Can near-retirees limit the impact of COVID-19 on their financial well-being?

Many households are experiencing negative wealth and income shocks due to the COVID-19 crisis. This financial stress can lead to increased short-term borrowing, or necessitate taking loans or withdrawals from retirement savings accounts.

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Given the increase in market volatility, some workers may also face financial losses due to poor market timing of asset transfers in their retirement savings accounts. Given these factors, how can older workers limit the impact of net worth decreases on retirement readiness?

Negative wealth shocks can have a relatively larger impact on near-retirees because they have less time to save, pay off debt, and recover from market losses. Institute research (*Retirement Savers Respond to the Market Meltdown*) found that during the Great Recession, most older workers in the higher education sector were concerned about downside market risks and decreased their equity exposure. About 3 in 5 workers increased their retirement savings amount, which can mitigate the impact to retirement security by dampening the effect of investment losses.

Understanding the pitfalls of expensive debt can lessen impacts to retirement readiness.

In the current crisis, many households need cash liquidity to finance current consumption needs. Taking advantage of low interest rates and avoiding overleveraging debt can limit potential negative impacts to retirement readiness. Institute research (*Debt Close to Retirement and Its Implications for Retirement Well-being*) found that individuals with low financial literacy are more likely to engage in high-cost borrowing, such as using payday loans, pawn shops, or credit cards (see also an earlier study focused on older working women). Improving financial literacy can improve understanding of the pitfalls of easy but expensive debt, helping near-retirees access needed liquidity while minimizing the impact on retirement readiness.

Behavioral biases can also affect debt decision making. Individuals may be present-biased, favoring consumption today while excessively discounting future well-being,[1] or underestimate how debt burdens compound over time (exponential growth bias).[2] Forming and operating on a sound financial plan can reduce the impact of behavioral biases on older workers' financial well-being.

[1] Meier, S., and Sprenger, C. (2010). Present-Biased Preferences and Credit Card Borrowing. *American Economic Journal: Applied Economics*, 2(1): 193–210.

[2] Stango, V., and Zinman, J. (2009). Exponential Growth Bias and Household Finance. *Journal of Finance*, 64(6), 2807–2849.

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Working longer can help older workers maintain their retirement well-being. Earlier research found many older workers delayed their retirement during the Great Recession.[3] Working longer can also provide a boost to retirement well-being through the increase in annual guaranteed income generated by delaying Social Security claiming. Taken together, these strategies can help maintain near-retirees' retirement readiness and dampen the adverse effects of short-term negative wealth shocks.

Working longer or delaying Social Security benefits can counteract net worth reductions.

Read more:

Yakoboski, Paul (2009). *Retirement Savers Respond to the Market Meltdown: Avoiding the "Hail Mary" Pass in Higher Education*

Lusardi, Annamaria, Mitchell, Olivia S., & Oggero, Noemi (2019) *Debt Close to Retirement and Its Implications for Retirement Well-being*

Lusardi, Annamaria & Mitchell, Olivia S. (2017). *Older Women's Labor Market Attachment, Retirement Planning, and Household Debt*

[3] Goda, G., Shoven, J., and Slavov, S. (2011). What explains changes in retirement plans during the Great Recession? *American Economic Review*, 101(3), 29-34.

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