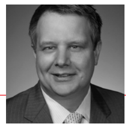
Creating Smarter Savers

Robert Vosper



We've gone to great lengths to help participants become better investors. But to avoid a retirement crisis, we now need to turn them into smarter savers.

As a nation, we are somewhat of a paradox. We are one of the wealthiest countries in the world, yet too many of us are marching toward a retirement in which we'll struggle to make ends meet. And some of us may never be able to retire at all. According to the Government Accountability Office (GAO), more than a third of Americans age 55 and older have nothing saved for retirement.

There are a few major flaws in our retirement system. Too many working Americans don't have access to an employer-sponsored retirement plan. We make it hard for employees to transfer account balances and too easy to pull money out of their accounts when changing jobs (according to the GAO, two in five participants cash out of their retirement plans when they leave their jobs). We also make it far too easy for participants to treat their retirement accounts like glorified savings accounts, tapping into them every time the fridge breaks or the car needs a new set of tires.

By far the biggest problem with our system is that Americans aren't saving enough. For all of the talk of a retirement crisis, what we really have is a savings crisis. Many Americans are simply spending more than they make. If we don't reverse that trend soon, we face a bleak economic future as millions of people enter retirement saddled with debt and with little means to support themselves.

Road to Improvement

As an industry, we've done a lot to improve defined-contribution plans since they were first launched. Most plans today have comprehensive educational programs in place, auto-enroll employees, and incentivize employees with matching contributions. Meanwhile, plan providers offer a range of features, such as auto-rebalancing and auto-escalation, to help participants better manage their accounts. And finally, the fund industry has made it easier to select investments by designing simple-to-use asset allocation and target-date funds (almost 60% of new hires favor target-date funds).

However, what we haven't done is put in place programs to change the way people think about saving and encourage them to save more.

There are two broad strategies we can use to improve overall contribution rates. The first is mandatory savings—simply force people to save a certain percentage of their paycheck into a retirement account. This is something that a number of industry experts have proposed. Unfortunately, I am pretty sure Americans aren't willing—especially in today's political environment—to allow the federal government to deduct money from their paychecks for retirement savings beyond what they are currently paying into Social Security.

A more palatable solution that almost accomplishes the same thing is increasing default savings rates at the plan level. The difference is that people may opt out or adjust the percentage if they believe it is too high. Plans today, though, generally set default rates too low. According to a 2014 BrightScope study, the most popular default savings is 3%, when it needs to be closer to 10%. The problem with a lower rate is that participants assume that it is sufficient to fund retirement and, according to the American Society of Pension Professionals & Actuaries (ASPPA), participants often don't realize they can increase their savings rates. In most cases, plans have set default rates too low out of fear that participants will opt out in droves if rates are too high. That is just not the case. In fact, study after study shows that increasing default savings rates has no real measurable impact on opt-out rates up to a certain point.

Cultivating Savers

Is it realistic to assume that every participant can afford to save 10% or more? Yes. They can save that much, but they need help getting there.

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Part of the problem is human nature. Even when we want to save, retirement or other future goals seem distant while buying a new iPhone or going on vacation gives us immediate pleasure. We tell ourselves that we deserve this purchase because we work hard, and that we'll start saving for retirement in earnest tomorrow.

That's where financial wellness solutions come in. An effective financial wellness solution helps employees embrace good fundamental financial behaviors in budgeting and debt management. The key to any financial wellness product is not so much to educate participants, but to make long-term positive changes in their spending and saving activities. One of the more popular financial wellness components is student-loan payoff assistance. This helps to attract younger talent and help that talent save for retirement (or any other goal, for that matter) during those formative working years, making it more likely they'll be able to retire. Additionally, loan-free employees are generally less financially stressed and thus more productive and focused.

Some plan sponsors have taken the position that it's not their job to help their employees become more financially responsible. However, it is good business, as the workplace is where we receive our paychecks and where most of us conduct our financial business. PWC found in its 2015 Financial Wellness survey that 37% of workers spend three hours or more each week at work thinking or dealing with issues related to their personal finances. A financial wellness solution is a relatively inexpensive benefit to offer, and can show immediate benefit both for the plan and the participant.

Additionally, plans should look at offering investment solutions that combine personalized retirement savings advice with a diversified retirement portfolio. Target-date funds are a great investment product, but they don't tell you how much you will need to accumulate to achieve a comfortable retirement or how much to save to get there. From the participant's perspective, that information tends to be in short supply. Charles Schwab published an in-depth survey of participants in 2015 titled, "401(k) Participant Study: 2015." A couple of interesting things stood out in that survey: first, participants have a much better understanding of what their ideal body weight, blood pressure, and credit score should be than they do of what percentage of their salary they should be saving for retirement. They have an even poorer understanding of how large their retirement pot needs to be to fund a comfortable retirement. Nevertheless, they are motivated to learn. According to the survey, participants ranked "knowing how much to save for retirement" almost as high a priority in their lives as they did "maintaining strong relationships with their family."

About the only in-plan solution that provides this level of savings advice and insight is managed accounts (full disclosure here: Morningstar's subsidiary is a managed accounts provider). The benefit of a managed accounts solution is that it combines personalized savings guidance with a personalized investment portfolio. Additionally, that advice—whether it is savings or investment-related—is based on an assessment of all of the participant's total retirement holdings, including projected Social Security payments, pensions, IRAs and any other money the participant or a spouse has squirreled away for retirement.

Participant Responsibility

Managed accounts, financial wellness, and default savings rates are all great tools that plans can use to boost contribution rates. But avoiding a retirement crisis in this country will take a lot more than that. More than anything, it will require participants to assume a much greater responsibility for their own financial health and become better shepherds of their financial futures. The good news is it that it seems to be happening. In 1979, the savings rate for the bottom 90% of families was 7%. In the years since, it dipped as low as negative 7%. However, in recent years, it has crawled back to 0%. There are a couple of reasons for that. The first is that we've made it harder for people to borrow money. Additionally, I think the American mindset is starting to shift as people become more willing to the make the necessary sacrifices today to live a better life tomorrow.

It's our job, and the job of plan sponsors, to give participants as many tools as we can to make saving and investing easier within the workplace and help participants achieve that better life.

Robert Vosper is the head of industry and competitive analysis for the retirement solutions division at Morningstar, Inc. In that role, he helps set the direction of the business and works on a variety of strategic projects. He also is in charge of tracking industry trends and assessing market competition.