Commentary October 2023

How Americans can save more for retirement

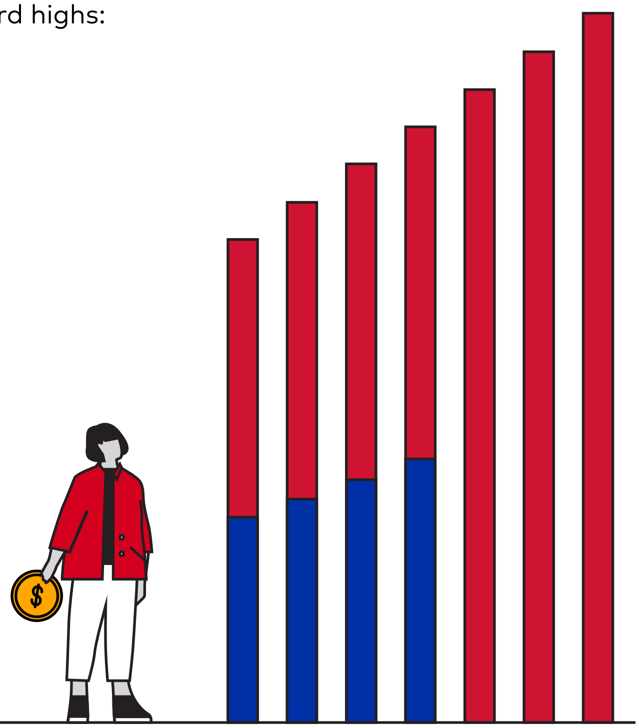
Introduction

In June, Vanguard published the 2023 edition of *How America Saves*, our annual deep dive into the saving behaviors of nearly 5 million participants across our full-service recordkeeping business.

This year's report, our 22nd, highlighted several record highs:

- Plans adopting automatic enrollment, 58%.
- Automatic enrollment plans defaulting at rates of 4% and higher, 59%.
- Participants with access to advice, 77%.
- Plan participation, 85%.
- Participants using a professionally managed allocation, 66%.
- Participant-directed exchanges (record low), 6%.

These results are a credit to many of our plan sponsors who have strategically improved their plan designs over the years, and we are encouraged by these trends. By leveraging strong plan designs, more Americans are now saving for retirement and investing in age-appropriate equity allocations. The success is undeniable.



Author

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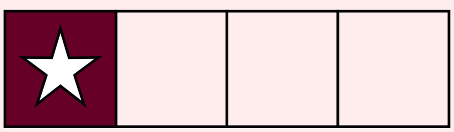
★ **Participants' median total saving rate was 10.6% in 2022.**

But there is still work to be done, specifically regarding participants' saving levels. While average and median deferral rates are trending up, there are still many participants who should be saving more. We believe they should be saving at least 12% to 15% (including employee and employer contributions) of their pay to meet their retirement goals. Participants' median total saving rate was 10.6% in 2022. Therefore, while about one-half of participants were saving at relatively strong levels, the other half may need to save more. This commentary provides insights into the saving behaviors of participants and helps answer the questions, "What can plan sponsors do to help participants increase retirement savings?" and "How can Vanguard help?"



1 in 4 participants have a deferral rate below 4%.

Participant savings

In a typical retirement plan, participants are the main source of funding, while employer contributions play a secondary role. Therefore, the level of participant deferrals is a critical determinant of whether the plan will generate an adequate level of savings for retirement.

Vanguard participants deferred an average of 7.4% of their income in 2022, up from 6.8% in 2016. The median deferral rate rose from 6.0% in 2016 to 6.4%. While these increases in saving rates are encouraging, opportunities for improvement remain.

Deferral rates vary considerably among participants (**Figure 1**). One in 4 participants had a deferral rate of less than 4% in 2022. In addition to deferring at a low rate, these participants were most likely not maximizing their employer match either, missing out on valuable retirement contributions. Another 1 in 5 participants were deferring between 4% and 6%. In this case, they may be maximizing their employer match, but by boosting their deferral rates a few percentage points, they may be able to reach an optimal total saving rate.

FIGURE 1.

Distribution of participant employee-elective deferral rates

Percentage of participants

Deferral rate	2016	2022
0.1%–3.9%	30%	25%
4.0%–6.0%	22%	19%
6.1%–9.9%	28%	32%
10.0%–14.9%	14%	17%
15.0% +	6%	7%
Deferring >6%	**48%**	**56%**

Source: Vanguard 2023.

Employer contributions

Employer contributions typically account for about 40% of participant retirement assets. Recognizing this vital role in helping participants save, 95% of retirement plans offered a matching contribution, a nonmatching contribution, or a combination in 2022. Eighty-five percent of plans offered an employer matching contribution, and 46% offered a nonmatching contribution. More than a third (36%) of plans offered both types of employer contributions.

The average employer match value was 4.5% of pay in 2022, and the average nonmatching value was 5.1%. When employer contributions are more generous, participants are more likely to save at optimal total saving rates.[1]

Savings sufficiency/Optimal targets

Vanguard estimates that a typical participant should target a total contribution rate of 12% to 15%, including employee and employer contributions, and invest their retirement assets in an age-appropriate, well diversified mix of stocks and bonds.

Vanguard participants' average saving rate was 11.3% in 2022, up from 10.4% in 2016. The median total saving rate was 10.6%, up from 9.7% in 2016. As with deferral rates, while the increases are encouraging, there is room for improvement. Total saving rates continue to vary considerably (**Figure 2**). About 1 in 4 participants saved a total of 6% or less in 2022, and unless their path is altered, they could face a significant shortfall in retirement. Another 1 in 4 participants saved between 6% and 10%, but they could reach the optimal saving rate by increasing their deferral rates by just a few percentage points.

FIGURE 2.

Distribution of participant total savings rates

Percentage of participants

Total savings rate	2016	2022
0.1%–3.9%	16%	14%
4.0%–6.0%	11%	9%
6.1%–9.9%	25%	23%
10.0%–14.9%	27%	29%
15.0%–19.9% +	13%	15%
20.0%–24.9%	5%	6%
25% +	2%	3%
Saving 10%+	**47%**	**53%**

Source: Vanguard 2023.

Plan design solutions

Automatic enrollment—with an automatic annual increase feature and an age-appropriate, well-diversified target-date fund—helps participants create a strong retirement savings foundation. But not all automatic enrollment designs are the same. Several features can affect participant savings.

Automatic enrollment defaults

When retirement plans first started adopting automatic enrollment, the overwhelming majority set an initial saving default of 3%. Plan sponsors quickly realized improved participation with automatic enrollment, but they noticed participants were not saving as much as they may have been with voluntary enrollment. While the inertia of automatic enrollment was helping them save, it was also leading many to "undersave." In response, many plan sponsors increased default rates, often setting them in line with the full value of the employer match.

As of 2022, 59% of automatic enrollment plans defaulted in participants at 4% or more, up from 48% of plans in 2016. Recent increases in average deferral rates are partly attributable to plans' higher automatic enrollment default rates. Furthermore, our research has found that employee quit rates (proactively choosing to not save) do not vary in response to the initial deferral rate.[2] Plan sponsors should set a default rate that is equal to or greater than the deferral level necessary to receive the full employer match. This helps employees maximize the employer match benefit and save at a relatively strong level as soon as they enter the plan.

[1] *The Vanguard Participant Saving Rate Index*. Jeffrey W. Clark and Jean A. Young, Vanguard. July 2022.

[2] *Automatic Enrollment: The Power of the Default*. Jeffrey W. Clark and Jean A. Young, Vanguard. February 2021.

Automatic increases: 1% or 2%?

Seven in 10 automatic enrollment plans default participants into an annual increase feature. Our research shows that participants enrolled in a plan with automatic increases save, on average, 20% to 30% more after three years in the plan, compared with participants in an automatic enrollment plan that does not automatically increase.

While most plans enroll participants at a 1% annual increase, some accelerate participant saving by defaulting in participants at a 2% increase. As participants should reach a target savings rate of 12% to 15% as soon as possible, the annual increase default can play an important role in helping them expeditiously reach their target.

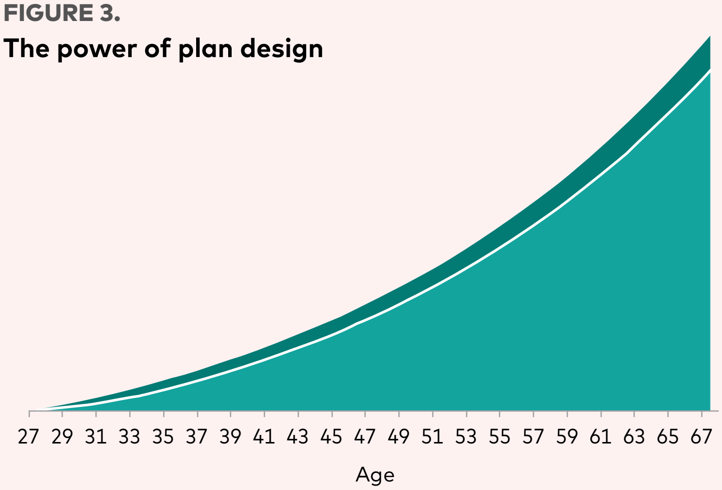
Plan sponsors also may elect to offer annual increases in voluntary enrollment plans. Participants are then presented with the annual increase election at enrollment and when they change their employee-elective deferral rate. In 2022, 65% of participants in voluntary enrollment plans had access to this feature and nearly 3 in 10 were using the service.

And plan sponsors should ensure their annual increase cap is set to a level that ensures participants reach at least a total saving rate of 15%. Setting a low cap (less than 10%, for example) could inadvertently cause some participants to undersave for retirement.

An automatic increase of just 1% to 2% can help participants save 20% to 30% more.

Finally, defaulting participants at a strong rate and enrolling them into a 2% annual increase can provide additional assets when they reach retirement. In Figure 3, we assume two participants start working at age 27 and are hired under different automatic enrollment designs. Participant A (blue) is defaulted in at 3% and is annually increased 1% up to a 12% deferral rate. Participant B (green) is defaulted in at 6% and is annually increased by 2%, again to a 12% deferral rate. In both cases, each participant receives a 50%-on-6% employer match and both cap out at a 15% total saving rate. However, based simply on the accelerated saving path when they begin employment, Participant B would have a balance 10% higher than Participant A at retirement, despite saving at the same 15% rate for most of their career.

FIGURE 3.
The power of plan design



Plan design	Balance at retirement
6% automatic enrollment deferral, 2% automatic increase to 15% total savings rate	$861K
3% automatic enrollment deferral, 1% automatic increase to 15% total saving rate	$780K

Source: Vanguard 2023.

This hypothetical illustration assumes a $50,000 starting salary, 1% annual salary increase, and 4% real return. This example does not represent any particular investment and the rate is not guaranteed. The final account balance does not reflect any taxes or penalties that may be due upon distribution. Withdrawals from a tax-deferred plan before age 59½ are subject to a 10% federal penalty tax unless an exception applies.

Automatic solutions

Given the benefits of automatic enrollment, are there additional ways plan sponsors can leverage the power of inertia in their employees' favor? Absolutely. The benefits of automatic enrollment can continue after an employee is hired and throughout their career in the form of additional automatic saving solutions.

Participants who received personalized nudges were up to 3x more likely to increase their deferrals.

There are three common types of automatic saving solutions:

- Reenrollment—automatically enrolls current nonparticipants into the plan.
- Undersaver—increases low-saving participants to the maximum employer match value.
- Automatic increase—enrolls participants into an automatic increase feature.

The financial health of workers and their households continually changes, affected by various factors (life adjustments, job changes, spending habits, etc.).

Automatic solutions are valuable plan design features that can help participants regain their footing and improve retirement saving behavior. These supplemental automatic solutions typically have high success rates (about 70% to 90% of participants choose not to opt out) and can further strengthen retirement outcomes.[3] Vanguard recommends these plan design initiatives be implemented every three to four years, helping ensure a reasonable interval between actions while not extending the period too long and missing out on saving opportunities.

Personalized participant experience

While strong plan design has the greatest influence on participant savings, there are many other opportunities to engage with participants throughout their career. Sponsors should encourage them to routinely check on their retirement plan and should provide targeted, relevant, and personalized experiences for participants to effectively drive engagement and positive actions. In 2022, participants who received a personalized meet-your-match offer (outbound email and corresponding web nudge) were up to three times more likely to increase their payroll deferral than were similar participants who did not receive the offer. The rapid evolution of technologies like machine learning and artificial intelligence, combined with the accessibility of digital tools and devices, has made it possible to deliver personalization at scale. Given the importance that artificial intelligence and machine learning will have in the future, we foresee a continual evolution in how recordkeepers reach and engage participants.

Automatic solutions typically have 70% to 90% success rates.

[3] *Automatic Solutions Don't End with Automatic Enrollment*. Vanguard. August 2022.

Conclusion

Strong retirement readiness rests on two important actions: saving enough and investing appropriately. Automatic enrollment and target-date funds have significantly altered the trajectory of how Americans save and invest for retirement. The percentages of employees saving for retirement and invested in a professionally managed allocation have never been higher. And while participant saving has increased marginally over the past few years, there is still room for improvement.

In summary, plan sponsors should consider the following actions:

- Automatically enroll participants at 6%, or at least to the level of the matching contribution.
- Consider enrolling participants into a 2% annual increase to help accelerate total saving.
- Consider ad hoc automatic savings solutions, such as undersaver, automatic increase, and reenrollment sweeps, every three to four years.

Strong plan designs, coupled with a highly personalized participant experience, can boost retirement saving and help participants achieve their retirement goals.

All investing is subject to risk, including the possible loss of the money you invest

Diversification does not ensure a profit or protect against a loss.

Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the work force. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target date funds is not guaranteed at any time, including on or after the target date.

Withdrawals from a Roth IRA or a Roth 401(k) are tax free if you are over age 59½ and have held the account for at least five years; withdrawals taken prior to age 59½ or five years may be subject to ordinary income tax or a 10% federal penalty tax, or both. (A separate five-year period applies for each conversion and begins on the first day of the year in which the conversion contribution is made).

We recommend that you consult a tax or financial advisor about your individual situation.

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