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At the Corner of Main and Wall Street: Family Pension Responses to Liquidity Change and Perceived Returns

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We study the range of factors leading to life course pension withdrawals as well as pension contributions. Are pensions now becoming another form of financial net worth accessible as a buffer stock to a range of cash flow and expenditure outlays prior to retirement? We seek to determine the factors that lead families to lose or gain defined contribution pension coverage and to put money into or draw money out of private pensions and annuities prior to age 65. We analyze microeconomic data from the Panel Study of Income Dynamics (PSID) during 1999-2009. We find that participation in and contributions to defined contributions has seen substantial variation, rising prior to the recessions of 2001-2002 and 2008-2009, and then subsequently declining as the recessions set in.

Research Questions

(1.) What has been the emerging pattern of coverage and coverage transitions, 1999-2009? Does participation appear to depend on anticipated returns on fund investments?

(2.) What factors are leading to withdrawals from DC pensions, 1999-2009? Are families drawing money out in response to cash flow needs from unexpected expenses or declines in earnings throughout the range of pre-retirement ages? Are they responding to the provisions that eliminate the penalty for withdrawals for medical needs at age 59 when the withdrawals are exempt from penalty? Do expenditures on durables appear to induce pension withdrawals?

(3.) Does mortgage foreclosure, and inability (or unwillingness) to continue mortgage payments, depend, in a significant fraction of cases, on recessionary unemployment? If so, did cash flow needs arising from mortgage payment problems and unemployment during the Great Recession lead to more pension withdrawals, 2007-2009?

(4.) Which groups are saving more in the form of pension contributions? At the present stage of the financial crisis, personal savings rates are rising and households are reducing their debt obligations (Federal Reserve Board, 2012). One pattern we can see from an analysis of the preliminary 2011 early files on housing and wealth (which include questions on liquid assets and also funds into and out of pensions by family) is an increase in the percent of homeowners with no mortgage, and a buildup of liquid assets, 2009-2011, by families with liquid assets greater than $50,000 as of 2009 (Stafford, Chen and Schoeni, 2012).

Possibly the shift to greater liquidity and to less debt reflects a decision of families to save by clearing out some debts – along with a newfound caution on the part of potential lenders. Are some of these families putting more aside in the form of pensions as another way to increase their liquidity or to save more for a more uncertain future retirement?

(5.) Which married men are making contributions to their pension plans and how has this differed in relation to overall financial market returns?

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(6) How are defined-contribution pension accounts faring (i.e., are they being cashed in to meet more immediate obligations)? Or conversely, does concern over the uncertain economy lead some families to put money aside – including increasing the funds put into their pensions? Are current responses to the crisis stripping away pension assets that will be missed by retirees in the future?

Decrease in Pension Coverage

We examine the basic pension patterns for married men over the period 1999-2009. The period includes the end of a boom, a recession, a recovery and yet another recession. The rationale for studying married men is to focus on those men who would be of employment age and are working full-time, and thereby more likely to hold a pension or IRA. While 50 percent of employed married men ages 25-63 had pension coverage as of 2009, only 42 percent of all married men in this age group had pension coverage. Those who were employed constitute a selected sample of all married men who are more likely to hold a pension.

Factors Contributing to Depletion of Pensions

We found that during both economic downturns, the probability of a family withdrawing funds from a pension, annuity or IRA rose, and the amounts conditional on making a withdrawal rose – notably at the 60th and 80th percentiles of the withdrawals distribution.

Examining participation in and contributions to their individual pensions by employed married men, one can again see the impact of recession – with both participation and contributions declining during recession. These patterns in the micro data are consistent with flow of funds data from the Federal Reserve Board, 2007-2011.

We found that low wealth, low income and out-of-pocket medical expenses are predictors of reduced contributions – just as these measures predict overall pension withdrawals by the family. Turning age 59 ½ is also predictive of making withdrawals, which supports the hypothesis that families are responsive to statutory provisions applying to pension management.

Of concern is the substantially higher probability of withdrawing pension funds for those ages 35-44 as of 2009. Moreover, those ages 35-58 were substantially less likely to make contributions to a pension fund, 2007-2009.

The housing market decline 2007-2009 led to a range of mortgage distress outcomes such as falling behind on the mortgage or taking steps to work with the lenders to modify the existing mortgage terms. These mortgage distress measures were predictive of making pension fund withdrawals.

Pension fund withdrawals appear to be a source of financing for consumer durables. The probability of a pension withdrawal is increased substantially for families who made additions and repairs of over $10,000 to their home. Having received an inheritance of $10,000 or more is associated with a greater probability of a family making contributions to a pension, IRA or annuity.

Younger families (age 35-58) were less likely to make contributions and those age 35-44 were more likely to make withdrawals. The behavior of the 35-44 age group suggests that pensions are subject to active management – sometimes with money going in and at other times money being withdrawn.

Conclusion

Pensions have become fungible with other elements in the family's financial portfolio during the pre-retirement years. While tapping into pension funds can stabilize a family's consumption during periods of financial distress, this may work to limit long-term wealth accumulation for retirement. Recent research indicates the presence of financial knowledge as a type of acquired human capital. This implies that families can learn to be better managers of their finances through experience, education or specific learning material on managing finances for the intermediate and long run.

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