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New Research from EBRI:

Retirement Readiness Rises in 2013, but Varies by Income and 401(k) Access

WASHINGTON—Overall retirement income adequacy for Baby Boomers and Generation X households improved last year, though factors like age, income, and especially access to an employment-based 401(k)-type retirement plan, can produce significant individual differences, according to a new report by the nonpartisan Employee Benefit Research Institute (EBRI).

Using its proprietary Retirement Security Projection Model® (RSPM), EBRI finds that last year's gains in the financial markets and housing values mean that fewer of these households are likely to run short of money in retirement.

EBRI's unique simulation model, unlike many other models, takes into account a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of age and income) as well as health insurance and out-of-pocket, health-related expenses, plus stochastic expenses from nursing-home and home-health care (at least until the point such expenses are covered by Medicaid). It found that the overall gains from a year ago are modest when aggregated by age cohort (between 0.5–1.6 percentage points); however, the EBRI Retirement Readiness Ratings™ (RRR) can vary widely, based on various individual factors.

EBRI's analysis, which analyzes the major factors that cause retirement outcomes to differ, and their impact, found:

- **Eligibility for participation in an employer-sponsored 401(k)-type plan remains one of the most important factors for retirement income adequacy**. Gen Xers in the lowest-income quartile with 20 or more years of future eligibility in a defined contribution plan are half as likely to run short of money as those with no years of future eligibility, while those in the middle-income quartiles experience increases in RRR values by 27.1–30.3 percentage points.
- **The risks of a long life and high health-care costs drive huge variations in retirement income adequacy.** For both of these factors, a comparison between the most "risky" quartile with the least risky quartile shows a spread of approximately 30 percentage points for the lowest income range, approximately 25 to 40 percentage points for the highest income range, and even larger spreads for those in the middle income ranges.
- **Annuities and long-term care insurance could mitigate much of the variability in retirement income adequacy at or near retirement age.** For example, the annuitization of a portion of the defined contribution and individual retirement account (IRA) balances may substantially increase the probability of not running short of money in retirement,. Moreover, a well-functioning market in long-term care insurance would appear to provide an extremely useful technique to help

control the volatility from the stochastic, long-term care risk, especially for those in the middle-income quartiles.

- **Future Social Security benefits make a huge difference for the retirement income adequacy of some households, especially Gen Xers in the lowest-income quartile**. If Social Security benefits are subject to proportionate decreases beginning in 2033 (when the Social Security Trust Fund is projected to run short of money), the RRR values for those households will drop by more than 50 percent: from 20.9 percent to 10.3 percent.

"It would appear that while retirement income adequacy depends to a large degree on the household's relative wage level and future years of eligibility in a defined contribution plan, a great deal of the variability in these values could be mitigated by appropriate risk-management techniques at or near retirement age," explains Jack VanDerhei, EBRI research director and author of the report.

The full report, "What Causes EBRI Retirement Readiness Ratings™ to Vary: Results from the 2014 Retirement Security Projection Model,®" is published in the February *EBRI Issue Brief,* online at www.ebri.org

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