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The Future of Retirement

Financial Education in Oklahoma Conference

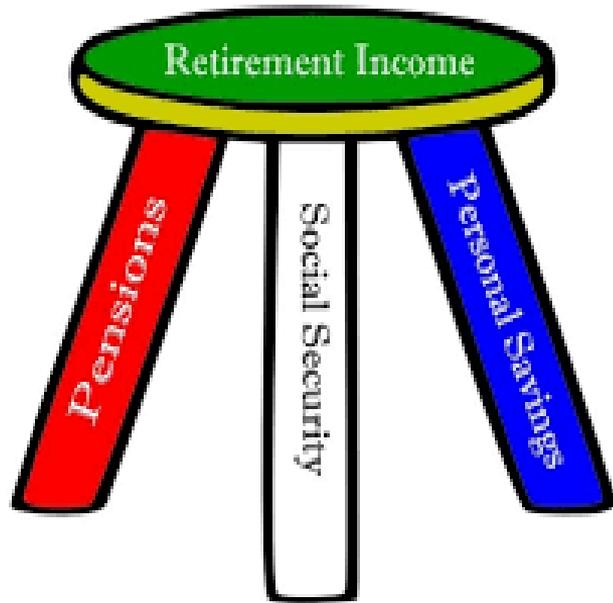
November 7th, 2018

Lowell Ricketts, Lead Analyst

**These are my own views, and not necessarily the views of the Federal Reserve Bank of St. Louis, Federal Reserve System, or the Board of Governors*



Overview



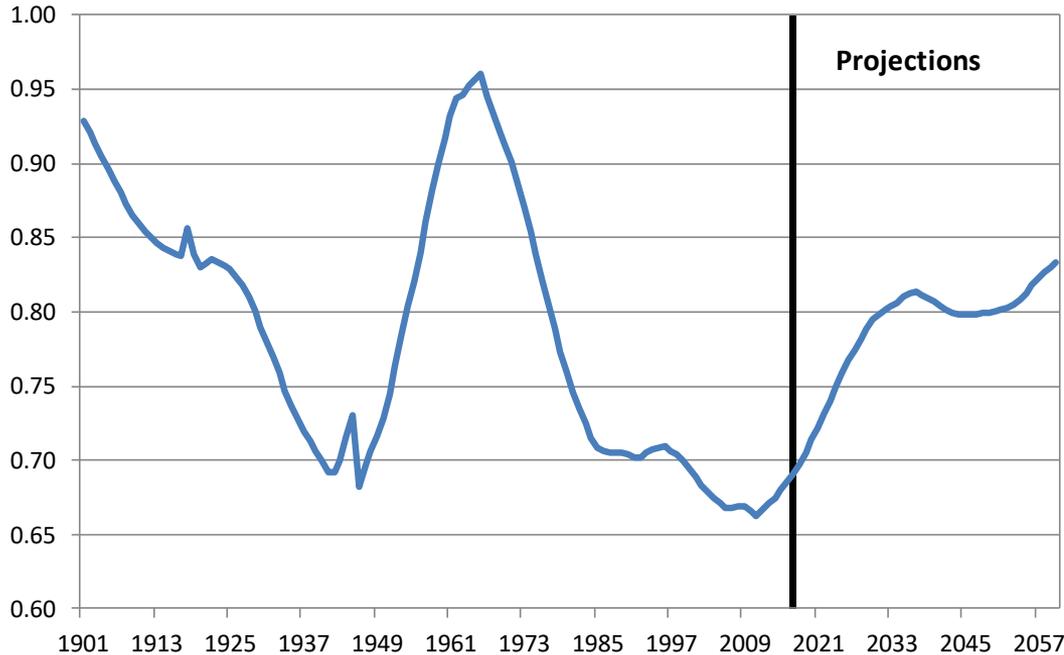
- I. Changing U.S. Demographics and Implications
- II. Preparedness of American Households for Retirement
- III. Potential Innovations and Reforms to Strengthen the Retirement System



Dependent Population Expected to Grow

Dependent-Age Population (<20 and 65+) per Prime-Age Person

Ratio



Source: Census Bureau/Haver Analytics, Projections as of December 2017.

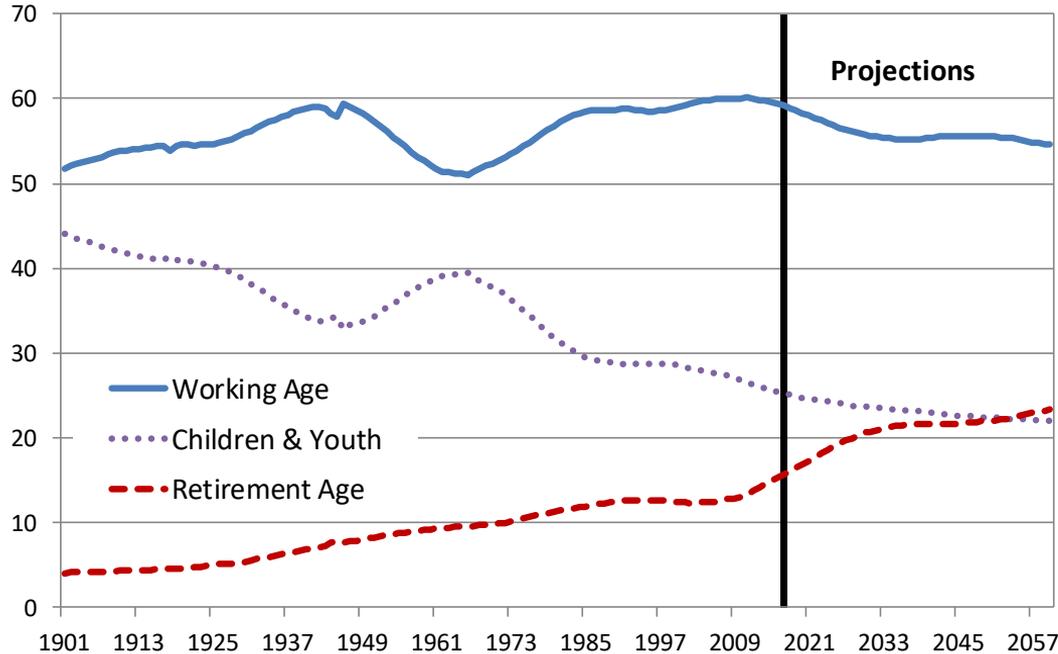
- Dependent individuals (younger than 20 and older than 65) are expected to rapidly rise as a share of the population in the next few decades.
- This will have important implications for the population and the economy.



Projected Surge in Retirees

Population Shares, Actual and Projected

Percent



Source: Census Bureau/Haver Analytics, Projections as of December 2017.

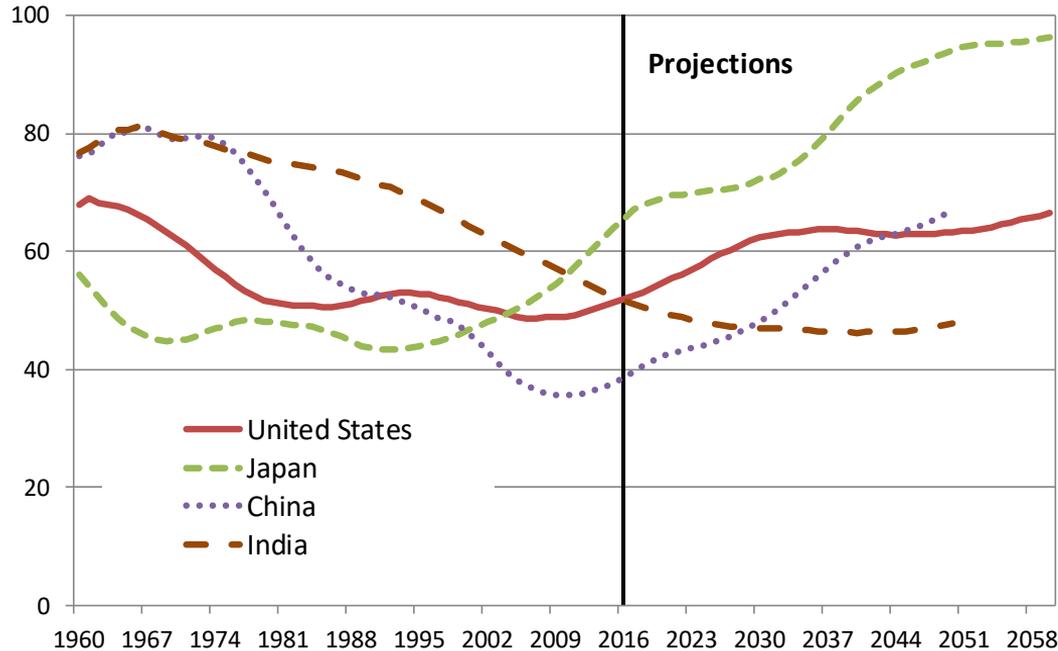
- The surge in the dependency ratio will be primarily driven by greater share of population reaching retirement age.
- Additionally, the U.S. fertility rate has been relatively steady.



Shifting U.S. Demographics Not as Volatile

International Dependency Ratios, Depend. Population/Prime-Age Population (15-64)

Percent

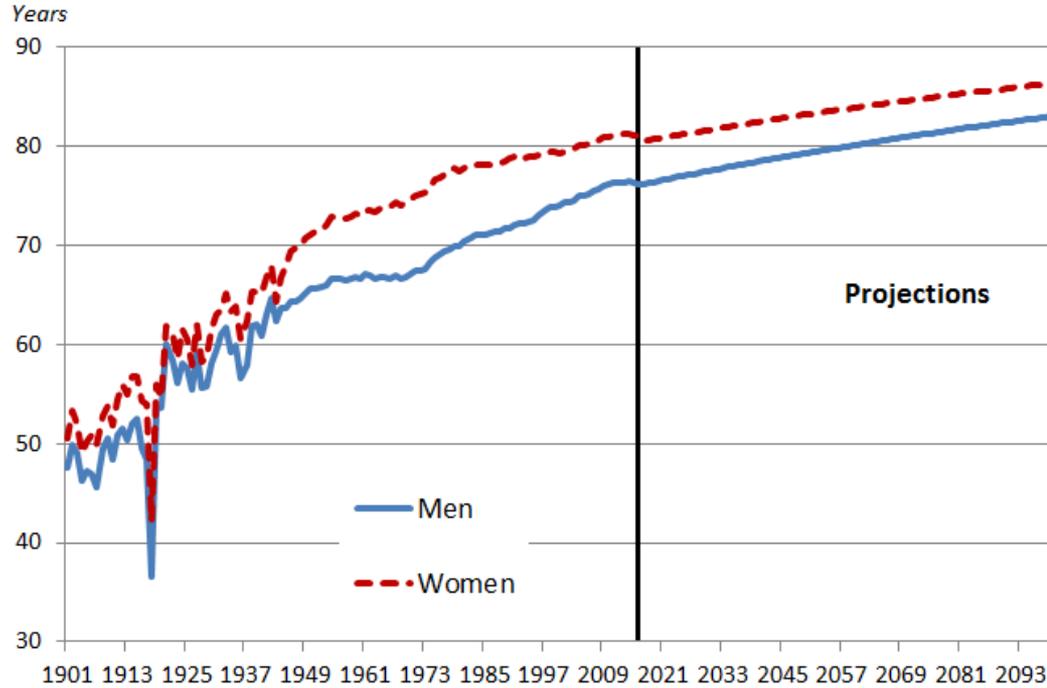


Source: Census Bureau (US), World Bank (China, India, Hist. Japan), IPSS (Forecasts for Japan, January 2012)

- Demographic trends in the U.S. are not as extreme as some other countries.
- For example, the Japanese dependency ratio already exceeds 65 percent and is expected to rise much further.

Longer Retirements Expected

Life Expectancy at Birth, by Gender



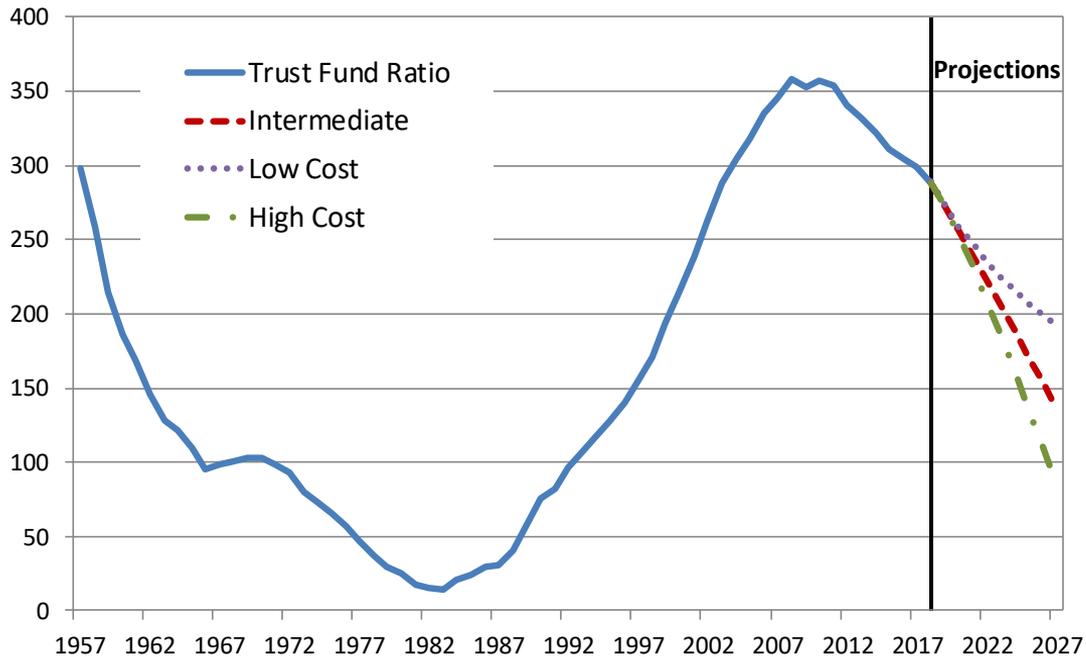
Source: National Center for Health Statistics, Projections from SSA, Bell and Miller (August 2005).

- The average life span increased dramatically during the 20th century.
- The life expectancy is expected to increase further, and the rate of that increase has surpassed earlier forecasts.

SS Outlays Growing Faster Than Income

Social Security Trust Fund Ratio (Assets as % of Cost of the Following Year)

Percent



Source: Social Security Administration/Haver Analytics, Projections as of June 2018.

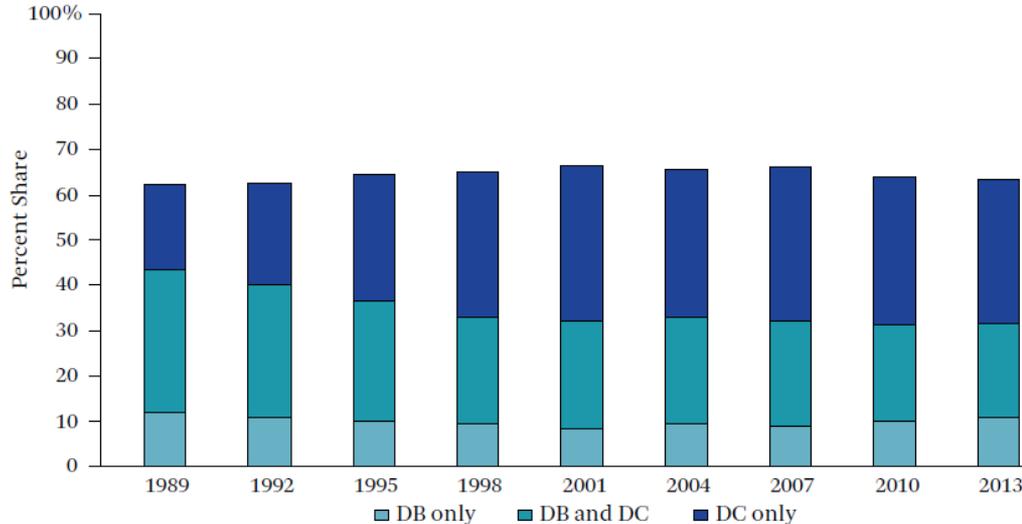
- Demographic and other factors are going to stress the social safety net in the form of social security and other programs.
- Supplemental poverty measures indicated that SSI kept over **17 million** seniors (65+) out of poverty in 2015.

How Prepared are Americans for Retirement?

- According to the SHED, less than 40 percent of non-retired adults think their retirement savings plan is on track.
- In contrast, 25 percent of non-retired individuals reported that they had no retirement savings or pension whatsoever.
- This and other indicators point to a significant share of Americans that may struggle to maintain their standard of living in retirement.

Transition from DB to DC, Coverage Gap

Figure 3. Aggregate Retirement Plan Participation, All Households



Source: Authors' calculations based on Federal Reserve Board 2014.

Note: DB coverage includes any traditional pension benefits through a current or past job. DC coverage includes IRA and DC pension coverage from a current or former employer in the PEU or observed holdings of such accounts.

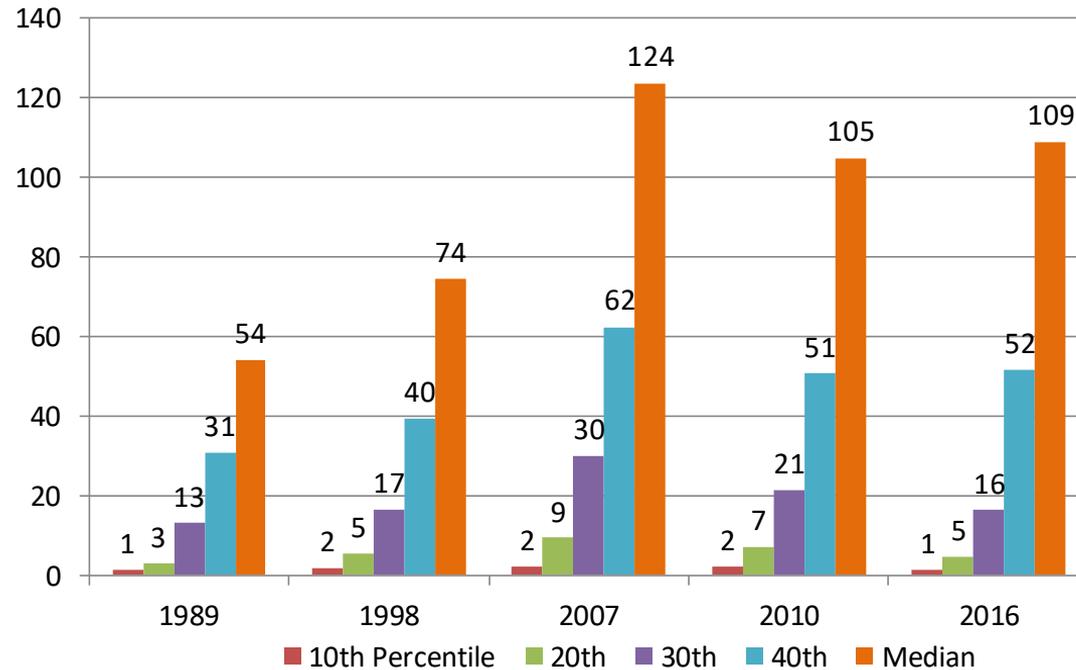
Source: Devlin-Foltz, Henriques, Sabelhaus (2017)

- DB retirement accounts, such as pensions, have been partially replaced by DC plans (e.g. IRA).
- Since 1998, the ownership rates have been largely stable.
- Note: close to 40 percent of households without either plan.

Insufficient DC Plans + Liquid Savings

Combined Retirement Accounts and Safe & Liquid Assets, Households 55-64

Thousands of 2016 \$ (Conditional on Ownership)



Source: Federal Reserve Board's Survey of Consumer Finances.

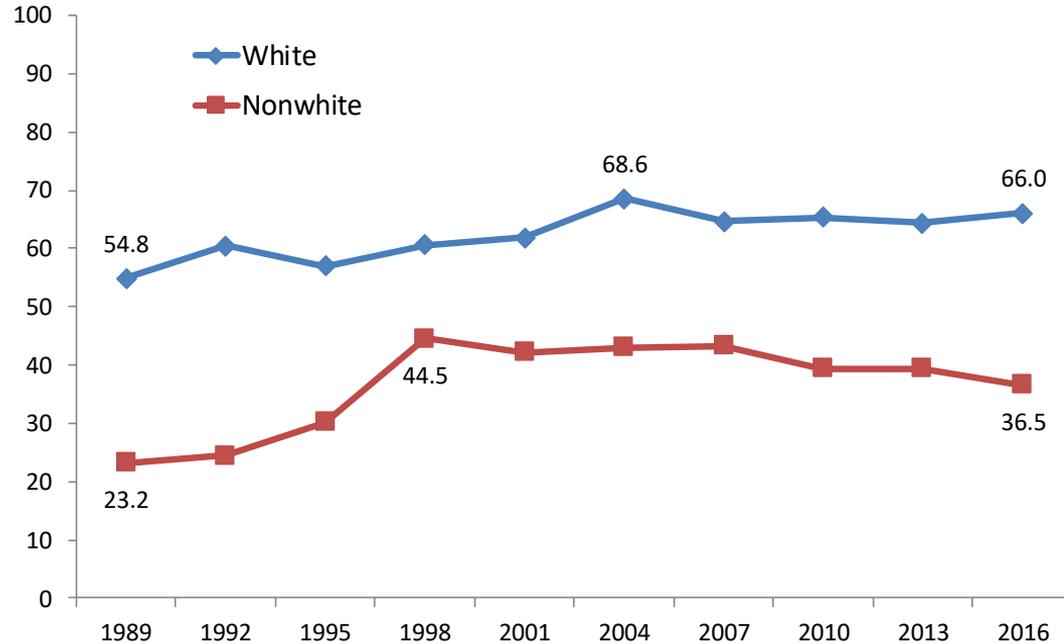
- Households approaching retirement have substantial funding shortcomings.
- Moving below the median, funding levels (which include liquid assets) shrink exponentially.



Coverage Gap, Whites vs. Non-Whites

Retirement Accounts, Households 55-64, Ownership Rate by Race/Ethnicity

Percent

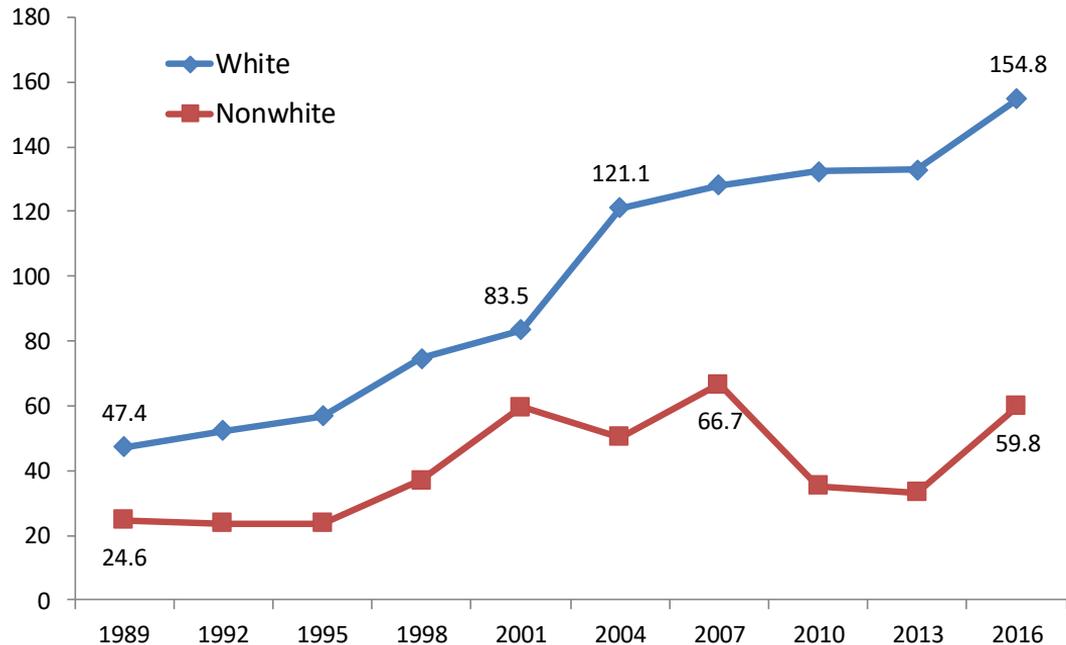


Source: Federal Reserve Board's Survey of Consumer Finances.

- Ownership of DC plans has always differed between white and nonwhite families.
- The gap was narrowest in 1998 and has since gradually expanded to 29.5 percentage points in 2016.

Funding Gaps, Whites vs. Non-Whites

Retirement Accounts, 55-64, Median Value by Race, Conditional on Ownership
Thousands of 2016 \$

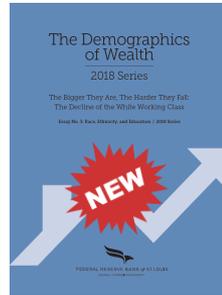
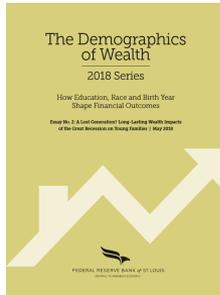
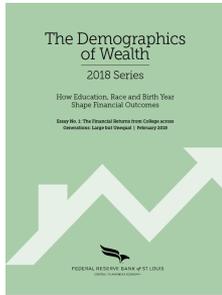


Source: Federal Reserve Board's Survey of Consumer Finances.

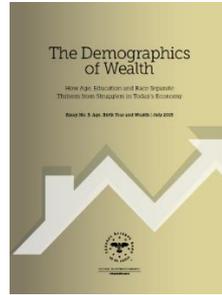
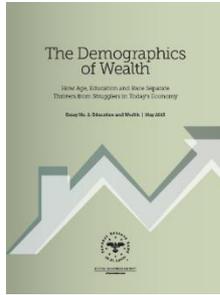
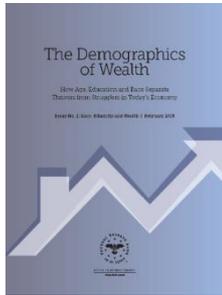
- Of those families that own DC plans, the typical white and nonwhite family differs dramatically in funding.
- As of 2016, the typical white family had 2.6 times the level of funding.

The Demographics of Wealth Series

2018 Series



2015 Series



- This essay series studies wealth and other key outcomes according to a person's or family's:
 - Race/ethnicity
 - Education (own and parents')
 - Age and birth year
- Your race, education and birth year are strong predictors of your income, wealth, and well-being.



The Demographics of Wealth Essay 2



The Lasting Impact of the Great Recession

- The Great Recession of 2007-09 inflicted deep and widespread losses to wealth across American families.
- While wealth losses occurred across the age spectrum, the extent of the damage has been unequal.
- Younger families suffered the most and have rebounded slowly.

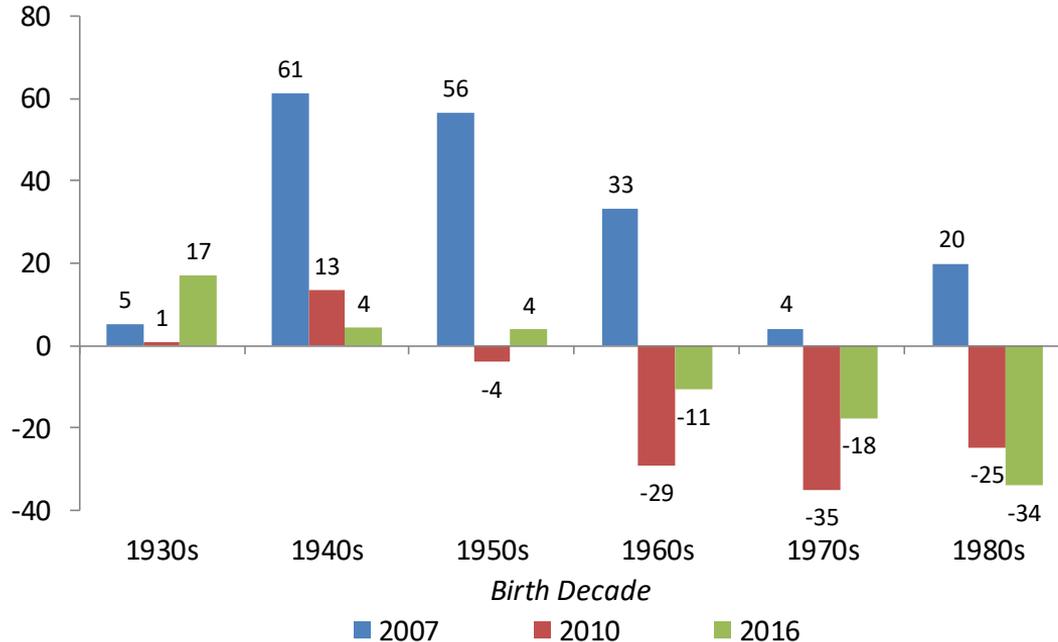
Can Families Recover What They Lost?

- For the families that lost the most wealth, how likely are they to recover in time for major goals?
 - First home purchase
 - Tuition for their children
 - **Retirement**
- Will young or middle-aged families at the advent of the recession become part of a “lost generation” that struggles to achieve life’s financial milestones?

Which Generations Have Recovered?

Median Wealth by Birth Decade: Difference from Expected Level

Percentage Points



Sources: Federal Reserve Board's Survey of Consumer Finances and authors' calculations.

- Cohorts born before 1960 were above benchmark levels in 2016.
- Cohorts born in 1960 or later were below predicted wealth levels.
- The 1980s cohort slipped noticeably further behind between 2010 and 2016.

Millennials and Retirement Savings

- 81% of Millennial workers are concerned that Social Security “will not be there” for them (Transamerica Center, 2014)
- 66% of Millennials expect their primary source of income to be self-funded (Transamerica Center, 2014)
- Employed Millennials offered a retirement plan at work were labeled “super savers” because they saved earlier and more than previous generations (Transamerica Center, 2014)
- Millennials perceive their financial prospects to be favorable even in the face of evidence to the contrary (Pew, 2014)

Long-Term Savings Require Short-Term Stability

- In 2017, **41 percent** of adults would have to borrow or sell something to cover an unexpected \$400 expense.
- This short-term financial insecurity precludes long-term savings.
- Thus, improving retirement preparedness must proceed hand-in-hand with other efforts to improve financial well-being.

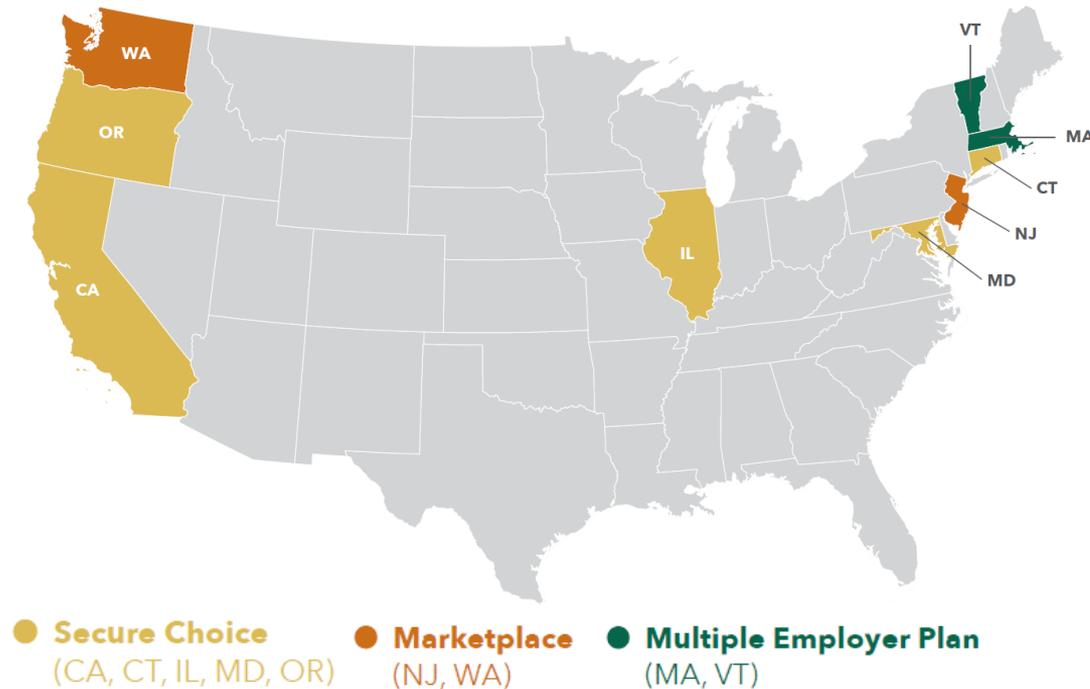
Potential Innovations and Reforms

- Strengthening the 401(K): Building on what works.
- Making plans more portable: Simplify rollovers.
- Create a sustainable future for the social security trusts.
- State-run IRA plans to close coverage gap.
- Sidecar accounts to address expense volatility, preserve retirement funds.

Create a Sustainable Future for Social Security

- Recent estimate is that combined trust funds will be depleted in 2034.
- Solutions consist of 2 options: raise revenue or cut benefits.
 - Raise tax rate paid by employer and employee.
 - Raise or remove earnings cap.
 - Change benefits formula; Raise retirement age; Change COLA.
 - Find new revenue streams.

State-Sponsored Retirement Plans



- Attempt to close the coverage gap with a plan that combines sound governance with portability.
- Secure Choice model: employers that can't or choose not to offer employer plan, their employees are auto-enrolled in state plans.

Source: Mitchell, David S., “[Building a More Robust and Inclusive U.S. Retirement System Amid a Changing Economy](#),” The Aspen Institute, September 27, 2017.

Sidecar Accounts

- Life's unexpected costs drive some DC owners to draw down retirement funds to meet short-term needs.
- The concept is as follows: Workers fund a short-term savings account reserved for emergencies.
- Once sufficient savings buffer is achieved, further contributions are automatically diverted to traditional retirement account.
- This concept is in the experimental stage and is an innovative area for further study.

Conclusion

- The U.S. is on the eve of large-scale demographic shifts, one of which is a large increase in new retirees.
- The safety net will be increasingly stressed as it provides support to these new retirees.
- Pensions and personal savings appear to be inadequate for large share of Americans.
- Innovations and reforms are necessary if the current system is to meet the needs of current and future generations.

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