The American Retirement Security Crisis: An introduction

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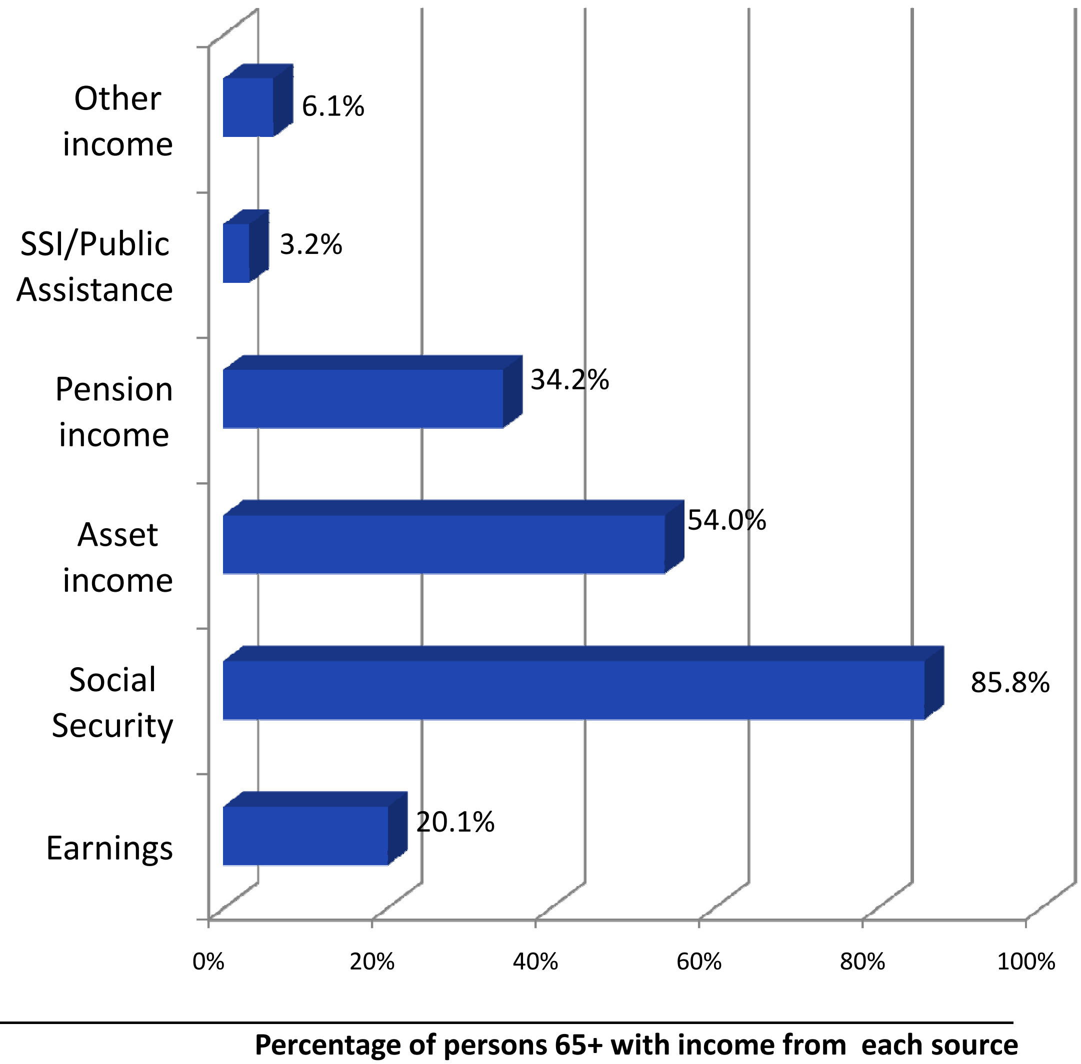
The three legs of retirement security are under strain

Americans primarily depend upon three sources for retirement income: pensions, non-financial assets (usually homes), and Social Security.

Pensions are the least broadly distributed asset: only 34.2% of Americans 65+ earn pension income, while 54% have income from assets and over 85% receive Social Security payments.

Percentage of Americans 65+ with income from each source



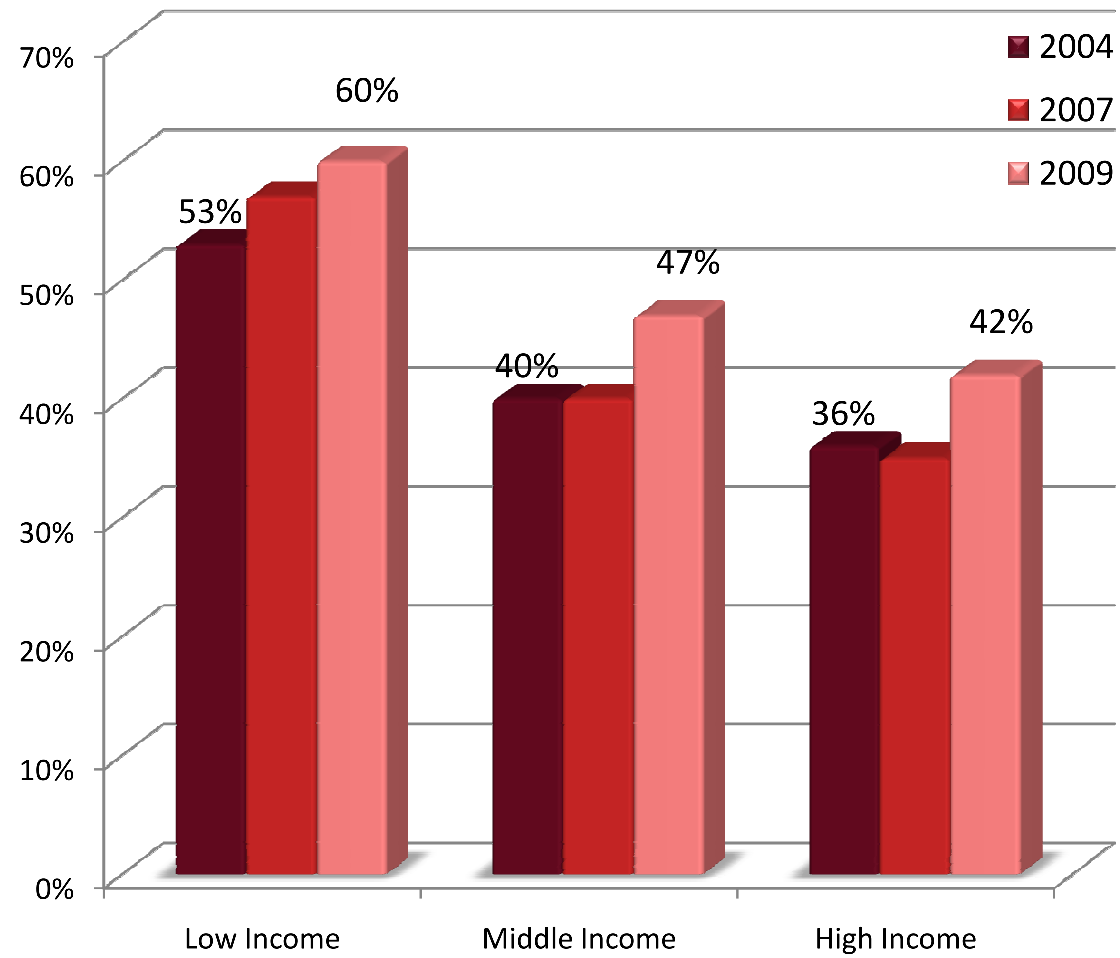
Source: Congressional Research Service, 2009.

The Great Recession has increased retirement insecurity

About half of all Americans are at risk of not having sufficient retirement income due to reduced pension and home values.

Fully 60% of low-income households are at risk of not having sufficient income to maintain their pre-retirement standards of living at age 65.

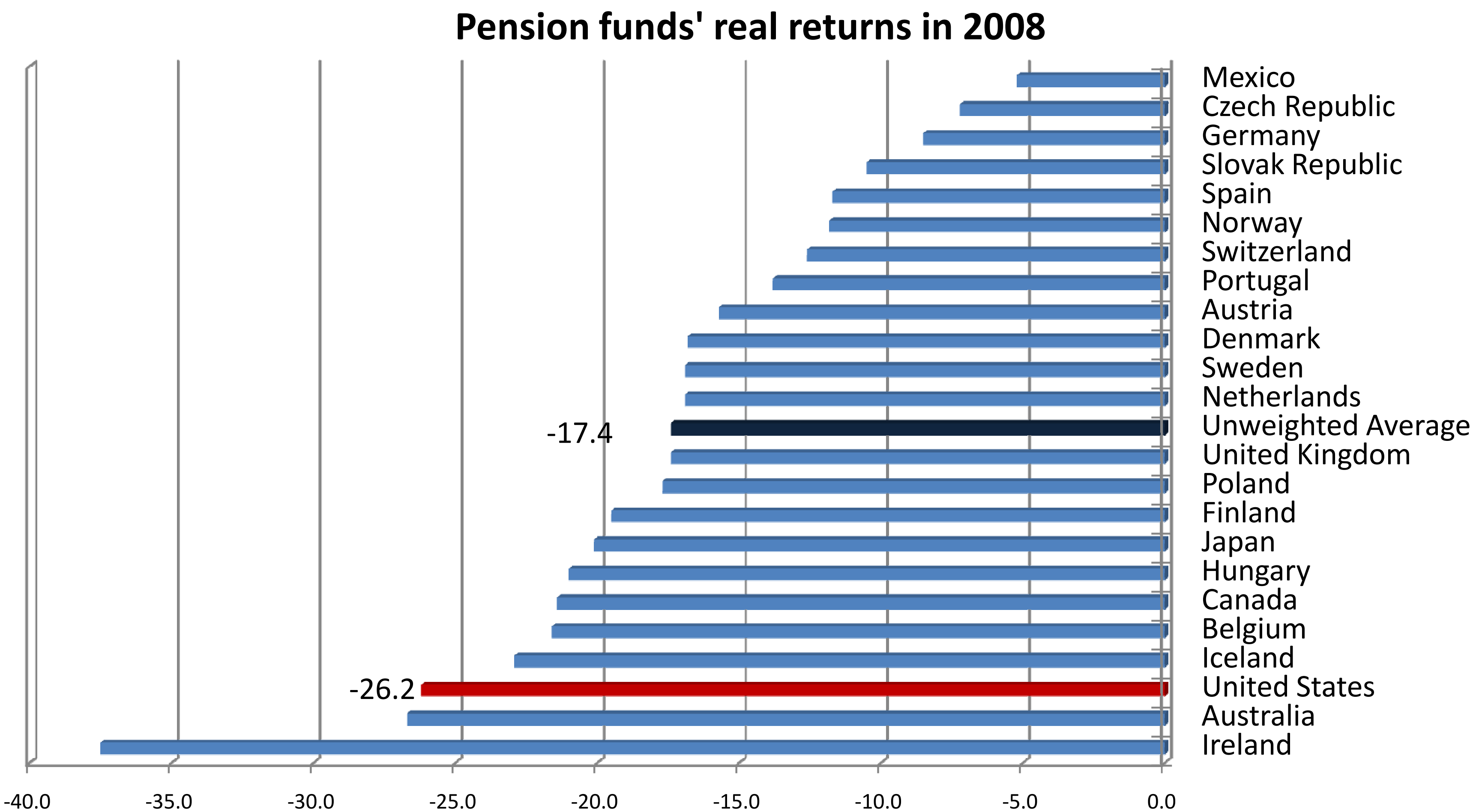
Percent of households at risk of not having enough income to maintain their pre-retirement standard of living at age 65, by income group



Source: Munnell, A. Center for Retirement Research, 2009.

American pension returns hit hard by the Great Recession

American pensions were some of the hardest hit by the Great Recession, falling by over a quarter in 2008.



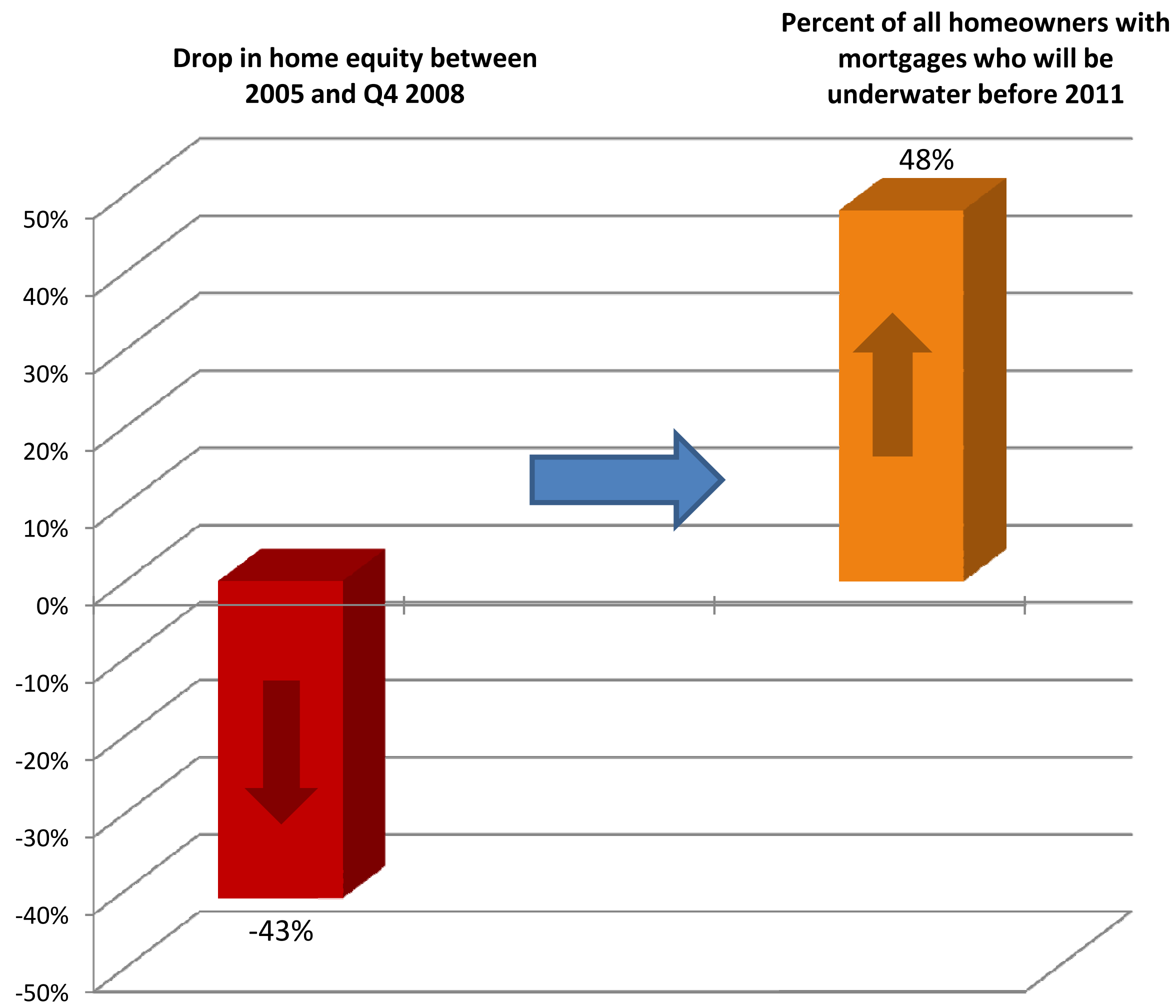
Source: OECD Pensions at a Glance 2009, Figure 1.3.

Dropping home values lead to more underwater mortgages

The Federal Reserve has estimated that homeowners lost $7.15 trillion in home equity from the beginning of 2006 to the end of 2009, a 53% drop.

Deutsche Bank predicts that the collapse of the housing bubble will lead to 25 million homeowners - half of all homeowners with mortgages - with negative equity, or underwater mortgages, before 2011.

A 43 percent drop in home equity will lead to a housing market in which 48 percent of mortgagors are underwater.



Source: Joint Center for Housing Studies of Harvard University, 2009; Deutsche Bank, 2009.

Deeper problems in the retirement system

Although exacerbated by the Great Recession, this state of Americans' retirement security was brought about by deeper structural problems in retirement savings patterns, due to:

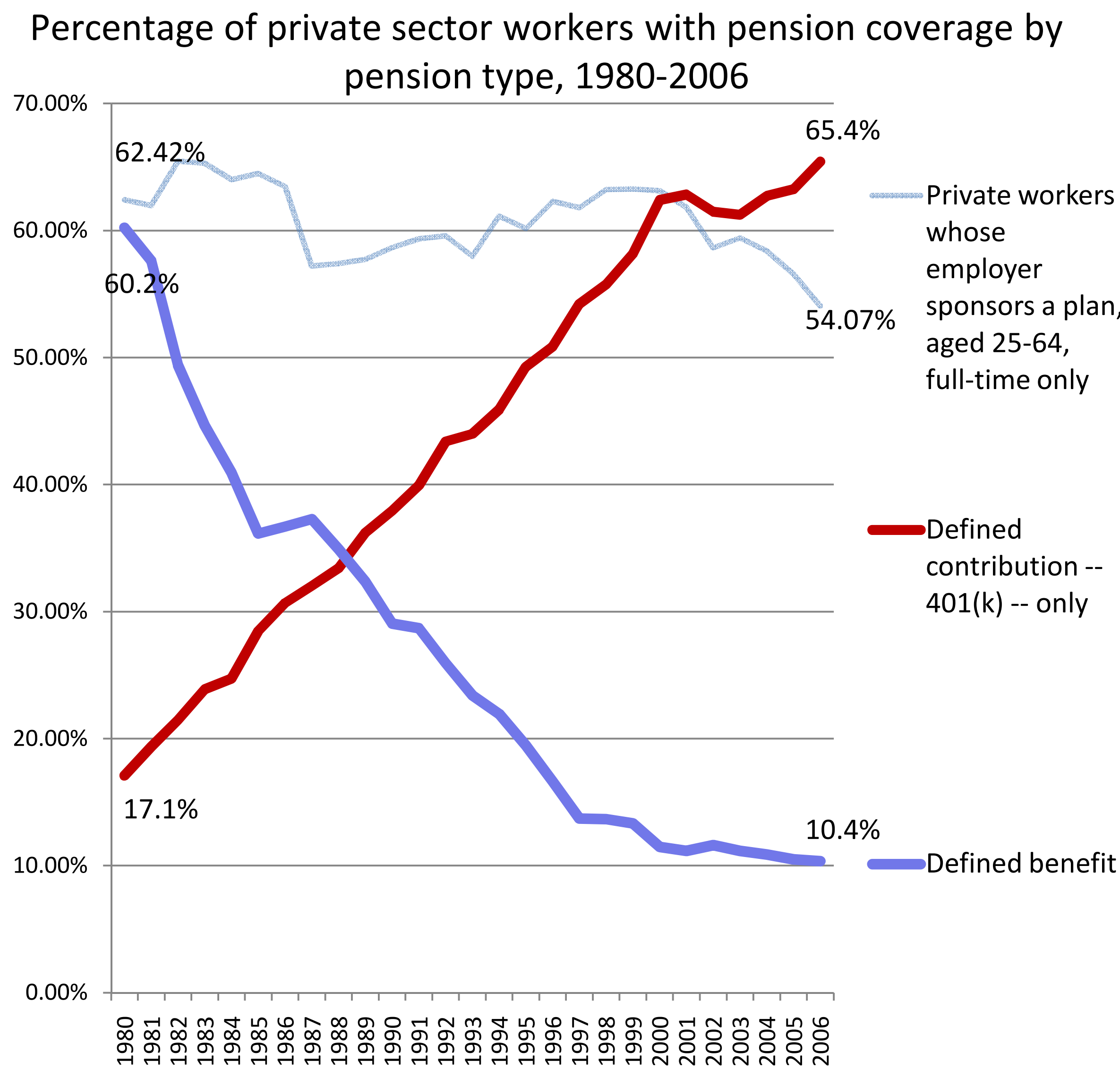
- A troubled transition from defined-benefit to defined-contribution plans.
- Widespread underfunding of public pensions.
- Families relying too heavily on ever-rising home values for retirement security.

The shift from defined-benefit to defined-contribution pensions

Prior to the recession, private pensions had already become a less steady leg of retirement security for individuals.

Since the early 1980s, businesses have shifted pension risks onto workers through a movement from defined-benefit to defined-contribution/401(k) retirement plans.

Individuals therefore bear the full risk of fluctuations in stock and investment returns.



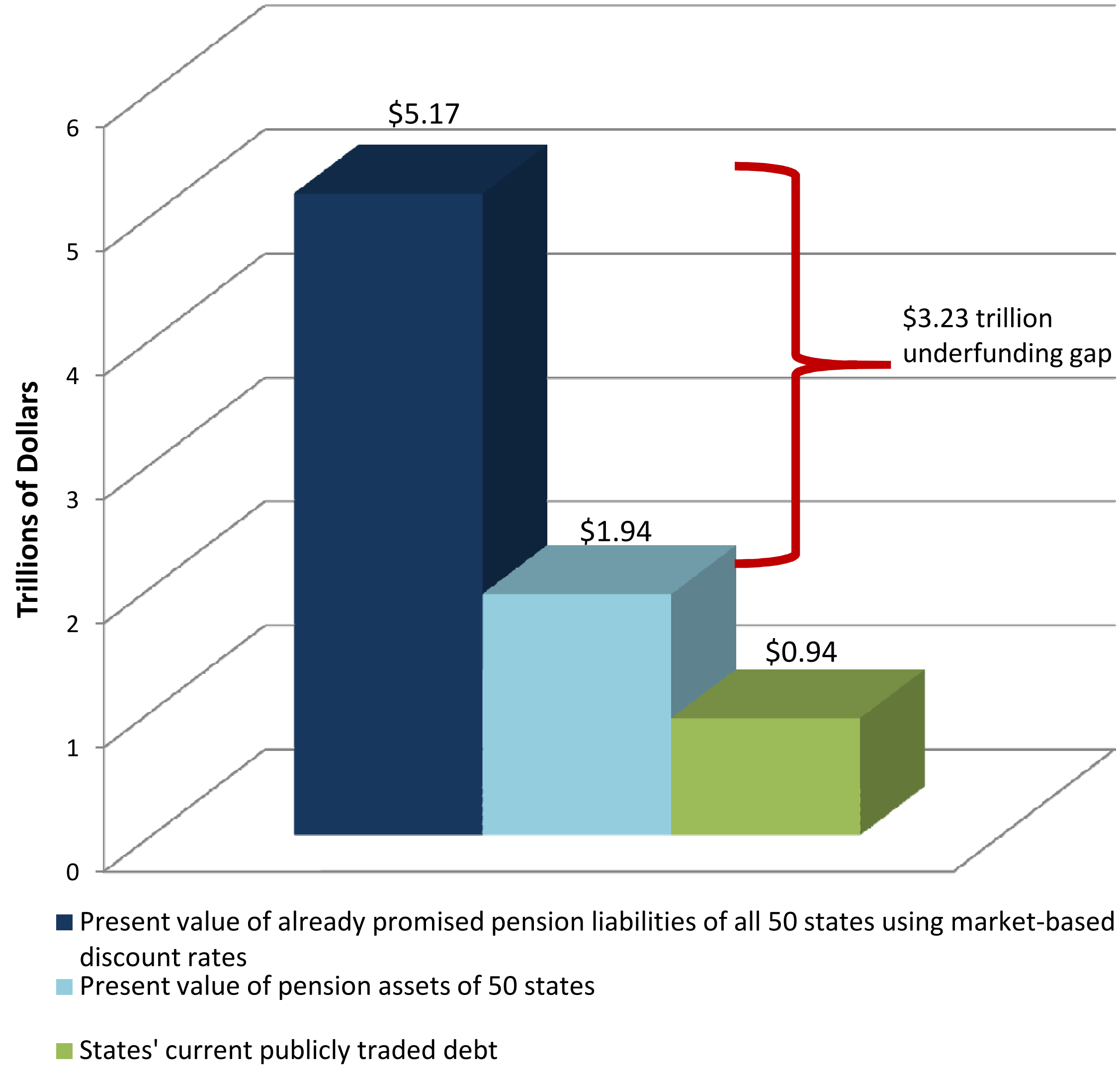
Source: Center for Retirement Research, 2009.

Public pensions are severely underfunded

State and local governments, tied to defined-benefit pension promises, are now experiencing underfunding gaps.

Novy-Marx and Rauh conclude that there is a less than a 5% chance that the current pattern of pension fund investments can fulfill obligations to retirees in 15 years.

Underfunding of state public pension plans dwarfs states' publicly traded debt



Source: Novy-Marx & Rauh, Journal of Economic Perspectives, 2009.

Public pensions are severely underfunded

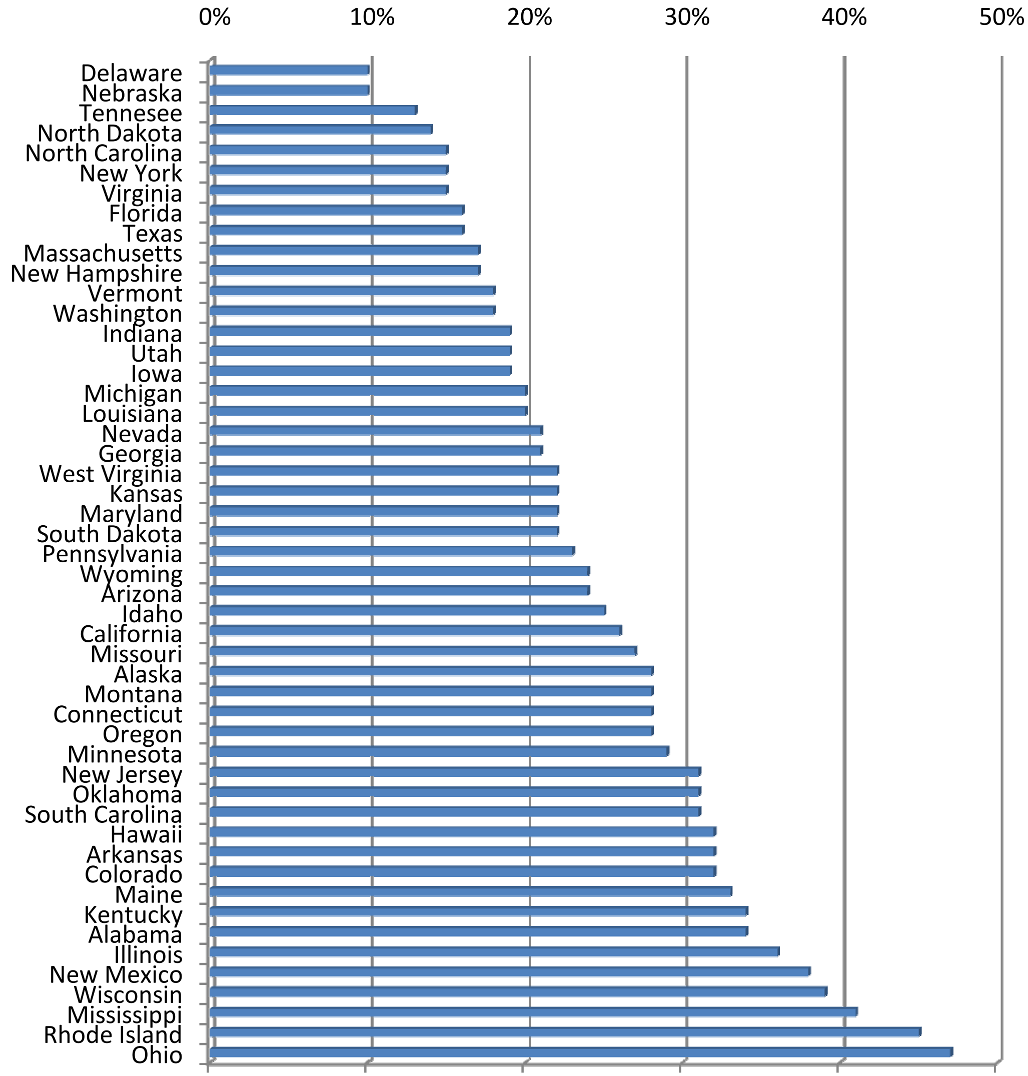
States have funded about 80 percent of their pension liability, leaving a $3.32 trillion funding gap.*

Fully 34 states have underfunded their public pensions by at least 20 percent of their gross state product.

In addition, states are responsible for more than $530 billion in unfunded Other Post-Employment Benefits (OPEB), which includes retiree health and dental insurance, life insurance, and legal services.

* This estimate understates the shortfall due to investment declines from the latter half of 2008.

State underfunding of public pensions as a percentage of gross state product



Source: Novy-Marx & Rauh, Journal of Economic Perspectives, 2009.

Many city governments are also suffering from pension shortfalls

For example, as of June 2009, Los Angeles had underfunded its public pension liabilities by $3.53 billion, with an additional $2.43 billion owed in Other Post-employment Benefits (such as healthcare). The city employees retirement plan is short by over 100% of payroll.

As of June 2009, New York City public pensions programs had liabilities that exceeded their assets by $39.9 billion with an additional $65.5 billion owed in Other Post-Employment Benefits. The NYC Teachers Retirement System (TRS) is underfunded by over 200% of payroll, Police by over 300%, and Fire by almost 530%.

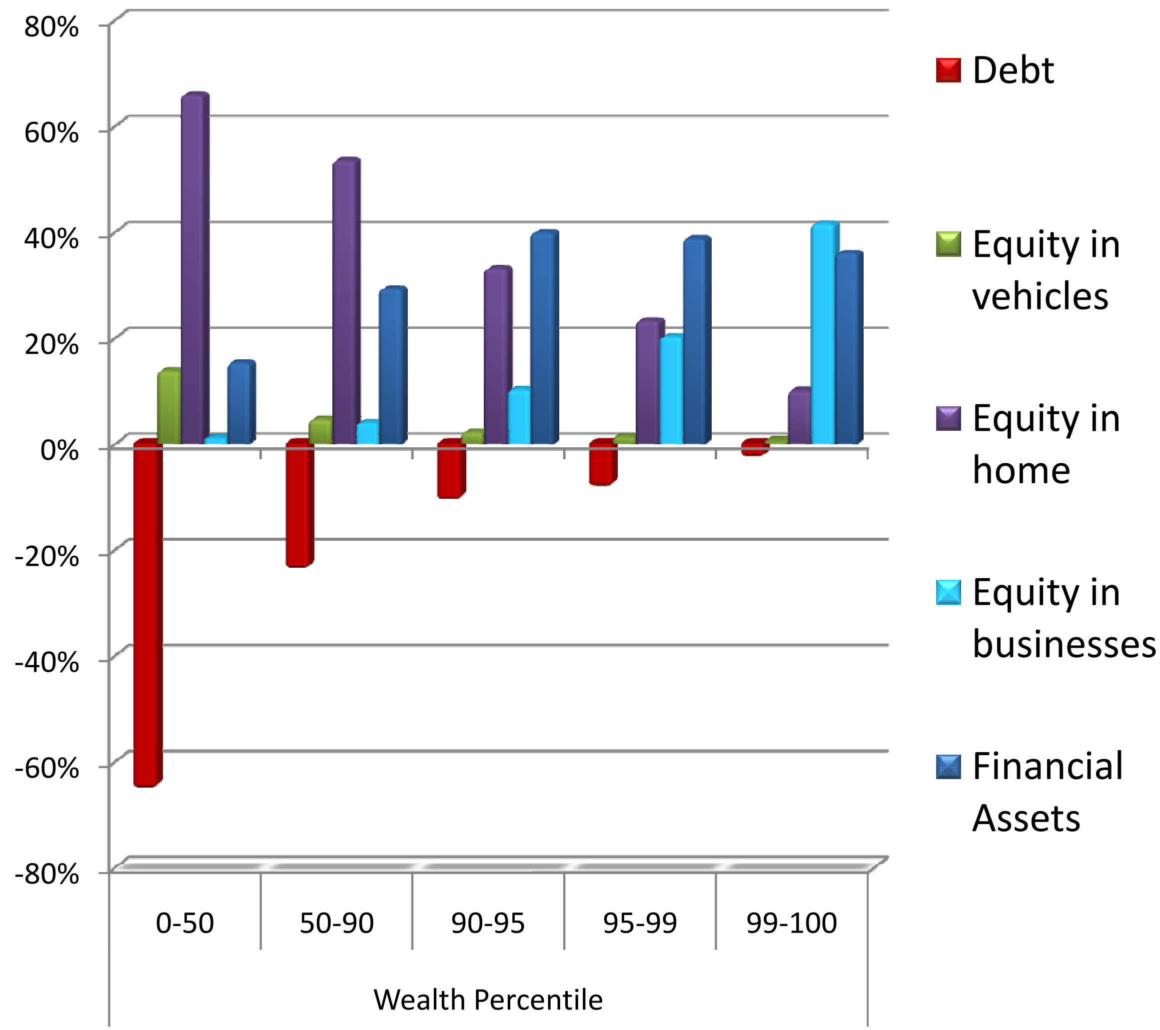
Emphasis on home ownership has led to retirement insecurity

Home ownership accounts for the largest proportion of assets for all but the richest 5 percent of the population.

But this has led to an over-reliance on rising home values for retirement security.

The bottom 50 percent have therefore not saved enough in secure financial assets and pensions to weather the bursting housing bubble.

Asset and debt items as a percent of assets by percentile distribution of wealth groups



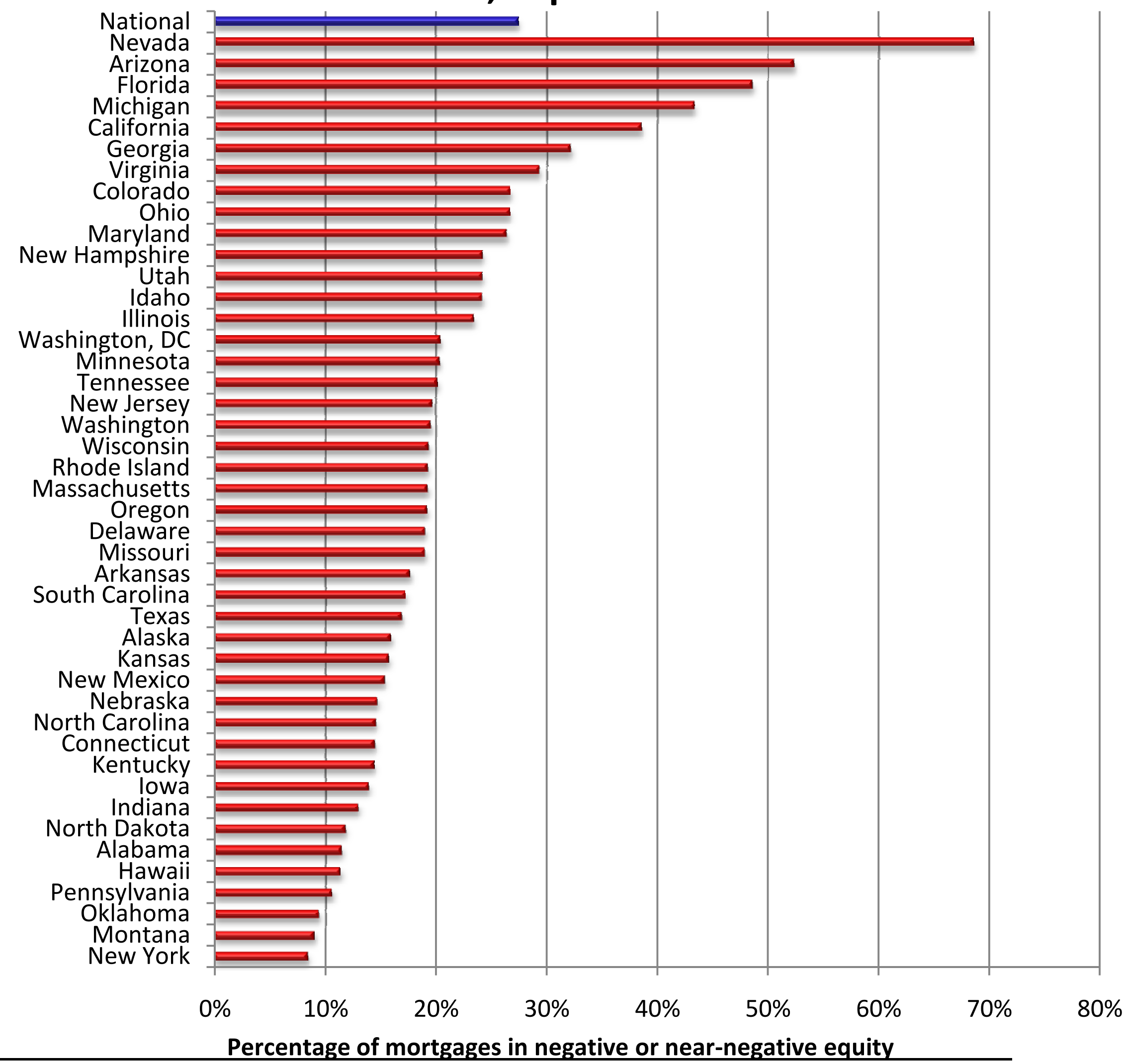
Source: Kennickell, A. Federal Reserve Board, 2009.

Huge numbers of homeowners are underwater

Over 10.7 million Americans are now in negative equity situations, meaning they owe more on their mortgage than their home is worth.

With home prices unlikely to ever recover, this loss in equity has significantly reduced the retirement security of the lower and middle classes, which are less likely to have pensions and other financial assets to sustain them.

Percentage of negative and near-negative* equity mortgages by state, Sept. 2009



*Near-negative equity defined as properties with mortgages within 5% of a negative equity position.

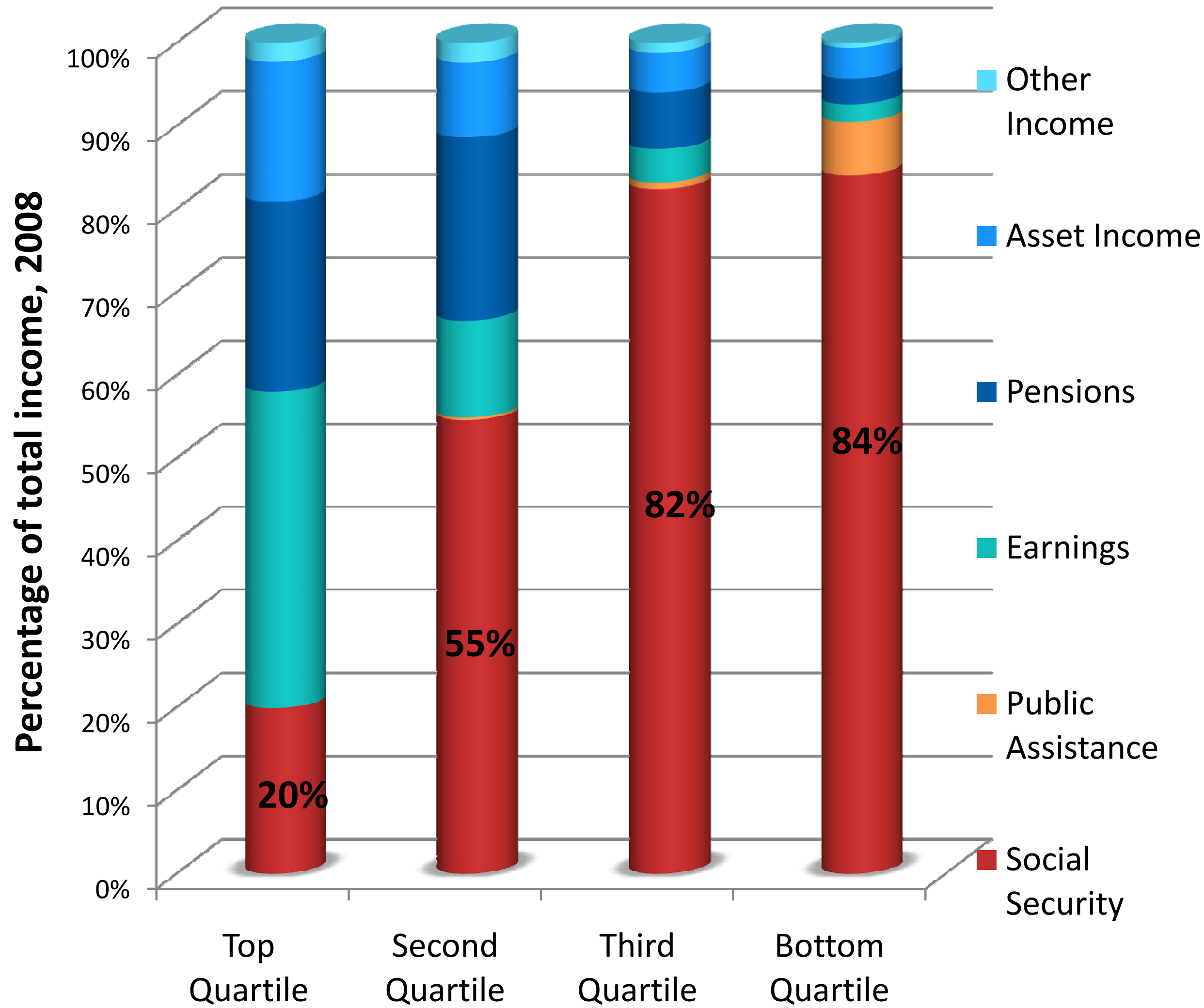
Source: First American CoreLogic, Sept. 2009.

Social Security is the main source of income for most Americans

Instead, the two bottom income quartiles (making less than $18,208) depend on Social Security for over 80 percent of their aged 65+ income.

The second quartile still depends on Social Security for over 50 percent of its retirement income.

Sources of income of persons aged 65+ by income quartile, 2008.



Source: Congressional Research Service, 2009

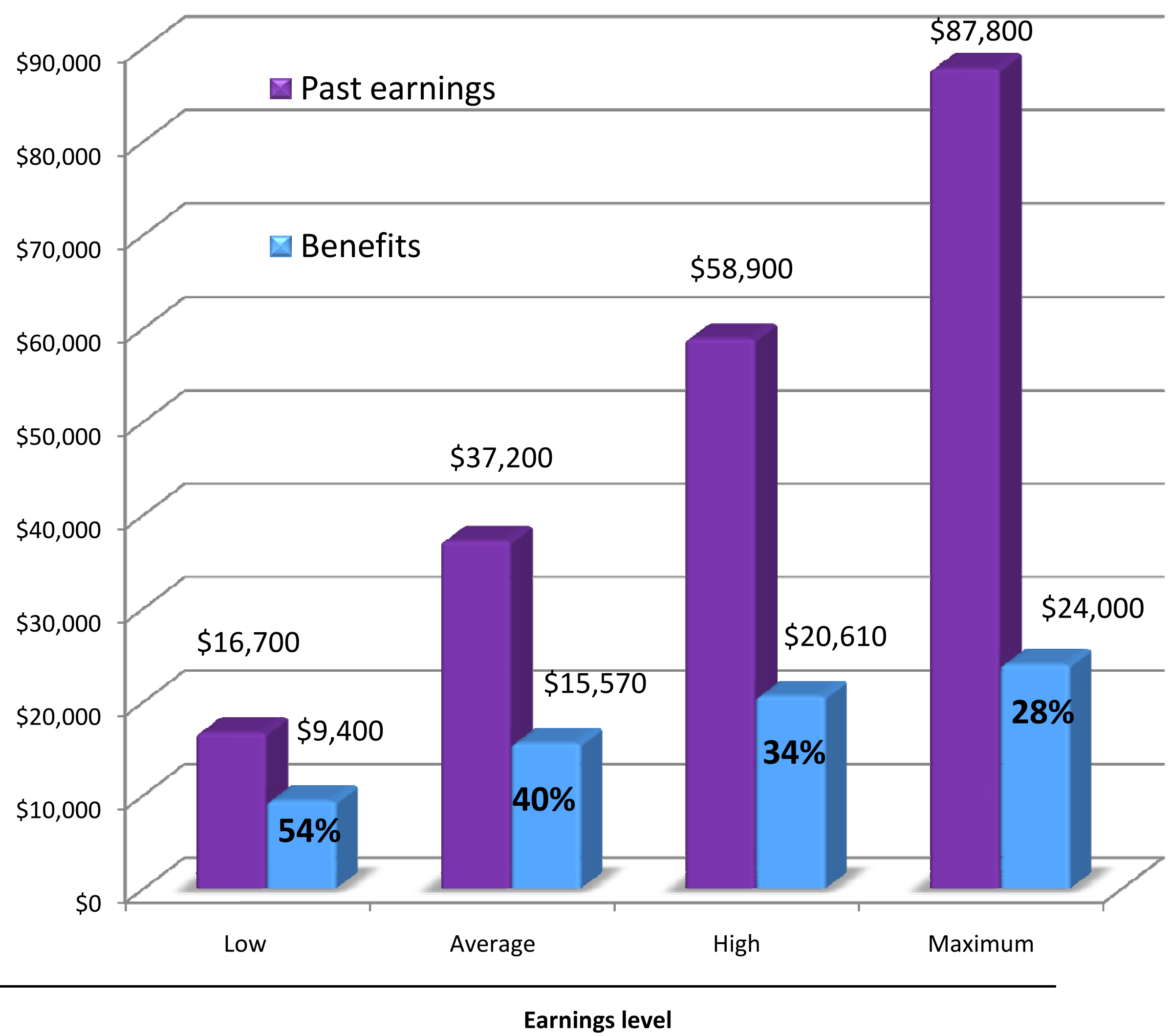
Social Security is too weak to provide retirement security

Social Security reduces and spreads market risk, but provides much lower than the 70-80% of pre-retirement income needed to maintain pre-retirement standards of living.

Many rely upon Social Security for over 80% of their retirement income, but it replaces less than half of pre-retirement income for the average wage earner with a continuous work history.

In reality, workers do not work steadily their entire lives, and Social Security replaces only about 33% of their average wage from the year prior to retirement.

Social Security benefits and percent replacement rates compared to past earnings for workers with continuous work histories, retiring at age 65.



Source: National Academy of Social Insurance, 2007.

A new way forward?

Our ownership society, based on defined-contribution pensions and home ownership, fully exposes Americans to volatile markets and has left many vulnerable to the possibility of never being able to retire.

With home values unlikely to recover and states and cities in serious financial trouble with promised defined-benefit pensions, what are our policy options?