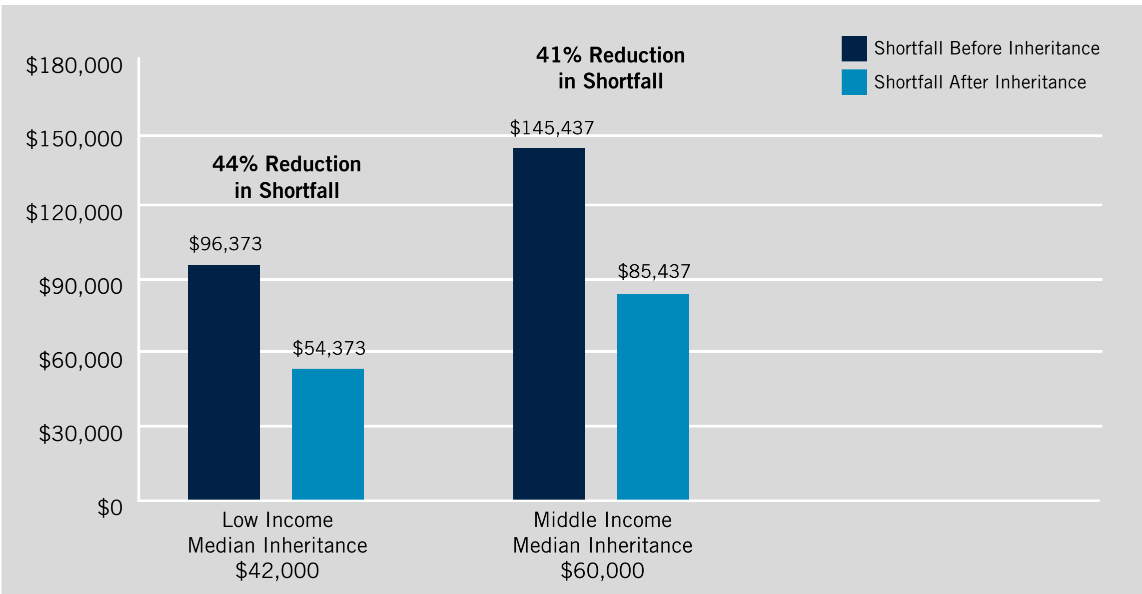
Note: Median inheritance amounts reflect values updated to 2013.

Prudential's Perspective

While not every household that receives an inheritance will cross the threshold from "at risk" to "not at risk," an inheritance can nonetheless dramatically improve retirement preparedness. For the median household in the low income tercile that received an inheritance and is still considered at risk, the average inheritance was $42,000, which reduced the shortfall (i.e., the assets needed to no longer be considered at risk) by 44%, from $96,373 to $54,373. For the median household in the middle income tercile, the shortfall was reduced by 41%. (See Figure 2.)

Figure 2

Impact of inheritances on retirement shortfalls



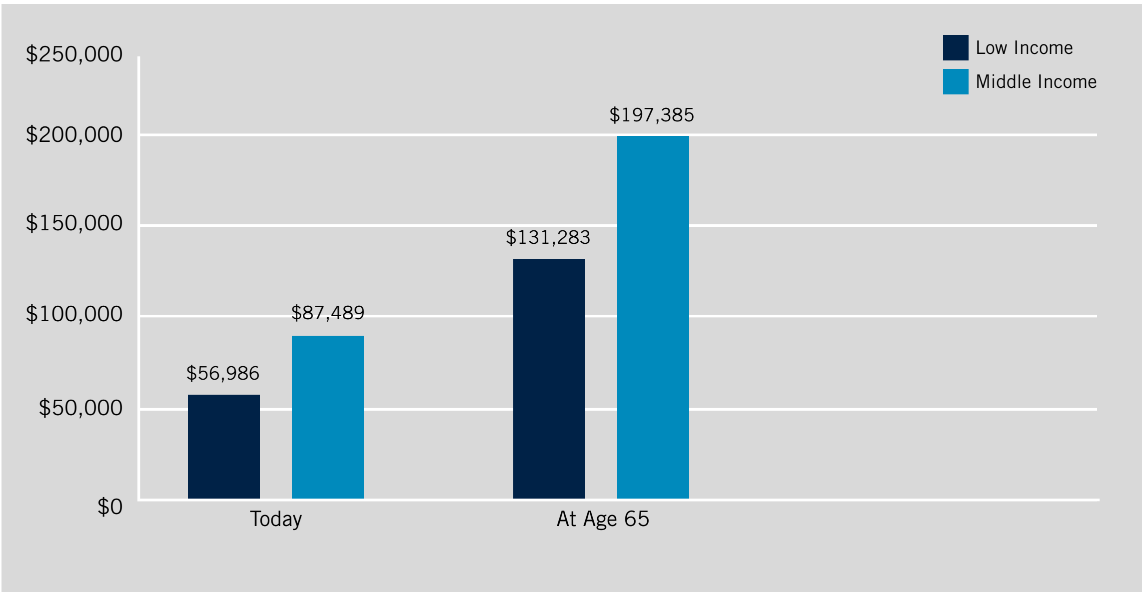
Note: Shortfall amounts are averages for households that received an inheritance but are still considered at risk.

An inheritance can be made in many different forms, including a house or financial assets. Life insurance proceeds can function similarly to an inheritance, if the death benefit is payable to a child who is the insured's beneficiary. The transfer of wealth through life insurance has the added benefit of generally being received federal income tax free {IRS Section 101(a).}

An inheritance or a life insurance death benefit can make a meaningful difference in closing the gap between being unprepared and being prepared for retirement. The median shortfall for lower income households at risk today is $56,986[4] and is projected to be $131,283 (in today's dollars) when the head of the household turns age 65. For middle income households, the median shortfall is $87,489 today[5] and is projected to be $197,385 (in today's dollars) when the head of the household turns age 65. (See Figure 3.) Closing all or even a portion of those gaps through the death benefit from life insurance may be an economically feasible option for many families.

Figure 3

Median gap for households currently at risk



Note: The median ages for the heads of household today in the low income and median income groups are 44 and 43, respectively. The amounts shown at age 65 are in today's dollars.

Conclusion

While the overall impact of inheritances on the National Retirement Risk Index may be minor, the impact for individual households who inherit assets is anything but. The death benefit from life insurance can be a tax-efficient way for parents to leave something to their children that may help to improve the retirement preparedness of the next generation – even a relatively modest life insurance benefit can have a meaningful impact.

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

[1] Target replacement rates vary by household type (e.g., married, single earner) and income group (e.g., middle income tercile). A household is not at risk if it is projected to provide at least 90% of a target replacement rate. For example, a household is not at risk if it is projected to replace at least 63% of pre-retirement income when the target replacement rate is 70%.

[2] These income thresholds are for households headed by 33- to 35-year-olds. The thresholds vary by age bracket.

[3] An inheritance received in the form of a house is valued in 2013 based on its current value, while an inheritance received as a financial asset is assumed to appreciate at an annual real rate of 4 percent from the time it was received until 2013.

[4] The median age of the head of household is 44.

[5] The median age of the head of household is 43.

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