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ICI Analysis of U.S. Retirement System: It Is Working and Serving Each Generation Better Than Previous

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Think of Retirement System as a "Pyramid" with Five Layers

Washington, DC, December 5, 2012 - An ICI examination of research and data on the U.S. retirement system finds that it has successfully provided adequate retirement resources to Americans and that successive generations of retirees have been better off than previous generations.

Specifically, the new analysis, "The Success of the U.S. Retirement System," looks at the U.S. retirement system broadly and finds that most households maintain their standard of living when they retire. In addition, analysis shows that, on average, more recent retirees have higher levels of resources to draw on in retirement than previous generations and that the U.S. retirement system has become better at providing resources. For example:

- Adjusted for inflation and the number of U.S. households, assets earmarked for retirement were nearly three times larger in mid-2012 than in 1985.
- Poverty among people aged 65 or older has fallen from nearly 30 percent in the mid-1960s to 9 percent in 2011.

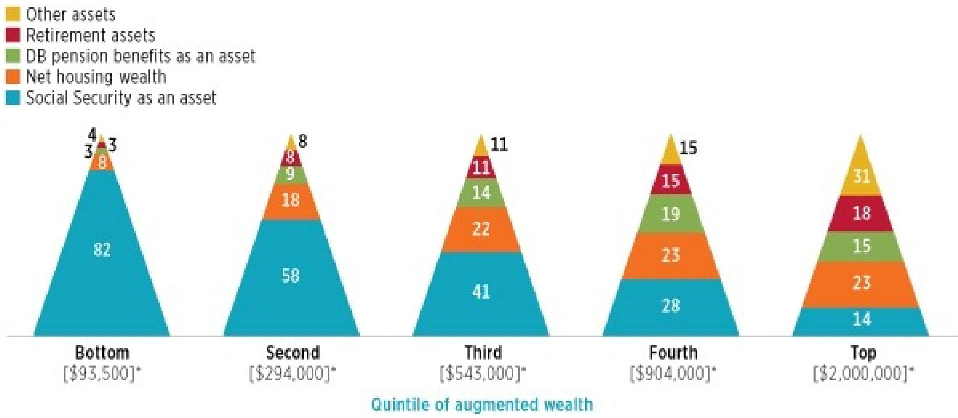
"This study examines the empirical evidence and finds that, contrary to what we too often hear, the U.S. retirement system has successfully provided generations of Americans the resources they need in retirement," said ICI President and CEO Paul Schott Stevens. "The future presents us with many challenges, such as an underfunded Social Security system and rising health care costs. As policymakers respond to these challenges, it is critical that they have research like this that analyzes the entire system. ICI believes we must preserve the best attributes of the system, including tax deferral and portability, and build on the system's success by strengthening Social Security for the long term, expanding coverage, and continuing to allow innovation in plan design."

It's a Retirement Pyramid (Not a Three-Legged Stool)

ICI economists suggest that, rather than the traditional three-legged stool analogy, retirement resources are better thought of as a pyramid with five basic components: Social Security, homeownership, employer-sponsored retirement plans (defined benefit [DB] and defined contribution [DC]), individual retirement accounts (IRAs), and other personal savings. The composition of the retirement resource pyramid varies from one household to another. The way in which resources vary by household wealth is as illustrated in the chart below.

Estimates of the Components of the Retirement Resource Pyramid for Households Approaching Retirement

Percentage of augmented wealth by augmented wealth quintile in 2006 for households with at least one member born between 1948 and 1953



**** Approximate average level of augmented wealth in 2006 for augmented wealth quintile, which includes estimates of Social Security and DB benefits as assets.***
Note: See Figure 16 in The Success of the U.S. Retirement System for definitions of the components. Percentage of augmented wealth in each category is represented by the height of the category rather than by the area of the category. Components may not add to 100 percent because of rounding.
Source: Investment Company Institute tabulation derived from Gustman, Steinmeier, and Tabatabai 2009 using Health and Retirement Study (HRS) data

“The pyramid is a better way to think about retirement resources because households do not need to rely on each part of the retirement pyramid equally to maintain their standard of living in retirement,” said Peter Brady, ICI Senior Economist. “The composition of the retirement resource pyramid varies to reflect the resources available to an individual household. Social Security provides resources to nearly all retirees, but provides a higher replacement rate to retirees with low lifetime earnings. Because Social Security benefits typically replace a smaller share of earnings for higher-income households, these households rely more on other retirement resources, such as employer-provided retirement benefits and IRAs.”

Households Save for Different Reasons at Different Times

This paper also illustrates that households save for a variety of reasons throughout their lives. Households’ focus on savings change as they age, with the emphasis shifting to retirement over time. For example:

- In 2010, only 14 percent of households younger than 35 reported that retirement was their primary savings goal, compared with nearly half of households aged 50 to 64.
- Younger households typically are focused on other goals: 32 percent of households younger than 35 reported that saving for education, homes, or other large purchases was their primary saving goal.

“While households save for multiple goals, this report makes clear that the focus on retirement saving changes over the life cycle. Younger and lower-income households tend to be more focused on saving for other goals than retirement,” said ICI Senior Director of Retirement and Investor Research, Sarah Holden. “Building the retirement resource pyramid is a career-long endeavor that starts with the foundation of Social Security earned through working. Younger households then may focus on saving for homes, which will provide shelter during their working careers and in retirement. Then, retirement saving through employer-sponsored plans or IRAs typically takes center stage. In fact, in 2010, eight in 10 near-retiree households had employer-sponsored retirement benefits, IRAs, or both.”

The paper was coauthored by Brady, ICI Economist Kimberly Burham, and Holden.