



# Updated Retirement Vulnerability Analysis:

The likelihood of outliving their  
financial assets

By Ernst & Young LLP

For Americans for Secure Retirement

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# How the Current Economic Climate Affects the Findings of the 2008 “Retirement Vulnerability of New Retirees” Report

In July, 2008, Ernst & Young LLP released a report entitled “Retirement Vulnerability of New Retirees,” commissioned by the Americans for Secure Retirement (ASR) coalition<sup>1</sup>. That report analyzed the likelihood that middle-income Americans would outlive their financial assets in retirement, and the reduction in pre-retirement standard of living necessary to minimize that risk. Following the publication of that report, the American and global financial markets have suffered dramatic declines, and the United States economy as a whole has entered a severe recession. In response to ASR’s request, Ernst & Young has produced this update examining the change in the retirement readiness of middle-income Americans in the time since the first Retirement Vulnerability Report was published.

The findings of the original Retirement Vulnerability Report revealed that a majority of middle-class Americans are likely to outlive their financial resources in retirement. A significant, guaranteed, lifetime income outside of Social Security, as provided by such retirement vehicles as a lifetime annuity, was a way to help secure one’s retirement future. The updated study reveals that the financial market downturn which began in the middle of 2008 makes this conclusion even truer today.

Social Security and traditional pension plans have for many years provided the bulk of retirement income, but fewer and fewer individuals are being covered by pension plans and Social Security cannot cover the resulting gap. Furthermore, Americans are living longer and longer.

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<sup>1</sup> Ernst & Young LLP, “Retirement Vulnerability of New Retirees: The Likelihood of Outliving Their Financial Assets,” July 2008.

The original Retirement Vulnerability Report showed that without making serious reductions to their standard of living, three-fifths of new retirees could expect to outlive their financial resources. Middle-income Americans retiring at the time of the original study without a guaranteed source of income beyond Social Security would have to reduce their standard of living by an average of 32 percent to avoid outliving their financial assets. Near retirees, those seven years out from retirement, without a guaranteed source of income would have to reduce their standard of living by 45 percent to minimize the likelihood of outliving their financial assets. These reductions would be necessary even when assuming that retirees can maintain the same standard of living with income equal to 59 to 71 percent of their pre-retirement wages.

As would be expected, the updated analysis shows that the changes in the American economy in the last six months of 2008, specifically the sharp declines in the financial markets, have increased the retirement vulnerability of both near and recent retirees. For the updated analysis, the retirement vulnerability metrics were re-estimated for six of the original 36 representative households, chosen because they were some of the most common analyzed in the previous report and because they illustrate the increase in retirement vulnerability across all of the representative households: Married couples at or near retirement making \$75,000 in earnings with and without guaranteed retirement income, and single females making \$50,000 in earnings seven years before retirement with and without guaranteed retirement income.

**The decline in equities during the last six months of 2008 significantly decreased the value of American household retirement assets.** For example, from July 1, 2008 to December 31, 2008, the value of stocks plunged 28 percent for large cap stocks, 34 percent for small cap stocks, and 37 percent for international stocks. The overall economic downturn resulted in reductions of middle-class retirement savings from -17 percent for an average worker seven years from retirement to -14 percent for an average recent retiree<sup>2</sup>.

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<sup>2</sup> The larger reduction in financial assets for near retirees is due to the heavier portfolio allocation towards stocks before retirement. For a description of the target retirement fund allocations assumed for near and new retirees, see the original report's Appendix Table B-5.

**Households with a defined benefit plan continue to show the greatest chance of maintaining necessary financial resources in retirement.** As a result of the declines in retirement savings caused by the market downturn, the probability of middle-income households having the financial assets they need in retirement has significantly decreased. As found in the original study, households with a defined benefit plan providing guaranteed income outside of Social Security continue to show the greatest chance of maintaining the necessary financial resources in retirement. Households without a defined benefit plan continue to show a near certainty of outliving their assets in retirement unless they reduce their standard of living significantly.

For households without a significant guaranteed lifetime source of income beyond Social Security, the changes due to the stock market declines have reduced their already extremely low likelihood of having the financial resources they need in retirement. A married couple without a defined benefit plan both at retirement and nearing retirement had more than a nine-in-ten likelihood of outliving their financial assets in July 2008. After the market declines, their retirement vulnerability increased even further to a 19-out-of-20 chance.

**Changes in retirement vulnerability metrics of middle-income households without defined benefit plans from July 1, 2008 to December 31, 2008**

Marital status/gender	Income group	Retirement age	Probability of not outliving their financial assets (success rate)			Percent reduction in pre-retirement standard of living to increase success rate to 95 percent		
			July 1, 2008	Jan. 1, 2009	Percent Change	July 1, 2008	Jan. 1, 2009	Percent Change
Married	\$75,000	Near retirement	7%	4%	-42%	-49%	-51%	5%
Married	\$75,000	Recent retiree	10%	6%	-44%	-38%	-41%	9%
Single female	\$50,000	Near retirement	23%	18%	-19%	-38%	-41%	6%

A middle-income near retiree married couple covered by a defined benefit pension plan experienced a 26 percent decrease in the probability of maintaining their financial assets in retirement. This probability also fell for the other representative groups covered by a defined benefit plan as well: by 18 percent for recent retiree married couples and by 10 percent for near retiree single females.

**Changes in retirement vulnerability metrics of middle-income households with defined benefit plans from July 1, 2008 to December 31, 2008**

Marital status/gender	Income group	Retirement age	Probability of not outliving their financial assets (success rate)			Percent reduction in pre-retirement standard of living to increase success rate to 95 percent		
			July 1, 2008	Jan. 1, 2009	Percent Change	July 1, 2008	Jan. 1, 2009	Percent Change
Married	\$75,000	Near retirement	43%	31%	-26%	-26%	-28%	9%
Married	\$75,000	Recent retiree	69%	57%	-18%	-14%	-18%	24%
Single female	\$50,000	Near retirement	73%	66%	-10%	-13%	-16%	17%

**A likely consequence of the reduced likelihood of maintaining enough retirement assets is that middle-class Americans near and at retirement will now have to reduce their standard of living *even further than previously determined to ensure that they will have adequate lifetime financial resources.*** For example, a recently retired married couple making \$75,000 with a defined benefit plan would have to reduce their standard of living by an additional 24 percent since July 2008 (from 14 percent to 18 percent) to reduce their chances of outliving their financial resources. The percentage reduction in the standard of living to maintain retirement financial assets for a single female making \$50,000 with a defined benefit plan grew by 17 percent in the same period. The other groups all would have to scale their standard of living back further than estimated last July due to the stock market declines to minimize outliving their financial assets: an additional nine percent for near retiree married couples covered by a defined benefit plan, nine percent for recent retiree couples not covered by a defined plan, five percent for near retiree uncovered married couples, and an additional six percent for a single near retiree female, earning \$50,000 and not covered by a defined benefit plan.

This update demonstrates that typical middle-income new retirees and near retirees have even higher probabilities of outliving their financial assets since the initial report's release in July 2008. Typical middle-income households interested in minimizing the risk of outliving their financial assets now will have to reduce their post-retirement standard of living even further. The second half of 2008 unfortunately illustrates the volatility of investment returns that Americans preparing for retirement are facing, and also highlights the importance of increasing retirement savings and having a guaranteed lifetime income stream in retirement.

As determined in the original 2008 analysis, a focus on additional guaranteed lifetime income streams, such as income provided by an annuity or a defined benefit pension plan, can reduce middle-income Americans' risk of outliving their financial assets and living their final years in poverty.

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