

Slide 7



The slide features a teal gradient background. In the top left corner is the logo for the National Academy of Social Insurance, which consists of the words 'NATIONAL', 'ACADEMY', 'OF SOCIAL', and 'INSURANCE' stacked vertically. To the right of the logo, the title 'Financial Demographics' is written in a large, bold, italicized serif font. Below the title, the speaker's name 'Lisa Mensah, Aspen Institute' is written in a smaller, italicized serif font. In the top right corner, there is a small thumbnail image of a book cover titled 'Uncharted Waters: Preparing for the Retirement Risks of a Future Without Defined Pensions'. The main content of the slide is a bulleted list of four topics, each preceded by a teal diamond symbol. The topics are: 'Role of Social Security', 'Pension Trends', 'Tax-Favored Retirement Savings', and 'Lessons from Individual Development Accounts'. The number '7' is located in the bottom right corner of the slide.

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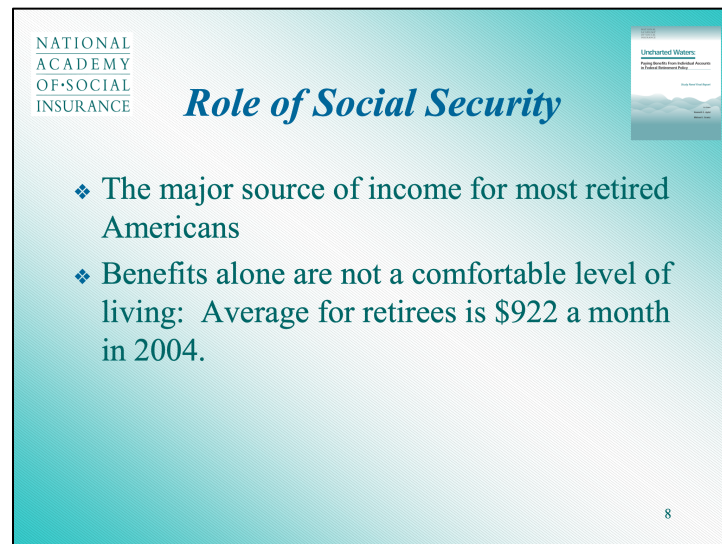
Financial Demographics

Lisa Mensah, Aspen Institute

- ❖ Role of Social Security
- ❖ Pension Trends
- ❖ Tax-Favored Retirement Savings
- ❖ Lessons from Individual Development Accounts

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Our first speaker is panel member Lisa Mensah of the Aspen Institute.



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Role of Social Security

- ❖ The major source of income for most retired Americans
- ❖ Benefits alone are not a comfortable level of living: Average for retirees is \$922 a month in 2004.

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Social Security is the major source of income for most retired Americans. About 90 percent of people aged 65 and older receive benefits. For two in three of those beneficiaries, Social Security is half or more of their total income. Women without husbands are the most reliant on Social Security benefits. For three in four elderly unmarried women receiving Social Security, the benefits are more than half their income. For nearly three in ten of such women, Social Security is their only source of income. Social Security benefits alone do not provide a comfortable level of living. The average benefit for a retired worker was about \$922 a month, or \$11,060 a year in 2004. Under current Social Security law, benefits for future retirees are scheduled to rise in real terms. Benefits will grow somewhat more slowly than earnings, however, because the 1983 law raised the “full benefit age” from 65 to 67. That law phases in over the next 20 years. Although the real level of benefits will be higher, benefits for 65-year-old retirees will replace a smaller share of prior earnings than is the case today or at any time in the last 30 years. Because Social Security is not in long-run financial balance, other changes might be enacted that would either raise revenue or lower benefits.

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Pension Trends

- ❖ About half of couples and one third of unmarried persons age 65+ have pensions.
- ❖ Half of private sector workers are covered.
- ❖ Plans are shifting to defined contribution. Workers have more choice, more responsibility, and more financial risk.



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Employer-sponsored pensions are an important supplement to Social Security for the half of married couples and one third of unmarried men and women age 65 and older who receive pensions. At any time over the past 25 years, about half of private-sector workers have been covered by pension plans. The form of these plans has shifted dramatically from the 1970s and 1980s when defined-benefit plans were dominant. Today, defined-contribution plans, such as 401(k) plans, are more common. In defined-contribution plans, workers have more choices about whether to participate and how much to contribute; they can take the accounts with them when they change jobs; and they have more choices about when and how to withdraw the money. At the same time, workers take on more responsibility for financing the plans and bearing the investment risk that employers bear in defined-benefit plans.



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Tax-Favored Retirement Savings

- ❖ About half of U.S. families own tax-favored retirement savings. Median value is \$29,000
- ❖ Many families are “asset poor” – without enough savings to stay out of poverty during a 3 month gap in income.

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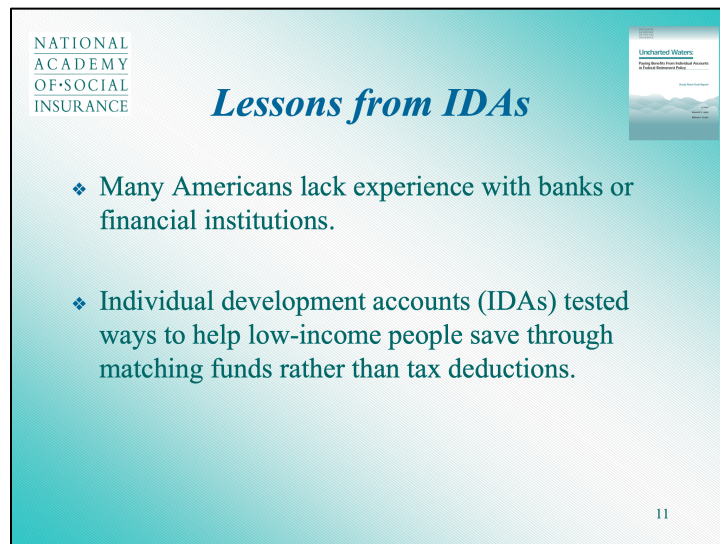
Today, about half of all U.S. families own a tax-favored retirement account other than a defined-benefit retirement plan.. The median value of the accumulated balances in those accounts was \$29,000 in 2001.

The lack of tax-deferred retirement savings affects middle income families as well as families with lower incomes. Of families in the middle fifth of the income distribution, half lack retirement savings accounts. At all income levels, the typical value of tax deferred savings (for those who had any) was less than one year’s income.

Age differences matter. Younger workers have more of their working lives ahead of them, while older workers have little time left to increase their savings. Of families age 55-64, about 59 had any retirement savings accounts. The median value was \$55,000.

Another measure of economic vulnerability is the capacity of families to withstand setbacks such as joblessness or prolonged illness. Haveman and Wolff (2001) define households as “asset poor” if they lack sufficient assets to meet basic needs (to stay out of poverty) for three months without income. By this measure one in four families is asset poor, if their total net worth, including home equity, is considered available to meet

basic needs. If only liquid assets (excluding home equity and retirement savings) are considered, four in 10 families are asset poor. .



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Lessons from IDAs

- ❖ Many Americans lack experience with banks or financial institutions.
- ❖ Individual development accounts (IDAs) tested ways to help low-income people save through matching funds rather than tax deductions.

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Many Americans lack experience with financial institutions. This lack of financial experience merits attention in the design of a new individual account system. The size of the “unbanked” population – those who do not have a checking or savings account with a bank or credit union – is estimated to be between 10 and 20 percent of all U.S. families. Low-income and minority families are most likely to be without a connection to a financial institution.

Individual development account experiments have offered financial education and matched savings to low-income workers. The savings are earmarked for specific purposes, such as higher education, purchase of a first home, or starting a business. Conditions that appear to foster successful saving include: (a) access to a savings plan, (b) incentives through matching funds, (c) financial education, (d) ease of saving through direct deposit and default participation, (e) clear saving targets and expectations, and (f) restrictions on withdrawals.

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How Big Might Accounts Be? After 40 years



If 2% of wages and 4.7% real investment returns, after 40 years, account at 65 would be about 1.7 times annual earnings.

Earnings level	Account	Annuity*
\$34,700 (medium)	\$59,400	\$333
\$15,600 (low)	\$26,700	\$150
\$55,500 (high)	\$94,900	\$536

* Inflation-indexed monthly single life annuity

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How Big Might Accounts Be?

Size will depend on how much people put in, how long they have to contribute before reaching age 65, and their investment returns.

We have examples for illustrative workers who contribute 2 percent of their earnings and reap investment returns of 4.7 percent a year over inflation. After 40 years, a 65 year old would have an account equal to about 1.7 times his or her annual earnings. Examples of what this means for workers at different lifetime indexed earnings levels follow.

A **medium earner** – making about \$34,700 – would have an account of about \$59,400 after 40 years. It would pay an inflation-indexed life annuity of about \$333 a month.

A **low earner** – making about \$15,600 – would have an account of about \$26,700 after 40 years. It would pay \$150 a month.

A **high earner** – making about \$55,500 – would have an account of about \$94,900 after 40 years. It would pay a life annuity of about \$536 a month.

If contributions are 4% instead of 2%, accounts would be twice as big. If contributions were only 1% instead of 2%, they would be only half as big. Actual investment returns would make an important difference.