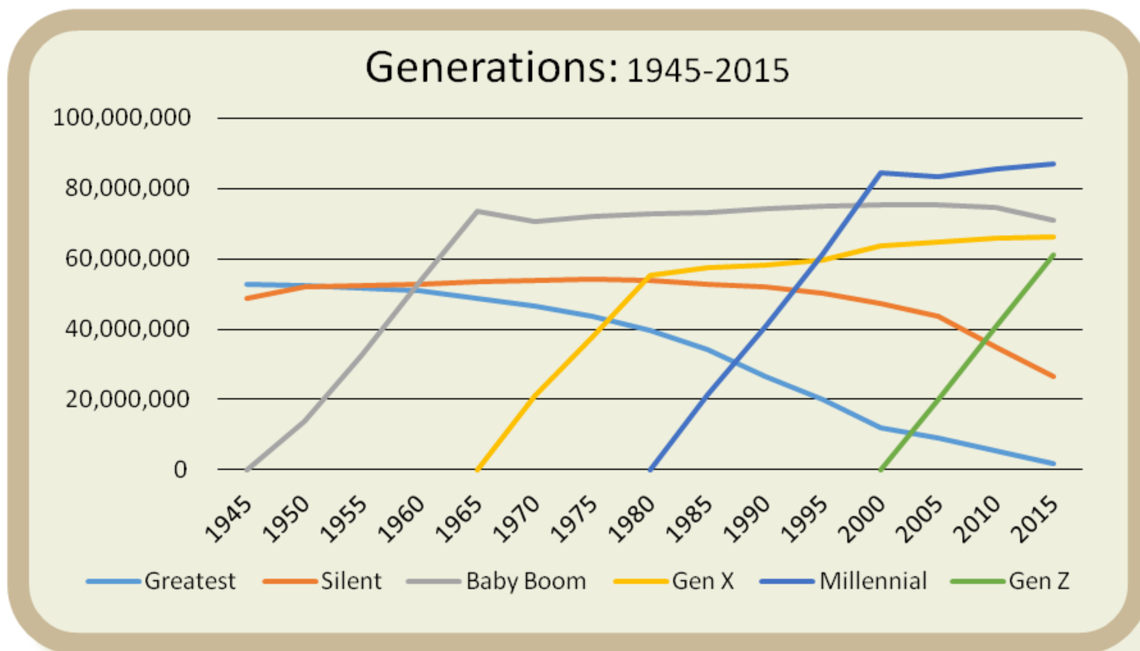
Millennials:
Facing a Changed Retirement and Financial Landscape
By Kevin Chambers

Over the years, social scientists and journalists have defined generations who grew up in similar circumstances as a way to categorized groups of people. Tom Brokaw popularized the usage of the "Greatest Generation" to define those born in the early 1900s who lived through the Great Depression. The Silent Generation came after, those born in the 1920s through 40s. The Baby Boomers were from the mid 40s to mid 60s and were defined by the large increase fertility rates after WWII. Generation X is the generation following the Boomers. Gen Xers were born in the late 60s through the early 80s. The Millennial Generation (also called Generation Y) is the generation of Americans born in the mid 80s through the early 2000s.



Source: Census Bureau

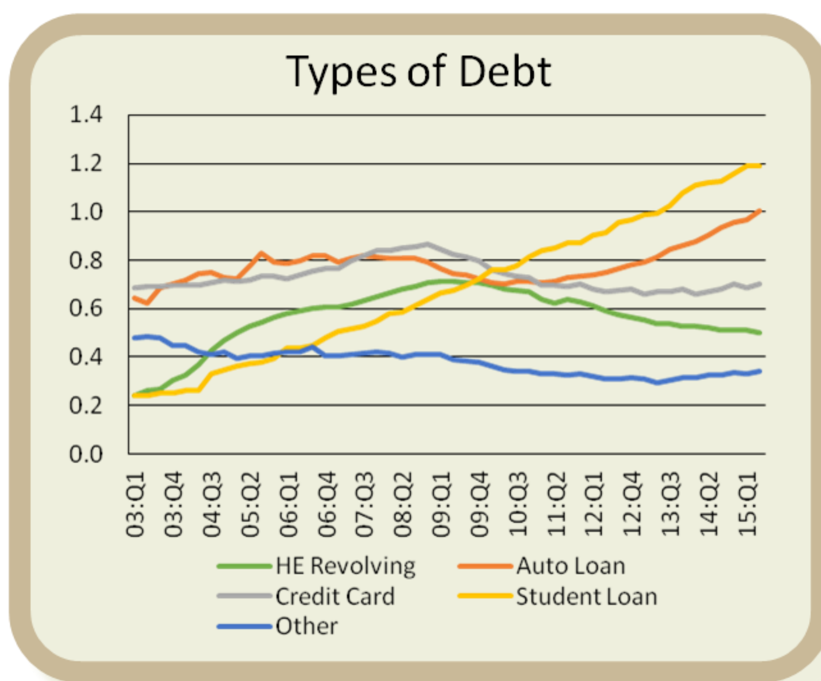
Millennials are the first generation to grow up in the digital age. They grew up with the internet and advanced technology as commonplace. They are currently the largest generation in America, recently passing the Baby Boomers. Many of them are just now entering the work force, and how they are changing the social, economic, and political landscape has made them a point of discussion for many people.

Many of the ways we think about retirement are shaped by the experience of the Baby Boomers. Since the 1960s they have been the biggest population in America. As Millennials enter the workplace, they are being shaped by a challenging economic landscape. The 2008 crisis hit just as the front end of Millennials were graduating and finding jobs. Now the roadmap to a successful career and retirement has changed. Millennials face challenges, as well as advantages over previous generations.

Challenges for Millennials in Retirement Planning

Student Debt:

Student debt has risen to prominence in just the last 10 years as one of the most challenging aspects of life for a Millennial in the US. In 2005, student debt was one of the smallest debt sectors. Auto loans, credit card debt, and home equity loans all out ranked student debt. Now, student debt is the largest non-mortgage source of debt in the United States and has risen to $1.2 trillion. In 2015, the average graduate will have to pay back $35,000 and over 70% of all graduates will have some debt (Sparshott, 2015).



Source: New York Federal Reserve

The rise of student debt is concerning, driven mostly by the increase in college education prices. Despite the rapid increase in college tuition, the importance of a college education is still compelling. The Pew Research Center published a report in 2014 titled "The Rising Cost of Not Going to College." This report details the continued value of a college education in our economy. For Millennials ages 25-32, the median income is 60% higher for college graduates versus high school graduates; their unemployment rate is 8% lower; and they report more job satisfaction. This disparity has been growing. In 1965, the spread of median incomes was only 24%, or about $7,500. The Great Recession that resulted from the 2008 Crisis hit all Millennials very hard; however, those with college educations have fared much better (Pew Research Center, 2014).

Although it still make sense to go to college, the student debt problem is significant. Having student debt delays wealth accumulation and home purchases, as well as encourages more indebtedness. Millennial college graduates with no student debt have a median wealth 7 times greater as those with debt: $8,700 for those with debt vs. $64,700 for those without. Student debt carriers are also more likely to owe money on a car and carry a credit card balance. Although young people are more likely to have large debts, compared to older cohorts, the separation of those with and those without student debt is almost double. Young households who have debt have a median debt to income ratio of 205%, versus 108% for no debt (Fry, 2014).

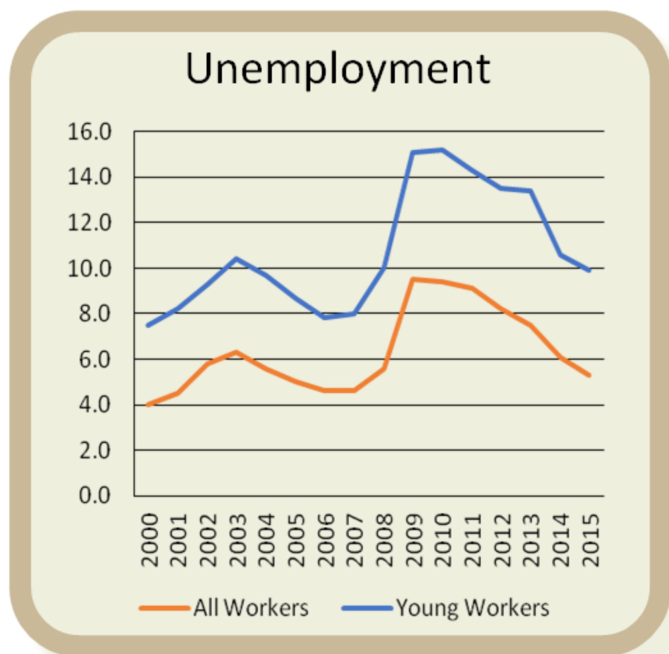
Student debt loads also delay homeownership, reversing a trend. For the first time in 20 years, students without student debt are more likely to own a house at 30 then those with student debt (Brown & Caldwell, 2013). One major factor affecting home purchases is the large gap in credit ratings between graduates with student loans and those without loans, due mostly to rising delinquencies on student loans (Mitchell, 2014).

Tough Job Market:

Another headwind for Millennials is the current job market. Even for those graduates with college degrees, the current employment landscape for young Americans might be one of the toughest in recent history. The Great Recession hurt the American workforce across the board, but the young American populous was arguably hit the hardest. Millennials aged 18 to 34 make up the largest share of the current workforce at about 34%, recently passing the Gen-Xers at 32% (Gellman, 2015).

The college graduate unemployment rate for Millennials is 3.8%. This is more than double the 1.4% unemployment rate for graduates in the 1960s. Without a college education, the difference is triple. Likewise, the time it takes for young Americans to find a job is increasingly arduous. College graduates in 2013 spent about 27 weeks to find a job. A high school graduate had to search for about 31 weeks. Baby boomers needed about half the time to find a job, only 12 weeks. The jobs Millennials are finding are also for less pay, or less hours. Since 1965, median annual earnings have been fairly flat when adjusted for inflation, so with increased payments, such as debt, the importance of finding a job is even more important (Pew Research Center, 2014).

Another change to the job landscape for Millennials is that they are actually not moving between jobs as much as previous generations. Traditionally, people change jobs due to an economic incentive. You get a new job for more money. Those jobs are harder to find. Millennials are stuck in lower paying jobs, with less upward mobility (Marte, 2014). Another factor influencing this change is that the 2008 Crisis put a halt to Millennial migration. The Census Bureau reported that young Americans, traditionally the most mobile age group, have moved locations significantly less since the Great Recession (Benetsky & Fields,



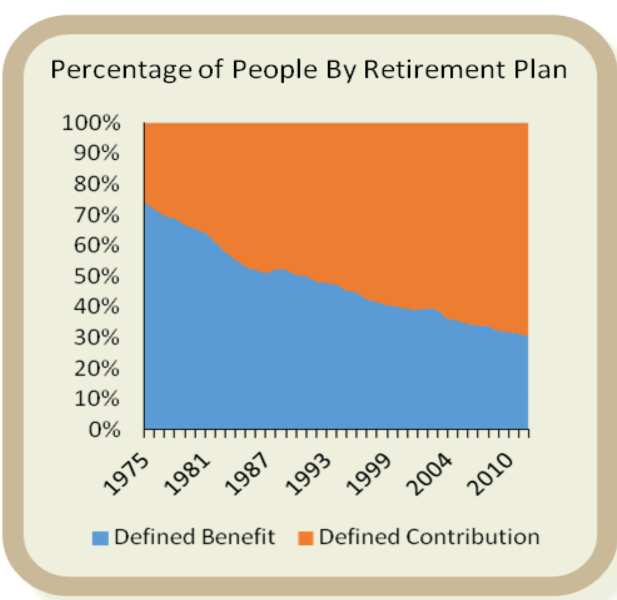
Source: Department of Labor

2014). Wages for young Americans have fallen since 2008, the only age group for that to happen (Thompson, 2014).

Pensions:

Many current retirees rely on pensions as an important source of income. Pensions, also called Defined Benefit (DB) plans, give out guaranteed income for life. The amount of monthly income is usually related to the workers tenure and salary at the company or organization. Pensions were common in large corporations, in industries with unions, and in the public sector.

Over the last 30 to 40 years, many organizations have been moving away from Defined Benefits plans into Defined Contribution plans. In 1975, 74% of people with retirement plans were enrolled in a DB plan, compared with just 30% today. There are a few factors that are driving this shift. First, since the 1980s the federal government has continually added more regulations and requirements for pension plans. This forced many companies to forgo a DB plan as administrative cost grew too high. Secondly, DB plans are more common in manufacturing and labor jobs, and are often supported by unions. As the modern US economy has shifted towards more service jobs, the number of workers enrolled in a pension plan fell (Butrica, Iams, & Toder, 2009). Finally, many workers prefer DC plans over DB plans. DC plans allow for more flexibility and control for the employee.



Source: Department of Labor

Defined Benefits vs. Defined Contributions

All employer sponsored retirement plans fall into one of two categories: Defined Benefit (DB) and Defined Contribution (DC).

DB plans are retirement plans that pay out a pension to employees based on a formula using factors such as tenure and ending salary. In these plans, investment decisions and risk are under the control of the employer. Employees have no say in how the funds are invested. Upon retirement, the company will pay a monthly payment to the employee for life. For some pensions, the payments will change based on inflation. These changes are called Cost of Living Adjustments (COLA).

DC plans are a retirement plans in which the employer puts a certain amount or percentage of the employee's income in an account for the employee to use upon retirement. This is different from a DB plan because the input into the account is fixed, not the benefit. Examples of DC plans include 401(k)s, SEP IRAs, and SIMPLE IRAs. Employees are responsible for how the money is invested, and take on the risk. Upon retirement, the employee is also in charge of managing the account. Investment managers, such as Headwater Investment Consulting can help retirees manage their retirement assets and help them create an income stream from the lump sum they receive at retirement.

This is a trend that is certain to continue. Millennials planning for retirement should expect to receive a DC plan from their employer, not a pension. Ultimately, this shift requires Millennials to have more financial literacy. When 75% of people had pension, their knowledge of finances and investments was less important. The investment decisions were handled by someone else. Now, with the dominance of DC plans, most people should have a working understanding of how investments work, or seek professional advice.

Social Security:

Going forward, Millennials will probably not be able to rely on Social Security as early as current generations. Social Security will most likely never go away, just the ages at which people can file for benefits will be pushed back. Social Security is known as a "pay as you go" system (Blankenship 2011). The current work force pays the benefits for the current retirees. Because the baby boomer generation was an abnormally large demographic shift, it threw a wrench into the system. They put in more income into the system then was needed, but now because they are living longer than expected, they are slowly spending social security down. There are more recipients and the average age that people are starting to take social security has not changed materially for 40 years. Until 2020, the interest of the trust fund will cover the short fall, but then the SSA will be eating into the principal of the trust. Currently, the SSA estimates that the trust fund will run out by 2033. At this point, there will still be tax revenue, but it is estimated to be enough to cover only about ¾ of all benefits (Desilver 2013).

The most likely solution to this problem is to change the age that Social Security benefits are available. This solution would not affect current retirees. As life expectancies have increased, some policy makers think it makes sense that Social Security benefits should be pushed back farther too. People are more physically fit; therefore, they can work for longer. Many current policy makers are looking at this solution as a viable option going forward. Other solutions include privatization, lowering benefit levels, and raising taxes, all of which seem fairly unpopular in the current political landscape. Therefore, Millennials should still expect to receive Social Security, but it might not be until they are into their 70s that they can trigger payments.

Overcoming Obstacles:

Overall, it seems that the Great Recession hit the ability for Millennials to save for retirement hard, and they have not really recovered. Many Millennials are putting off savings because they feel they don't have enough to spare, especially while paying off debts. However, more Millennials are financially conscious and think about retirement versus earlier generations. The 2008 Crisis was eye opening for many young people entering the work force. However, many Millennials are fairly financially illiterate. Only 25% knew what investments were in their retirement account. Moreover, 40% did not know how much they needed to save for retirement (Wells Fargo, 2014). In a survey of basic financial literacy, 18-34 year olds averaged a score of 43%, compared with 66% for other age groups (FINRA, 2013).

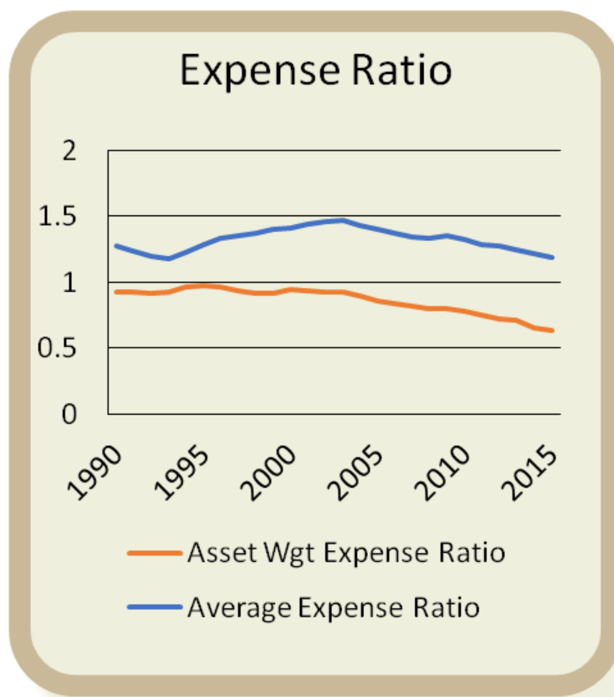
Millennial Retirement Advantages

Easier Access to Information:

Despite their apparent lack of financial knowledge, Millennials have a distinct advantage previous generations lacked: information about investing is abundant and readily available. Access to financial markets used to be reserved for traders in New York City. Now information and the ability to trade are available to anyone with an internet connection. All brokerage houses and mutual fund companies have online access, so it is easy to find out exactly what is in your account. Many websites offer detailed information for consumers on expenses and risk. Millennials have grown up in a digital age and should take advantage of the wealth of information available to them.

Cost of Investing Decreasing:

Partly attributable to the ease of access to information, the cost of investing has decreased. Mutual fund expense ratios have been steadily declining over the last decade. The average mutual fund fee was around 1% on an asset weighted basis for much of the decade from 1990 – 2000. Since 2000, expense ratios have been a steady decreasing. Now the average mutual fund fee is 0.64% on an asset weighted basis. This change has been driven by investors; over the last decade, 95% of investment flows have gone into funds that are in the lowest cost decile. This has been driven by the ease of internet investing and the popularity of the passive style (Rawson & Johnson, 2015).



Source: Morningstar

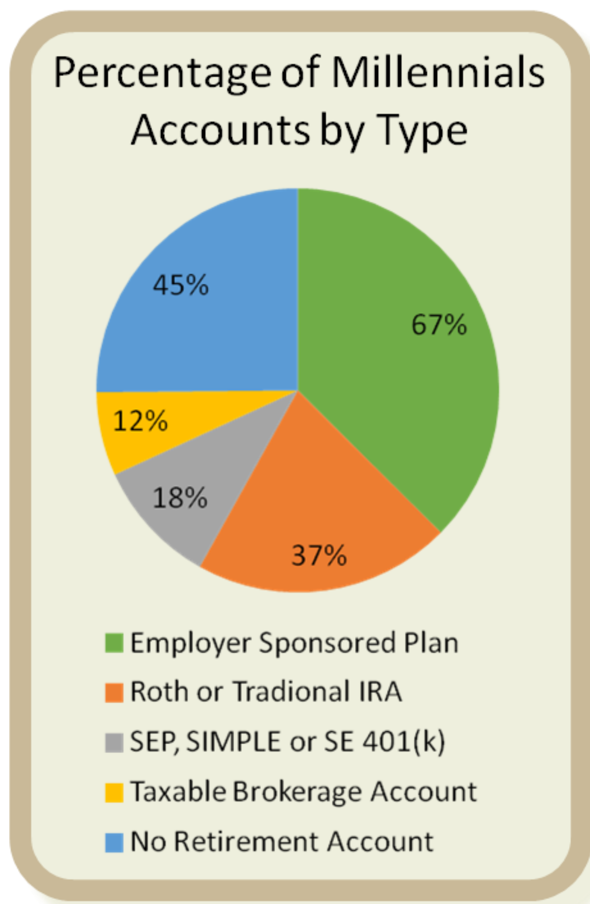
Roth IRAs:

Probably the biggest gift to Millennials is their ability to invest in Roth IRAs over the long term. Roth IRAs are great retirement saving tools, especially for young people who don't earn very much income. For a traditional IRA or 401(k), the money you add goes into the account before it is taxed. These types of accounts are called "tax deferred." You don't pay the tax now, but you will have to pay when you take the money out. The money in a traditional IRA grows, tax free. For a Roth IRA, the money that goes into the account is after tax. It grows tax free, like the other types of retirement accounts, but when you take money out, it is not taxed.

Roth IRAs make a lot of sense for people that have lower incomes, like young people just starting out in their careers. They are likely in a low tax bracket, so paying the tax now will not impact their tax bill very much. Roth IRAs are also not subject to required minimum distributions (RMD) like traditional IRAs or 401(k)s. Roth IRAs can allow for tax free income in retirement, making the most of your savings. There are limits for who can contribute to a Roth IRA. Once you make above a certain amount, you can no longer contribute to a Roth IRA.

State of Millennial Retirement Savings:

In general, Americans are unprepared for retirement. Participation in employer sponsored planners has dropped from 61% in 1999 to 53%, and only 13% of Self-employed workers have a retirement plan. (Saad-Lesser, Ghilarducci, & Bahn, 2015). The ratio of wealth to income, across age groups, is at its lowest point since 1983 (Munnell, 2015). The Center for Retirement Research at Boston College has developed a National Retirement Risk Index (NRRI). The NRRI projects the risk that households will not be able to maintain their standard of living in retirement. Currently the NRRI projects 50% of all households will fall below this threshold, up from 30% in 1983 (Munnell, 2015).



Source: Wells Fargo

Millennials, at this point, look like they are not doing much better than the previous generations; fortunately, they have time to change. The wealth to income ratio for families that the head of household is less than 35 is just below 30%. The average since 1989 is about 36% (Munnell, 2015). 45% of 22-33 year olds have no retirement plan. For the 55% that do, most don't contribute very much. In fact, 51% contribute below 5% of their income, with 5% contributing nothing (Wells Fargo, 2014). The National Institute on Retirement Security produced a report that for all Millennials the median retirement account balance is $0. The same study found that 80% of Millennials do not meet retirement savings targets for their age (Rhee, 2013). However, Millennials are starting earlier. The median age of starting a retirement account is 22, down from 27 for Gen-Xers and 35 for Boomers (Pardes, 2015).

The changing retirement and financial landscape that Millennials face mean that they cannot rely on Pensions and Social Security for their retirement income. As more of the Millennial generation enter the workforce, they need to take immediate steps to ensure they plan for their retirement. Educating themselves about retirement savings options and working with a financial adviser is a good place to start.

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