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An Inside Look at How America Saves

By Randy Myers

It should not be that difficult. For a defined contribution plan to work for you, says Jean Young, senior research analyst at Vanguard Group and lead author of its periodic report on retirement plan participant behavior, How America Saves, you simply need to save enough and invest appropriately.

Unfortunately, Young said at the 2014 SVIA Fall Forum, many individuals struggle with that challenge. Often, their struggles start with the imperative to "save enough." In worst cases, they don't save at all. Across the nearly 2,000 plans for which Vanguard provides recordkeeping services—a universe that covers 3.4 million participant accounts—about three quarters of eligible workers participate, Young said. That's up from about two-thirds in 2004. Still, saving and saving enough can be two different things. On average, Young said, the participants in Vanguard plans are saving about 7 percent of their pre-tax income. (The median deferral is 6 percent, which has not changed for as long as Vanguard has been looking at that data.) The average has dipped a bit since 2008, but Young attributed that to the growing use of automatic enrollment by plan sponsors, who, when they embrace that feature, often set the default deferral rate at just 3 percent of pay. "The average should start coming back as plans use an annual (deferral rate) increase option," she said.

About a third of the plans for which Vanguard provides recordkeeping services have adopted automatic enrollment, Young said, with 65 percent of those setting the default deferral rate at 3 percent of pay or less. Sixty-nine percent of the plans with automatic enrollment also have automatic deferral increases, and 95 percent use target date funds as their default investment option. Another 5 percent use a traditional balanced fund. Nine out of 10 employers in the Vanguard universe contribute to their employees' retirement savings accounts, Young said, and when those contributions are factored in the average deferral rate jumps to 10.2 percent and the median deferral rate jumps to 9.2 percent. That may not be ideal, she suggested, but it's not bad. "We say this population should be saving 12 to 15 percent or more," she remarked, "but we'd be happy as a nation if everybody was saving 10 percent of their income for retirement."

Young observed that every time Vanguard publishes a new edition of How America Saves, reporters ask her what story they're missing. "This is the one they're missing," she said. "People in these plans are saving 10 percent of their income. I can't get that story written." So just how much have participants actually saved for retirement? In the plans for which it provides recordkeeping services, Young said, the average account balance in 2013 was $102,000 and the median was $31,000. Twenty-six percent of participants had account balances above $100,000. Most of them were older, longer-tenured and higher-income employees. By contrast, 30 percent of participants—mostly younger, shorter-tenured, and with lower incomes—had account balances below $10,000. The numbers are impacted by more than what people are saving.

"Every year about 15 percent of the participant base takes money from their plan, either rolling it over or cashing out," Young said. "At the same time we have 10 percent to 15 percent coming in new and starting at zero. So you have higher balances leaving and being replaced by people with basically nothing in their accounts."

While critics often complain that the average 401(k) account balance isn't sufficient to support someone in retirement, Young argued that the average figure also is misleading because of the wide range of participants represented in that number. About 60 percent of participants are men. The typical participant earns $70,000 a year, Young said, is 46 years old, and has eight years of tenure with his employer. If he continues to save 10 percent of his pay in a balanced portfolio for the next 20 years, she said, he should be able to rely on his savings and Social Security to replace 75 percent to 80 percent of his pre-retirement income after he stops working. "That's another story none of the reporters want to write," Young observed. In terms of how their assets are invested, Young said, plan participants held about 9 percent of their money in company stock at the end of 2013, plus 44 percent in diversified equity investments, 28 percent in target-date or other balanced funds, 7 percent in bonds, 8 percent in stable value and 4 percent in cash. Overall, equity accounted for about 71 percent of total account balances, up from 65 percent as recently as 2011. About 58 percent of the plans in the Vanguard universe offer a stable value investment option, Young said, little changed over the past nine years. However, the percentage of participants using stable value where offered has fallen since 2006, from about 40 percent to about 23 percent.

Based on a deeper dive into those asset allocation figures, Vanguard has calculated that about a third of participants appear to make portfolio construction errors, either by investing too conservatively or too aggressively. For example, 9 percent of participants allocate more than 20 percent of their plan assets to company stock. However, Young said, participants in general have more appropriately constructed investment portfolios today than they did in 2004. That year, only 37 percent used balanced strategies; by 2013, two-thirds had them. Another big change in the way plan participants are investing, Young said, is reflected in their enthusiasm for indexing. In 2004, about 28 percent of all the assets in plans for which Vanguard provides recordkeeping were indexed; at the end of 2013, the figure was about 50 percent. For many of the criticisms aimed at defined contribution plans today, Young seemed to suggest, there is an offsetting positive development. While half of plan participants don't appear to save enough, for example, half do have strong savings rates. And while a third appear to make portfolio construction errors, that's down from two-thirds not too long ago. Also, 40 percent are now wholly invested in a professionally managed investment, such as a target-date fund, balanced fund or managed account program, up from 7 percent in 2004. Finally, she said, evidence suggests that people are working longer on average, which not only gives them more time to save for retirement but also lessens the time their nest eggs need to last. SVIA