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THEME ONE

Access and Adequacy

Getting on track and staying there

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T. Rowe Price research has found that more than 40% of the U.S. private sector workforce does not have access to a retirement savings plan at work.

Lack of access to a retirement plan is particularly acute for racial and ethnic minorities. Our research found that, overall, only 40.5% of Black workers and 31.9% of Hispanic workers in the private sector participated in a retirement plan, compared with 57.7% of their white peers.[1] However, that participation gap narrowed significantly when we accounted for reduced access to a retirement plan among non-white workers. Participation is higher among underrepresented communities when they are given the opportunity to participate in a workplace retirement savings plan. It is commonly agreed that the access gap needs to be closed. However, how to do so involves robust political discourse and differing legislative proposals.

Among employers that do offer retirement savings plans, the focus has pivoted from simply providing access to helping employees take full advantage of the benefits offered to them by encouraging increased participation and saving. But there are additional barriers to achieving better financial outcomes.

The coronavirus pandemic has exposed basic underlying economic frailty among many workers. Participant interest in usage of coronavirus-related distributions during the peak of the pandemic suggested that, for many workers, retirement savings were likely the greatest or perhaps the only source of liquid savings available for them to tap when facing pandemic-related economic hardships.

Premature use of retirement savings was not the only effect of the pandemic. The rush to return to economic normalcy inspired many workers to seek new employment opportunities. However, this might have unintended consequences for their retirement savings. While auto enrollment and auto escalation (a plan feature that automatically increases an employee's contribution) have benefited many employees by increasing their savings over time, our recordkeeping data show that newly enrolled employees, on average, saved less than longer-tenured employees. This disparity highlights a potential unintended consequence of job changes and the need to better understand the effects of plan defaults.

These are the realities that policymakers, employers, and other retirement stakeholders such as recordkeepers, financial professionals, and plan consultants now face.

Who Under-Saves and Why

Retirement savings gaps among different races, ethnicities, and genders are well-understood inequalities that need to be addressed. However, a pivotal nuance is often overlooked: *When* people start to save for retirement can make a big difference in whether they get on track toward achieving their retirement objectives.

In a recent research study, we found that 38% of white 401(k) participants said they started saving before age 30, compared with only 18% of Black and 29% of Hispanic participants. More than 30% of Black and Hispanic participants who responded to our survey said they didn't start saving for retirement until age 40 or later.

A late start in saving can have major consequences (Figure 1). Successful retirement outcomes usually depend on starting early, saving at a high enough rate, or increasing that rate over time and saving persistently. Someone facing a savings shortfall at retirement can't go back and give themselves more time: Once lost, the opportunity to start saving early can never be regained.

[1] Among private-sector wage or salaried workers between 21 and 64 years old.

See pages 17-18 of the full 2023 U.S. Retirement Market Outlook for T. Rowe Price research sources.

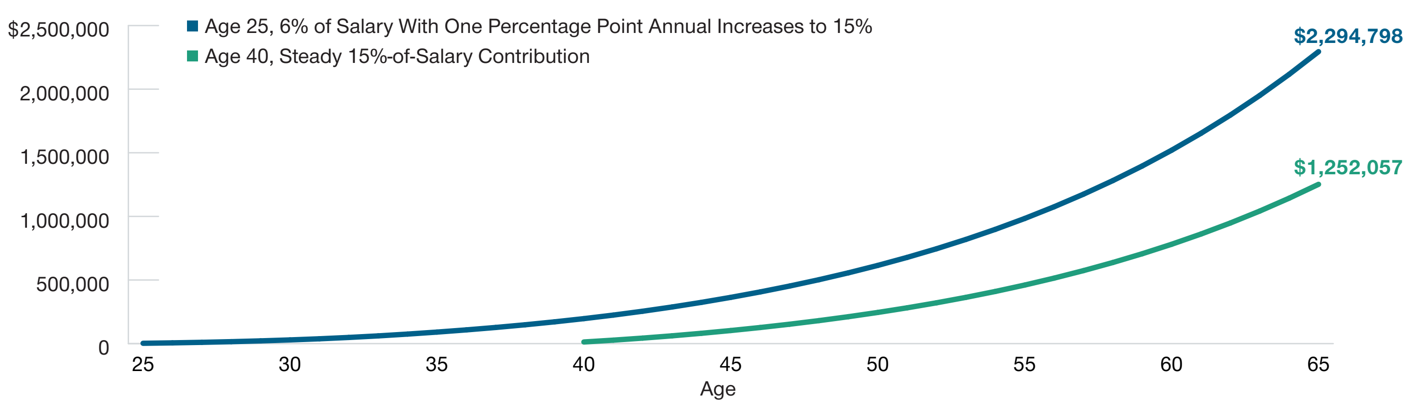
However, under-saving is not solely a function of race or ethnicity. Gender differences exist as well. Our research found that the median 401(k) account balance among women was just $21,600—less than a third of the $62,000 median balance among men. Unsurprisingly, single women fared even worse. What's more, the savings gap between men and women appears to be increasing: While the median 401(k) balance among baby boomer women was 54% of the median for men, the median balance for millennial women was only 35% of the median for their male counterparts.

In addition to lack of access to a plan or a failure to begin saving early, competing financial priorities also can play a major role in under-saving. Under-savers often have needs that are more immediately pressing than saving for retirement, which may be decades away. Priorities such as day-to-day living expenses, establishing an emergency savings fund, or servicing debt often take precedence. This is particularly true in underrepresented communities. For example, our research suggests that Black and Hispanic participants are likely to hold more debt than their white counterparts. Among Black participants, 41% held student loans, more than twice the rate for white participants. Black and Hispanic participants were also more likely to cite credit card debt and medical debt as barriers to saving.

Financial priorities often change with age, too, our research found. Not surprisingly, people in the 50 to 64 age group cited saving for retirement as a major financial goal more often than younger workers did. In middle age, retirement grows nearer, yet many savers feel competing financial demands most intensely during those same years—from servicing a mortgage to paying for a child's college education to helping support elderly parents.

Saving Early Can Make a Large Difference

(Fig. 1) Hypothetical accumulation of retirement savings with early and late starts



As of March 2022.
Source: T. Rowe Price.
Assumptions: The hypothetical example that starts at age 25 assumes a beginning salary of $40,000 that increases 5% a year until age 45 and then rises 3% a year until age 65. Retirement savings are calculated based on a beginning savings rate of 6% of salary, with one percentage point annual increases until 15% of salary is reached. The hypothetical example that starts at age 40 assumes a beginning salary of $80,000 that increases 5% a year until age 45 and then 3% a year until age 65. Retirement savings are calculated based on a flat savings rate equal to 15% of salary. The annual rate of return for both examples is assumed to be 7%, which is lower than the average annual return for the S&P 500 Index between 1957 and 2021. All savings are assumed to be tax-deferred. **These examples are hypothetical and for illustrative purposes only, and are not meant to represent the performance of any specific investment option. Results do not reflect actual investment results and are not a guarantee of future results. Actual investment returns and outcomes may differ materially. The assumptions used may not reflect actual market conditions or your specific circumstances and do not account for plan or IRS limits. Results do not include management fees, trading costs, and other related investment fees that would serve to reduce ending balances. Investors cannot invest directly in an index.** Please be sure to take all of your assets, income, and investments into consideration in assessing your retirement savings adequacy.

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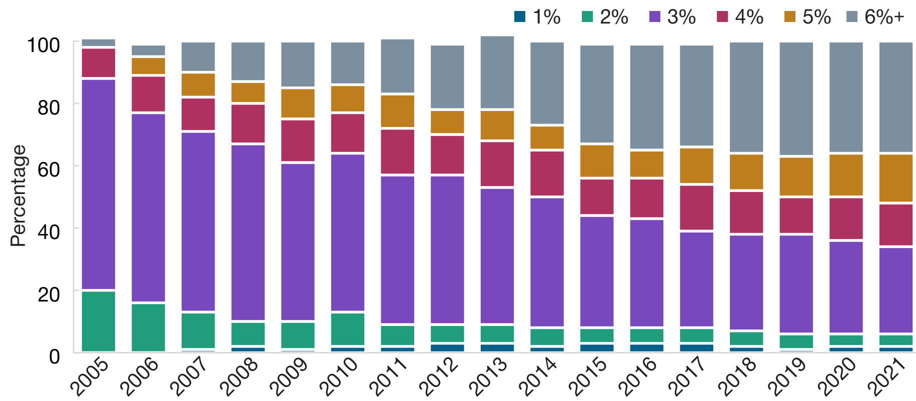
6% of Salary Is Now the Most Common Default Contribution Rate

(Fig. 2) Default automatic enrollment contribution rates in 401(k) plans*



As of December 2021.
Source: T. Rowe Price Retirement Plan Services, Reference Point 2022.
*Columns may not total 100% due to rounding.

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Who Can Help and How

Plan sponsors and those who help them, such as recordkeepers, financial professionals, and plan consultants, have a variety of means at their disposal to help close racial, ethnic, and gender savings gaps among participants. Not only can employers address this challenge, for many it is emerging as a key business objective.

Increasingly, we see companies viewing their retirement plans as critical components in their human capital management strategies, including benefits; total rewards; talent management; and diversity, equity, and inclusion (DEI). Further, we see at least three areas where employers potentially can benefit by helping their employees get and stay on track with their retirement savings.

- **Tight labor markets:** We see employers turning more to their benefit offerings to help attract and retain talent, with their retirement plan as a key component.
- **Aging workforces:** Employers face costs if some employees must work past the typical retirement age because they can't afford to retire. Examples may include direct compensation or benefits such as health care. Other costs may relate to broader workforce management expenses if younger workers leave due to limited promotion opportunities.
- **Social equity:** Employers could consider if and how to use their retirement plans as elements of their DEI strategies and seek ways to ensure that all employees fairly benefit from the forms of compensation companies offer.

In all of this, one should not lose sight of the impact that plan design can have on both participation and savings behavior. Among our recordkeeping clients, the average participation rate is 85% for plans that offer automatic enrollment but only 39% for those that do not.[2]

Among our recordkeeping clients, 6% of salary was the most commonly used default contribution rate in 401(k) plans (Figure 2).[3] In our view, plan designs that combine a 6%-of-salary default deferral with an automatic escalation feature that

[2] As of December 31, 2021. Automatic enrollment and opt-in figures are rounded. Source: T. Rowe Price Retirement Plan Services.
[3] As of December 31, 2021.

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increases the deferral annually by one percentage point to at least 10% (and, ideally, to 15%) could do a lot to help people who otherwise would not invest for retirement get and stay on track.

How Policy Changes May Help

Employers are not the only ones who can help address under-saving. U.S. lawmakers can, too. As of the date of this report, Congress is considering several retirement-related legislative proposals. These include:

- **Increasing the safe harbor default deferral rate:** The default deferral rate for the automatic enrollment safe harbor in the Pension Protection Act of 2006 has remained at 3% of salary since the legislation was enacted. Congress is considering legislation that would raise the minimum default rate for new types of safe harbor plans to 6%.

- **Improving the saver's credit:** Use of the tax credit for eligible contributions to retirement plans and IRAs has been limited due to the relatively modest size of the credit and the need to owe taxes in order to claim it. Congress is discussing two proposals that would increase the percentage of a taxpayer's eligible contributions that could be claimed. One of the proposals also would allow refundable credits, as long as the refunded amount was contributed to a retirement vehicle.

- **Facilitating emergency savings:** Federal law allows employers to withhold money from employees' paychecks for retirement savings via automatic enrollment in an employer-sponsored plan. However, it's not clear whether federal law also allows automatic enrollment in emergency savings vehicles, and state wage garnishment laws also could present issues. Congress is discussing two proposals to boost emergency savings using retirement plans. One would permit the creation of "sidecar" savings accounts within a retirement plan as part of automatic enrollment. The other would exempt withdrawals for "emergency personal expenses" from the early withdrawal excise tax. In addition, employers currently have the option of creating emergency savings accounts outside of the plan. All of these options could encourage greater plan participation by employees with limited savings ability because they would know that they were also building up their emergency savings and would have more immediate access to those balances.

- **Matching student loan repayments:** Many younger workers have sizable student debt loads that can limit their ability to start saving for retirement. To help address this challenge, pharmaceutical company Abbott Labs obtained a favorable private letter ruling from the Internal Revenue Service (IRS) for an innovative program called Freedom 2 Save, in which employees who showed that they had used at least 2% of their eligible salary to pay down student loans during the year received 5% employer nonelective contributions to their 401(k) accounts. In a private letter ruling to Abbott Labs before it implemented the program, the Internal Revenue Service (IRS) interpreted this benefit as a nonelective employer contribution, not a match. The private letter ruling did not address complexities with coverage, nondiscrimination testing, or application to safe harbor plans, nor was it applicable beyond Abbott Labs. If Congress passes legislation allowing plans to consider these contributions as employer matches, it could encourage similar programs and help improve the retirement readiness of younger workers.

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