EBRI FAST Facts
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Assessing COVID-19's Impact on the Retirement Income Adequacy of American Workers

The current pandemic represents uncharted territory in many ways. One of them is the impact on the retirement income adequacy of American workers. We know market losses, layoffs, and suspension of defined contribution (DC) company matches are happening, and they will affect American workers' retirement income adequacy. However, it is difficult to gauge their extent and how workers might react in terms of their own reductions in DC plan contributions, hardship withdrawals, or plan loans. Nonetheless, it is tremendously important to understand the range of possible outcomes so that policymakers, plan sponsors, and providers can help workers best navigate this treacherous landscape.

Market Losses

Using its Retirement Security Projection Model® (RSPM), the Employee Benefit Research Institute (EBRI) started by examining three possible market scenarios in a recent *Issue Brief*:[1]

- **Optimistic**: Market losses for the year are restricted to *half* of first quarter 2020 losses.
- **Intermediate**: Market losses for the year are equivalent to first quarter 2020 losses.
- **Pessimistic**: Market losses are equivalent to those experienced in the 2007–2009 financial crisis.

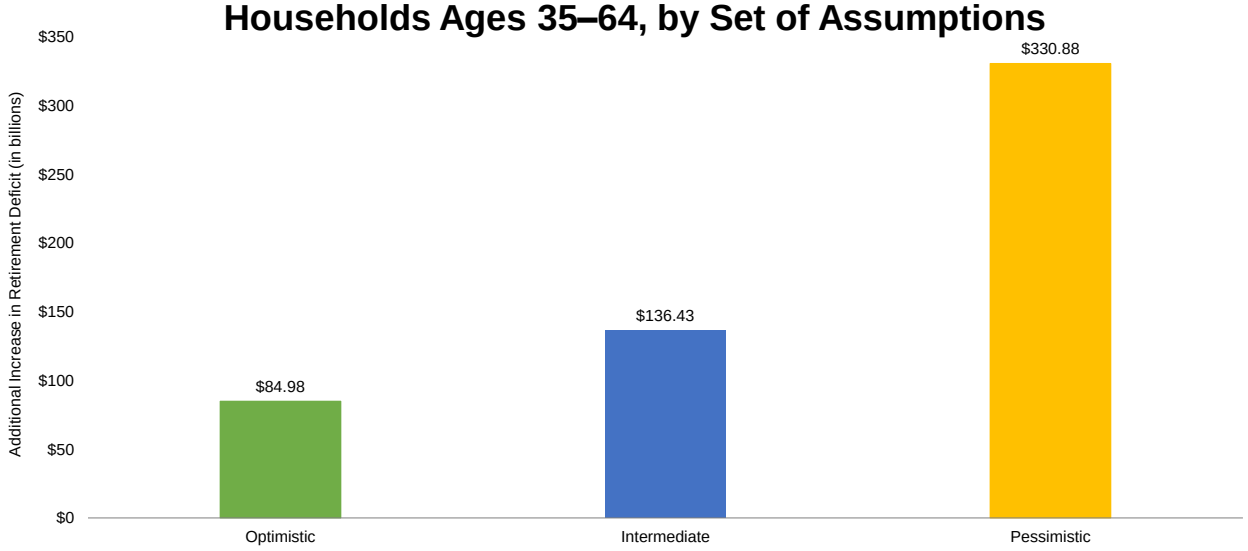
As of January 1, 2020 the aggregate value of retirement savings deficits for all U.S. households from the ages of 35–64 was simulated to be $3.68 trillion.[2] Figure 1 shows how much this deficit is projected to increase under the Optimistic, Intermediate, and Pessimistic scenarios due to the current pandemic.

In the case of the Intermediate scenario, we find that the retirement deficits would increase 3.7 percent, or an additional $136.43 billion. In the case of the Optimistic scenario, we find that the retirement deficits would increase 2.3 percent, or an additional $84.98 billion. In the case of the Pessimistic scenario, we find that the retirement deficits would increase 9.0 percent, or an additional $330.88 billion. In other words, the percentage increase in retirement deficits due to market volatility from the pandemic *alone* is not projected to run into the double digits even in the Pessimistic scenario.

[1] Jack VanDerhei, "Impact of the COVID-19 Pandemic on Retirement Income Adequacy: Evidence From EBRI's Retirement Security Projection Model®," *EBRI Issue Brief*, no. 505 (Employee Benefit Research Institute, April 21, 2020).
[2] Retirement savings deficits are the present value of retirement deficits for those households simulated to run short of money in retirement.

Figure 1

Increase in Aggregate Retirement Deficits From 1/1/20 Baseline of $3.68 Trillion (in billions) Due to Market Volatility, All U.S. Households Ages 35–64, by Set of Assumptions



Source: EBRI Retirement Security Projection Model® Version 3623.

Impact of Behavioral Changes

But how much more impact will behavioral changes resulting from the crisis — reductions by employers of company matching contributions to DC plans, lower deferrals by plan participants, plan terminations, and withdrawals — have on deficits? Building on the Intermediate market scenario, and assuming commensurate economic impact including job losses, Figure 2 shows potential additional increases in retirement deficits due to behavioral changes by plan sponsors and participants resulting from the economic fallout of COVID-19.

The model shows that:

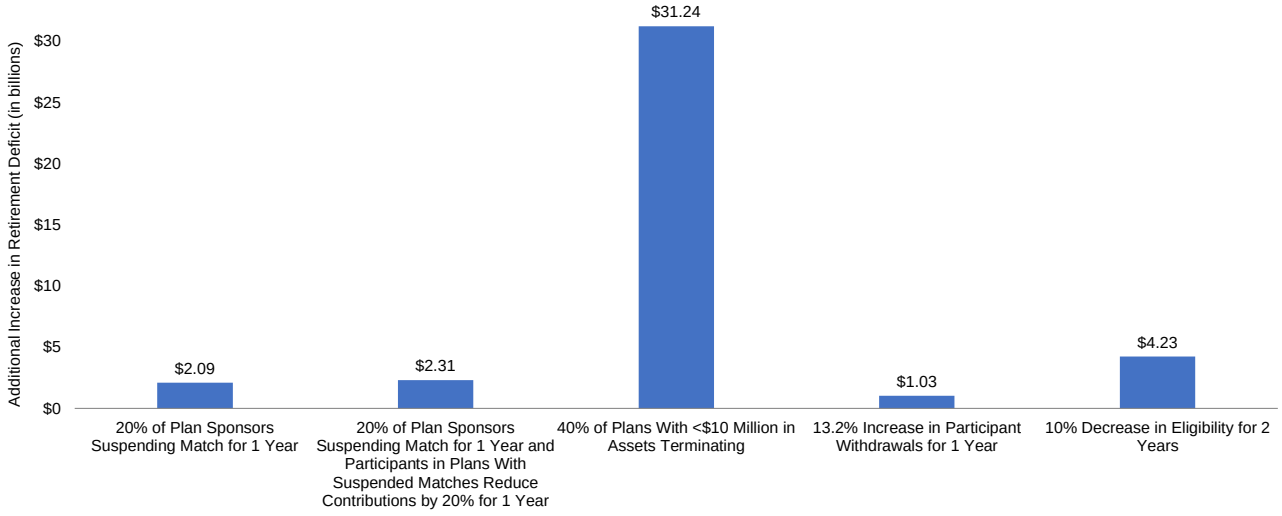
- If 20 percent of 401(k) plan sponsors were to suspend their DC matching contribution for a single year, aggregate retirement deficits would increase by $2.09 billion.[3]
- If employees facing suspended matching contributions were to also reduce *their* contributions by 20 percent for a one-year period, aggregate retirement deficits would increase by $2.31 billion (or an increase of $0.22 billion over the $2.09 billion increase from the impact of the suspension of employer matches alone).
- If there were to be a one-time increase in the individual DC withdrawal probabilities of 13.2 percent, aggregate retirement deficits would increase by $1.03 billion.[4]
- If unemployment caused a decrease in the eligibility rates for defined contribution plans of 10 percent for the next two years, aggregate retirement deficits would increase by $4.23 billion.

Clearly, none of the behavioral changes above pose nearly as much threat to retirement income adequacy as projected market losses related to COVID-19 in the Intermediate scenario. However, one behavioral change that would have a more material impact on retirement income adequacy is plan terminations: The analysis finds that if 40 percent of plans with assets of less than $10 million were to be terminated, aggregate retirement deficits would increase by $31.24 billion.[5]

[3] Assumption based on a 2011 Towers Watson study that found that since late 2008, 13 percent of respondents have suspended their match, and 5 percent have reduced their match.
[4] Assumption based on analysis from an Investment Company Institute time series (Holden and Schrass 2019). NB: This is NOT saying that withdrawal probabilities increase by that percentage.
[5] Assumption based on a 2020 American Retirement Association survey (Adams 2020).

Figure 2

Increase in Retirement Deficits Above the $136 Billion Experienced From 1st Quarter 2020 Market Volatility: *Intermediate* Case Set of Assumptions (in billions)



Source: EBRI Retirement Security Projection Model® Version 3623.

While market volatility is clearly the largest factor driving decreases in retirement income adequacy, that is not to say behavioral changes may not have a very significant influence on those impacted by these factors. Employers and policymakers cannot control market fluctuations, but they can be aware of the impact of plan sponsor and participant behavior on retirement income adequacy and develop approaches that can help mitigate damaging behavior today and position plans for robust utilization when the crisis ends.

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References

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Holden, Sarah, and Daniel Schrass. 2019. "Defined Contribution Plan Participants' Activities, 2018." ICI Research Report (May). Available at www.ici.org/pdf/ppr_18_rec_survey.pdf

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