

Evaluating the Retirement Crisis based on Contribution Levels

Fundamentals

Does America have a retirement savings crisis? There has been a lot of heated debate around this question, particularly as the Baby Boom generation enters their retirement years. But the concern extends to younger generations as well. For American working families, what percentage of their income is needed to be saved for retirement? This chapter evaluates the adequacy of retirement savings for American families age 25-64, by examining their retirement plan contribution levels, using the most recent Survey of Consumer Finances data.

Overview

This chapter reviews annual retirement savings goals suggested by various financial institutions, based on:

- (a) the age when a person starts saving for retirement;
- (b) the age when a person plans to retire in the future; and
- (c) the assumed standard of living in retirement.

Next, using the Survey of Consumer Finances data, we analyze:

- (a) the percentage of American families eligible for work-based retirement plans;
- (b) the percentage of eligible families making active retirement contributions;
- (c) the employee, employer, and total contributions as a share of income; and
- (d) how the contributions vary across socioeconomic-demographic groups.

Key findings:

- (1) Even under the most optimistic assumptions, not a single cohort examined is meeting the retirement savings goals at this point in time. Indeed, the younger cohorts – the Millennials and GenXs – are lagging behind their targets more than older cohorts.
- (2) Within each age group, retirement contribution rates are higher with each increase in educational attainment and at higher income levels.
- (3) Within each age group, African Americans and Hispanics have lower contribution ratios than non-Hispanic Whites.

The Specifics

Target Retirement Savings Goals

Any calculation of a retirement savings goal makes a handful of critical assumptions about the future [1]. Table (1) compares two projections of annual retirement savings goals, based on the age at which an individual starts to save and their age of planned retirement. These two projections are based on different assumptions, as discussed below.

Based on this table, for individuals who start saving at age 25 and plan to retire at age 65 need to contribute between 10-17% of their income to retirement plans every year. For those who start saving at 35 or 45, their target contribution rates should be even higher. Note that these target contribution rates assume workers continuously contribute to retirement each year between the starting age and retirement age, with no break due to career disruptions.

Later in this chapter, we will compare Americans' actual contribution levels to the targets.

Table 1. Suggested retirement contributions as a percentage of current income, including employee and employer contributions.

Projection by Munnell, et al. [2]			
Retirement age	Start Saving at Age 25	Start Saving at Age 35	Start Saving at Age 45
62	15%	24%	44%
65	10%	15%	27%
67	7%	12%	20%
70	4%	6%	10%

Projection by Aon Hewitt [3]			
Retirement age	Start Saving at Age 25	Start Saving at Age 30	Start Saving at Age 35
65	17%	20%	25%
67	14%	16%	20%
70	10%	12%	14%

The following assumptions need to be made to calculate a retirement savings target:

- Rate of return on savings
- Inflation rate
- Salary growth rate
- Retirement age, and life expectancy at retirement
- Whether retirees continue working part-time
- Household structure: single, married, presence of dependent children or parents
- Amount of Social Security benefits
- Amount of existing savings in retirement and non-retirement accounts
- The existence of traditional pension benefits
- Whether the retiree will tap home equity to help fund their retirement

- Expected living expenses at retirement, the largest of which will most likely be housing costs and medical costs
- The income tax rates at retirement

Reasonable differences in these assumptions can produce significantly different conclusions about retirement savings targets. The farther away that future retirement is, the more likely it is that the assumptions will turn out to be different from the reality that emerges.

Reality Check - Participation Rate in Work-Based Retirement Plans

Taking into account these parameters for retirement savings goals, we now turn to examine whether American families are saving above or below the ideal levels.

In the context of the present analysis, a family is considered *eligible* to participate in a work-based retirement plan if either spouse/partner is included in any pension or retirement plans or tax-deferred savings plans connected with their current jobs. These data are evaluated at the family level, in line with the convention established by the Survey of Consumer Finances. We will discuss the implications of using family versus individual as analysis unit on the results in later sections.

Table (2) shows that roughly half of all households are offered work-based retirement plans at their current jobs (column 1) and of those households, the vast majority are choosing to make contributions (Columns 2-3).

Table 2. Eligibility and participation in work-based retirement plans

Age group	(1) Eligible to participate in work-based retirement plan	(2) Positive contribution in work-based retirement plan	(3) Participation percentage: (2)/(1)
25-34	46.5%	42.3%	91%
35-44	51.9%	47.3%	91%
45-54	53.7%	49.3%	92%
55-64	45.3%	40.1%	89%

Table (3) shows the median contribution percentages for employee, employer, and total contributions in work-based retirement plans by households headed by members of various age groups. Note that these statistics are only for eligible families. Employee contribution percentages are calculated by summing the total contributions made by all members of the household, divided by the sum of pre-tax income earned by all members of the household.

Table 3. Median contribution as a percent of income in work-based retirement plans, for eligible families

Age group	(1) Median Employee Contribution	(2) Median Employer Contribution	(3) Median Total Contribution
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25-34	4.00% of income	2.00% of income	6.21% of income
35-44	4.04%	2.36%	7.22%
45-54	4.84%	2.88%	8.14%
55-64	4.86%	2.08%	7.54%

Next, to assess retirement savings adequacy, we calculate total retirement contributions as a share of family income, and see how many families' contributions actually meet three important thresholds: 5%, 10%, and 15% of income (Table 4). Compared to younger families, older families are more likely to meet the criteria. At the highest threshold of 15% or more of income, 10.2% of families age 25-34 contribute at that level, whereas 18.3% of families age 55-64 do the same.

Table 4. Percentages of families whose total contribution as a percent of income equal or exceed various thresholds, for eligible families

Age group	(1) Total Contribution Equals or Exceeds 5% of Income	(2) Total Contribution Equals or Exceeds 10% of Income	(3) Total Contribution Equals or Exceeds 15% of Income
25-34	60.3%	29.3%	10.2%
35-44	64.0%	30.8%	12.3%
45-54	70.2%	38.0%	15.8%
55-64	63.9%	36.8%	18.3%

Reality Check - Retirement Contribution Variations Across Demographics

The median total contribution increases with the highest educational attainment of a family (Table 5). Again, the statistics only include families eligible for work-based retirement plans. For the 45-54 age group, the families whose head of household received a high school education contribute approximately 7.03% of income to retirement, whereas those with a college degree or more contribute 9%.

Table 5. Median total contribution by educational attainment as a percent of pay in work-based retirement plans, for eligible families

Age group	Less Than High School	High School Diploma/GED	Some College	College Degree or more
25-34	n/a	n/a	5.66% of income	6.55% of income
35-44	n/a	n/a	6.59%	7.58%
45-54	n/a	7.03%	6.88%	9.00%
55-64	n/a	6.29%	6.07%	8.31%

n/a = insufficient data

Income levels are also strongly correlated with retirement contributions (Table 6). Within an age group, the contribution rate increases with income level. For instance,

in the 25-34 age group, the low-middle income families (the 2nd quartile) contribute about 5.66% of income to retirement, whereas the highest income families (the 4th quartile) contribute over 8%.

The annual income quartile values for household income in the SCF survey are as follows:

- 1st quartile: Under \$26,000
- 2nd quartile: \$26,000 to \$50,000
- 3rd quartile: \$50,000 to \$95,000
- 4th quartile: Over \$95,000

Table 6. Median total contribution by income quartile¹ as a percent of pay in work-based retirement plans, for eligible families

Age group	1st Quartile	2nd Quartile	3rd Quartile	4th Quartile
25-34	n/a	5.66% of income	6.25% of income	8.08% of income
35-44	n/a	5.89%	7.27%	7.84%
45-54	n/a	6.15%	7.50%	9.17%
55-64	n/a	6.81%	6.94%	8.46%

n/a = insufficient data

To the extent that post-retirement income expectations are a function of pre-retirement income, the perceived need to save for retirement may vary by income level. For example, those in the lowest income group (the 1st quartile) may hold the belief that their retirement income needs will be sufficiently met by Social Security. By contrast, Social Security payments may not provide sufficient replacement value for higher income groups.

The median total contribution is higher for Whites compared to Blacks and Hispanics (Table 7). The differences appear to be larger for the older age groups than for the younger ones. For families age 55-64, Whites contribute toward retirement at nearly double the rate of Blacks (8% vs. 4.13%). In comparison, the difference for families age 25-34 is much smaller (6.65% vs. 4.83%).

Table 7. Median total contribution by ethnicity as a percent of pay in work-based retirement plans, for eligible employees

Age group	Non-Hispanic Whites	Non-Hispanic Blacks	Hispanics
25-34	6.65%	4.83%	n/a

¹ A note about income quartiles used in this figure. Although we calculate retirement contributions as a percentage of current income (2016), families are sorted into income quartiles based on their previous year's income (2015).

35-44	7.66%	5.93%	5.86%
45-54	8.41%	6.62%	6.25%
55-64	8.00%	4.13%	n/a

n/a = insufficient data

Can Contributions to IRAs Make Up Any Shortfalls?

One possibility regarding insufficient employer-sponsored retirement savings by families is that they might be utilizing other methods of preparing for retirement. As such, we examined ownership rates in and account values in both Individual Retirement Accounts (IRAs) and Keogh Accounts (Table 8).

Table 8: Ownership of IRA/Keogh accounts

Age group	% of families with IRA/Keogh accounts	Median account value, only for families with IRA/Keogh accounts
25-34	17.7%	\$10,000
35-44	26.9%	\$26,000
45-54	30.1%	\$48,000
55-64	36.4%	\$76,000

These statistics show the shortfalls in employer-sponsored plans will likely not be made up by contributions to IRAs or Keogh Plans, for a few reasons:

- Many of the IRA accounts are rollovers from work-based plans, particularly for the older age groups. In this case, they may not be currently contributing to these accounts.
- Table 2 shows that more than half of households are not currently contributing to work-based retirement savings plans, a much higher rate than the IRA/Keogh ownership rates shown in Table 8.
- The limits on annual contributions are lower for IRAs (\$5,500 in 2018 for people under age 50, \$6,500 age 50 and older) than the limits on contributions to work-based retirement plans (\$18,500 for people under age 50, \$24,500 for people age 50 and older).
- Most employers do not contribute to IRA accounts.

How Do Our Results Compare to Other Studies on Retirement Savings Levels?

Here is a summary of recent studies of the level of Americans' retirement contributions, to determine if the Sightlines analyses are "in the ballpark." Note, however, that all these analyses look at contributions by individuals, not households.

- Fidelity Investments' *Retirement Savings Assessment 2018* [4] reports the following median total savings rates (including employer match) as follows:
 - Millennials: 7.5% of pay
 - Gen X: 8.6%
 - Boomers: 9.9%

- The *18th Annual Transamerica Retirement Survey of Workers* [5] reports the following *median* employee contribution levels:
 - Millennials: 10% of pay
 - Gen X: 8% of pay
 - Boomers: 10% of pay

Transamerica also reports that contributions higher than 5% of pay are reported by 69% of Millennials, 68% of Gen X, and 76% of Boomers. Contributions higher than 10% of pay are reported by 35% of Millennials, 39% of Gen X, and 36% of Boomers.

Note that these amounts do not include employer contributions.

- Vanguard's *How America Saves 2017* [6] reports contribution levels prevalent in defined contribution plans in 2016, as follows:
 - Median employee contribution: 5.0% of pay
 - Median total contribution: 10.0%

 - Average employee contribution: 6.9%
 - Average total contribution: 10.9%

The median contribution levels reported in our Sightlines analyses are generally lower than these survey results, for at least two reasons:

- We analyzed data at the family level, but many related surveys and reports are based on contributions by individuals. Table (9) shows that for a family with two income-earning spouses, where only one is eligible for a work-based retirement plan, the individual-based approach will result in a higher retirement contribution ratio than the family-based approach.

Table 9: Individual-based approach vs. Family-based approach

	Individual-based approach	Family-based approach
Pay:	Only spouse 1 is eligible for retirement contribution.	The family is eligible for retirement contribution.
- spouse 1: \$30,000		
- spouse 2: \$20,000		
Retirement contribution:	Contribution ratio	Contribution ratio
- spouse 1: \$1,200	= \$1,200/\$30,000	= \$1,200/(\$30,000+\$20,000)
- spouse 2: not eligible	=4%	= 2.4%

- Our analysis calculates retirement savings as a percentage of total family income, which includes both regular income and income from other sources.
- The SCF database is a broader representation of Americans than customers and participants of Fidelity, Transamerica, and Vanguard.

Do We Meet the Retirement Savings Goals?

Having calculated American families’ retirement contributions, we now compare results with the goals. Americans planning to retire at age 65 need to put aside 10-17% of income for retirement preparation, even if they start saving as early as age 25 (Table 1). If they don’t start saving until age 35 but still wish to retire at 65, then they need to contribute 15-20% of income to their retirement accounts. Based on our estimation, families age 25-64 are currently only saving a median of about 6-8% of income towards retirement (Table 3). Even if we use the individual-based approach, which tends to give a higher estimate for contribution rates, Millennials and GenXs are only saving 7-10% of income towards retirement, and Boomers are saving 9-10% [3, 4]. Thus, even if we assume that people start saving at age 25 – a very optimistic assumption – their actual contribution rates (6-10%, various estimates) are well below the targeted range (10-17%).

Across different birth cohorts, Millennials seem to fall short of the retirement savings goals most. Compared to earlier cohorts, Millennials will face a higher risk of receiving less from Social Security [7], and thus they should aim for a higher contribution rate. For example, one institution suggests as high as 22% of pay should be the new retirement savings goal for Millennials – making their current contribution even further below this targeted level [8].

Based on our analysis of retirement savings from every source we examined, the vast majority of American workers of any age will be unable to replicate and maintain their standard of living if they retire fully from working at age 65. This may be a crisis for those households that are unprepared for a significant drop in family

income or are not prepared to work beyond age 65. It's likely many Americans will adjust their spending and still experience a comfortable retirement, while many others may truly experience a financial crisis at some point in their retirement. Our results suggest that, at the very least, any increase in retirement savings levels is progress in the right direction.

Conclusions

This chapter reviews the retirement savings goals for Americans planning to start saving and retiring at various ages. Using the SCF's most recent data from 2016, we calculate the percentage of families eligible for work-place retirement plans, and their actual participation rates. Employee, employer-matching, and total contribution are analyzed based on socioeconomic-demographic background, including age, race and ethnicity, educational attainment, and income levels. A key finding is that Millennials, GenXs, and Baby Boomers all show retirement savings inadequacy, as their contribution rates fall short of the targets.

Policy-makers may want to look for ways to increase access to work-based retirement plans, since roughly half of all workers don't have access to these plans. One possible solution is multi-employer plans that are open to all types of employers. Multi-employer plans allow small employers to pool assets to achieve efficiencies of scale, and are currently only allowed for unionized workforces. Another possible solution is state-run retirement savings plans that target smaller employers who are unable to implement their own retirement savings plans.

We suggest that employers and retirement plan sponsors continually look for ways to increase their employees' total contributions to retirement plans, with a special focus on vulnerable groups that are contributing well below guidelines. Auto-enrollment and auto-escalation features have been successful at increasing contributions; employers who have not yet adopted these features may want to consider them. Recent offerings from financial wellness programs may also help workers of all ages find money in their budgets to save for retirement.

Employers could also consider providing statements to plan participants that estimate the amount of retirement income their savings might generate. This could motivate employees to increase their contribution amounts.

Employers who monitor the success of these programs and features will be in a better position to assist employees with their retirement planning. They can also prepare customized assessments of their employees' progress towards accepted retirement goals, given how much each employee has saved so far and the specific features of employer's retirement program.

Individuals of all ages will benefit greatly from increased consciousness about the impact of their current savings in relation to their plans for retirement. This will

allow them to better balance these decisions against other important goals, such as meeting current consumption needs for their families and saving for their children's education.

Even if these steps are adopted, many workers might still fall short of saving amounts deemed to be sufficient by the studies noted here. In this case, older workers will need to adopt one or more of the following actions:

- Work beyond age 65
- Reduce their standard of living in retirement
- Make every dollar of savings count by making conscious investment choices and adopting strategies to deploy savings in retirement

As noted in Table 1, working longer can have a powerful influence on helping to improve retirement security. Of course, there are challenges with working longer for both individuals and their employers [10]. Nevertheless, working longer may be one of the most realistic solutions for addressing shortfalls in retirement savings. Employers can help by offering alternative career paths for older workers to enable them to delay retirement, even if by a few years.

Citizens of developed countries now enjoy many additional years, even decades, of life compared to prior generations. But simply adding these extra years on to the retirement period is very expensive, and may require unattainable savings levels. Many older Americans are healthy, vital, and still productive [11]. Rather than adopting extreme work-life savings practices or dramatic cutbacks in post-retirement expenditures, they might need to work during some of the additional years of life they have gained, compared to their parents and grandparents.

References

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