NEWS REVIEW

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Why Gen X And Late Boomers Aren't On Track For Retirement

According to a recent study, Gen X and late baby boomers are on track to replace only about half of their current income when they reach retirement — which means they'll need to seriously downgrade their lifestyles. Most financial planners recommend replacing, at the very least, 70% of one's income.

In contrast, Depression babies, War babies and early boomers were on track to replace, respectively, 86%, 99% and 82% of their pre-retirement income.

Why are more recent generations finding it harder to save enough for retirement?
I talked with two economics professors who cite two types of factors — the breakdown in the employer-provided retirement benefits and a wider web of increased debt and lack of financial literacy. Unfortunately, neither explanation offers a quick-fix solution, though they do hint at ways you can help improve your retirement picture.

The Shift Away From Pensions To 401(k)s

Teresa Ghilarducci, a labor economist at the New School and a nationally recognized expert in retirement security, says there's only one explanation for why Gen X and late baby boomers will be less ready for retirement than their parents were.

"The reason for the lack of preparedness is because of the collapse of one layer of the retirement cake, which is the employer-provided layer," she said by phone.

In the last three decades, the number of unions fell, older workers faced higher unemployment and competition began to heat up with countries like China, making it harder for older workers to negotiate for stronger retirement benefits.

Additionally, as 401(k)s were being introduced in the 1980s, people thought they preferred to have control over their retirement accounts and their investments, said Ghilarducci. But it turns out that if they actually have a choice between a pension and a 401(k), they prefer the pension.

A pension is a type of "defined-benefit" account giving an employee a lifetime payout based on a formula taking into account factors such as how long he or she has been with a company and not necessarily based on how well the investments do. A "defined-contribution" plan, such as a 401(k), on the other hand, offers no guarantee on how much money will eventually be paid out.

"When people have a choice — and they have a choice in the public sector — they actually choose, when they're asked, for a defined-benefit plan. So, it's clearly employers who prefer the 401(k), and that's because they're cheaper," Ghilarducci said. (Companies that offer pensions have to dip into their own earnings if the pension's investments fall short, since the employee will still receive the promised payout.)

Why Defined-Benefit Plans Are Better For Workers

According to Ghilarducci, there are four reasons that, for workers, defined-benefit plans such as pensions are superior to 401(k)s and similar accounts:

1. A defined-benefit plan requires the employee to enroll, unlike defined-contribution plans, which are often voluntary.

2. With such a plan, neither the employee nor his or her relatives can get access to their retirement savings. (This is a big drain on assets in defined-contribution plans such as 401(k) accounts.)

3. Defined-benefit plans offer a higher rate of return. "Professionals invest the defined-benefit plan," Ghilarducci said, "not the individuals choosing various mutual funds. And defined-benefit plans always outperform defined-contribution plans." In fact, last week, a study by Towers Watson showed that, in 2011, investment returns in pension plans outperformed those of defined-contribution plans by the largest margin since the 1990s. Out of 2,000 plan sponsors analyzed, defined-benefit plans had median investment returns of 2.74%, while defined-contribution plans had median returns of −0.22%.

4. Finally, a defined-benefit plan pays out an annuity for the rest of the employee's life, so the employee doesn't bear the risk of outliving his or her money — a frightening possibility for holders of 401(k)s and similar accounts.

Ghilarducci discounts some other factors that are frequently cited: "There's a lot of noise that you'll hear — that it's lack of financial literacy, that it's student debt," she said. "None of those matter. Having an $8,000 or a $20,000 to $30,000 debt does not affect accumulating the more than $600,000 that most people need for retirement. Those are fly-speck reasons. There are lots more reasons to think that people are more financial literate now than they were 30 years ago. So no other reason holds a candle to the collapse of the employer-employee retirement system."

Financial Literacy, The Cost Of Education And Other Factors

Annamaria Lusardi, professor of economics at the George Washington University School of Business, agrees with Ghilarducci somewhat but also says that lack of financial literacy and a broader web of money challenges are hindering people's ability to save.

She agrees with Ghilarducci that the shift away from pensions toward 401(k)s has given people more responsibility — such as deciding how much to save in total, how much to contribute every month or year, and how to allocate that money once retired — but that financial literacy has not accordingly increased, so people are not equipped to make good decisions. "People always had a low level of financial literacy," she said by phone, "but in the past it didn't matter because they didn't have to make those decisions."

On top of that, Lusardi said that two new factors are exacerbating this lack of financial literacy: the cost of education and the access to credit. "People enter the labor market now, with respect to previous generations, always with a higher amount of debt…. And by the way, it's not just their own education but the education of their children," she said. She also noted how easy it is to borrow now in a multitude of ways, from our credit cards to home equity lines of credit. So, while the cost of education has drastically increased and acquiring debt has become easier, people have made saving for retirement a lower priority against taking on and paying down debt, both for their own and their children's education.

The fact that people are borrowing in riskier, more costly ways shows that their whole financial picture is shaky. For instance, a recent study by the Federal Reserve Board estimated that 45 cents of every dollar contributed to retirement accounts "leaks out," or is withdrawn early — meaning it is taken out before 59-and-a-half, and taxed and levied with penalties. Lusardi also recently published a paper with the National Bureau of Economic Research showing that in 2009, 24% of Americans had used a high-cost method of borrowing within the previous five years. These included using a pawnshop and taking out a payday loan. She says these facts indicate that the solution can't only focus on retirement but on the whole financial picture.

So, What Can Be Done?

Lusardi doesn't necessarily believe the return to a pension system will work: "Defined contributions are here to stay, because they are defined by the different demographics and labor markets we have today — people change jobs, and [their retirement accounts] need to be portable. We need to have financial education in the schools, so people are prepared for the new economic environment they will face," she said.

She also noted that many retirement experts advocate for automatic enrollment into retirement plans such as 401(k)s, but said, "because people borrow against their accounts, I think automatic enrollment is not enough."

She advocates for financial education at school and in the workplace and policies that make it easier for people to save and harder for them to borrow. "I think it's important to take a holistic approach. When we talk about retirement savings, we think too narrowly. In fact, all of the financial decisions are interrelated, and we need to find ways people can get help and advice on how to deal well with their financial wellbeing."

Ghilarducci, on the other hand, advocates for a new type of retirement plan that is better for employees than their current 401(k)s. These are the features she believes it needs:

- Universal coverage, so everyone would be saving for retirement
- Pooled assets, to reduce individual risk
- Payouts only at retirement, so people would not deplete or borrow against their accounts before retirement
- A steady lifetime income stream (a.k.a an annuity), so people don't outlive their savings
- Portable benefits, so people can take the savings with them from job to job
- Low-cost and transparent administration, to address the problem that some retirement plans charge fees that keep retirement savings from growing

While the retirement system isn't about to be transformed tomorrow, you can take concrete steps to bolster your nest egg, as certified financial planner Lauren Lyons Cole recommends, from securing a raise to refining your priorities so you're only spending on what truly matters to you.

But most importantly: shift your mindset. When considering money matters, always make retirement one of your top priorities. Save with every single paycheck, whether you're 22 or 62. Don't assume you'll be able to work past retirement age to make up for any shortfall in your savings, as many older workers are laid off. And remember that your expenses in retirement may increase, due to health costs. For all these reasons, with every big money decision you make, ask yourself how you can help take care of the 70- 80- or 90-year-old you.

Laura Shin, Forbes 5/23/2013

Women More Likely to Have High Financial Stress

High Stress Can Cost Employers in Lost Productivity

Women are almost twice as likely as men to report high or overwhelming levels of financial stress, according to research from Financial Finesse.
Furthermore, mothers between 30 and 44 and with incomes under $60,000 were nine times more likely to face high levels of stress than men between 55 and 64 without minor children and who had an income above $100,000.

Financial Finesse found that having young children appears to lead to higher stress over all. Almost twice the percentage of workers with children under 18 reported overwhelming stress as those without children.

While certain demographics report high levels of stress, overall stress has been trending down, falling significantly from 32% in 2010 to 18% in 2012. For the first quarter of 2013, 16% of employees reported stress levels that were high or overwhelming. Seventeen percent said they had no financial stress at all.

More vulnerable employees can end up costing their employers due to health issues commonly associated with high levels of stress: anxiety, depression and even heart attacks, according to an AOL/Associated Press poll. Financial Finesse referred to data from a 2010 Federal Reserve study that found the average cost of lost productivity is $5,000 per year.

Liz Davidson, founder and CEO of Financial Finesse, noted in a statement that the actual cost of lost productivity depends on the individual employer's work force demographics. To determine how much they may be losing, employers need to examine their demographics and identify the warning signs of stressed-out employees, such as a high percentage of hardship withdrawals or 401(k) loans.

"Employers who have high levels of employee financial stress are best served by financial wellness programs that focus on basic money management issues, since the source of stress is predominantly short-term, day-to-day concerns," Greg Ward, director of the firm's Think Tank, said in a statement. "However, employers with low levels of employee financial stress usually need proactive financial planning since their employees are concerned about how to invest effectively in an uncertain economy to grow their wealth over the long term."

Financial Finesse scored respondents across all stress levels in several categories, including money management, retirement planning, and investing. A score between 3 and 5 indicates employees who may be "sabotaging" their financial situations and need more basic information, while a score lower than 3 indicates employees who are facing serious financial consequences.

Unsurprisingly, the least stressed workers rated very highly in money management: 8.6 for unstressed workers and 7.3 for those with some stress, indicating they have good financial skills and habits, but may need to do more to protect themselves from unexpected challenges in the future. Those who are highly stressed scored 4.2, while overwhelmingly stressed workers had a score of just 2.5.

Workers with higher stress levels scored better in retirement planning than they did in money management, though. Highly stressed workers scored 4.5 and overwhelmed workers scored 3.1. Less stressed workers seem to struggle more with retirement planning than with day-to-day money management, as their scores were lower in this category: 6.9 for unstressed workers and 6 for those with some stress.

In investing, the category where even the least stressed employees scored less than 5, scores for employees at high and overwhelming levels were abysmal. Highly stressed workers scored 1.6, and overwhelmed workers scored just 0.2.

Financial Finesse asked respondents who reported some level of stress what was causing it and found the least stressed workers tended to worry about external factors like the economy or stock market. Those with higher levels of stress were most worried about not being in control of their current financial situation. Not being able to meet their goals was the second most common cause of stress among the higher stressed groups.
All three groups reported similar levels of concern about who to trust with their money, with over a quarter of each group saying they didn't know who to turn to.

Danielle Andrus, ThinkAdvisor June 14, 2013