THE COLLABORATIVE FOR EQUITABLE RETIREMENT SAVINGS

Same Income, Same 401(k), Different Account Balance: The Critical Role of Retirement Plan Design in Addressing Racial and Gender Retirement Savings Gaps

Summary of "How Large Are Racial and Gender Disparities in 401(k) Account Balances and What is Causing Them: Initial Findings from the Collaborative for Equitable Retirement Savings"

About the Collaborative for Equitable Retirement Savings

The Collaborative for Equitable Retirement Savings, or CFERS, initiated in 2022 by the Defined Contribution Institutional Investment Association, or DCIIA, the Aspen Institute Financial Security Program, and Morningstar Retirement, aims to examine the dynamics of defined-contribution retirement savings and identify disparities in outcomes based on race and gender by analyzing anonymized defined-contribution transactional plan data. Over time, this data, coupled with qualitative research to understand the people-centered context behind retirement plan usage, will provide the platform and tools for employers, recordkeepers, researchers, and policymakers to continue to shape the defined-contribution system and related employer benefits to work more effectively for all covered workers. This report summarizes the research findings from "How Large Are Racial and Gender Disparities in 401(k) Account Balances and What is Causing Them: Initial Findings from the Collaborative for Equitable Retirement Savings."

401(k)s Are Essential to Household Wealth–and They Don't Work the Same for Everyone

America's workplace retirement savings system plays an essential role in the financial lives of the millions of people who have access to a retirement plan at work. The employer-sponsored 401(k) plan, which people fortunate enough to be covered at work save into through paycheck deductions, does two things. First, the retirement savings balance that accumulates over time from saving, investment returns, and often an employer contribution, can serve as a source of income when someone retires. Second, it is a significant source of wealth–now the largest asset type for American workers outside of their homes.[1]

To be clear, millions of Americans are not fortunate enough to have access to a retirement plan at work. The US Bureau of Labor Statistics reports that only 63% of civilian workers have access to a defined-contribution plan such as a 401(k) at work.[2] Although the challenges with access are important and may leave millions of Americans ill-prepared for retirement, it is still important to examine how well the 401(k) and broader defined-contribution system is working for those lucky enough to have access. In this research, we discuss some reasons the system does not seem to work as well for Black, Hispanic, and female workers.

[1] Board of Governors of the Federal Reserve. 2023. "2022 Survey of Consumer Finances." https://www.federalreserve.gov/econres/scfindex.htm

While the root causes of – and the solutions to – America's racial wealth gaps are numerous and varied, we know that the retirement savings system has a critical role to play in creating a more inclusive future of wealth. The starting point for reducing the racial retirement savings gap is an analysis of the full set of drivers of balance disparities, controlling for income and looking through the lenses of both race and gender. Such an analysis can ultimately help employers and policymakers design retirement savings plans and benefit offerings that better support Black, Hispanic, and female workers in building and growing both retirement income security and household wealth.

New Views on an Old Problem

For years, researchers and policymakers have known about the large gap in account balances between men and women, Black and white workers, and to a lesser extent white and Hispanic workers saving for retirement. So, why did Morningstar Retirement, the Aspen Institute Financial Security Program, and DCIIA launch an ambitious effort—CFERS—to further study the problem?

We wanted to move beyond the simple snapshots most studies provide. Like other researchers, we could see there are differences in retirement savings across demographic groups. We could see there are gaps in savings even when controlling for income, and that the racial gap in retirement savings is not simply a story of class differences manifesting in demographics.

What we could not see—what no one could see in the existing data—was the rich complexity of real people's decisions. How much do different workers contribute to their plans, even when they earn the same salary? Are some groups more likely to withdraw money early, before retirement? How do different workers invest their savings? How do different kinds of workers respond to the incentives employers create to contribute? And who are the workers who choose not to save in their workplace plan, and why not?

These questions are enormously important because if there are ways employers or policymakers can make the retirement system work better for more people, it builds confidence in the system, improves the lives of workers when they retire, and relieves pressure on public-assistance programs.

To our knowledge the only other study to attempt to gather and analyze this data was "401(k) Plans in Living Color," published jointly by Ariel Investments and Hewitt Associates,[3] which used year-end 2007 information and then updated it with year-end 2010 information three years later. Given widespread changes in the retirement system since then, particularly after the passage of the Pension Protection Act, we believed we might find evidence of ways employers could close the lingering racial retirement savings gap.

In our recently published report, "How Large are Racial and Gender Disparities in 401(k) Account Balances and What is Causing Them: Initial Findings from the Collaborative for Equitable Retirement Savings," we began to unpack the answers to these questions. This is only the beginning. We have amassed a database of race and gender data for 180,684 active retirement plan participants by working with defined-contribution retirement plan sponsors, and we will continue to add to it in the years ahead.

[2] US Bureau of Labor Statistics. 2023. "National Compensation Survey." Please note that including defined-benefit plans, mostly for government workers, decreases the share of workers without any retirement coverage at all to 27%.

[3] Ariel Investments & Hewitt Associates. 2009, 2012. "401(k) Plans in Living Color."
https://www.rand.org/content/dam/rand/pubs/conf_proceedings/2010/CF283/401k-plans-living-color.pdf

We have enough data now to reach two important conclusions. First, there are good reasons to believe that low-cost solutions to nudge participants to avoid early withdrawals could make a significant dent in the racial retirement savings gap. More study is needed to investigate which plan design changes might help and by how much, and which solutions are most appropriate for different employee populations. Rather than blaming people for making the wrong choices, we seek to understand how to remove barriers to savings and keeping money in retirement accounts. We continue to gather data so that we can extrapolate our results to all defined-contribution (such as 401(k) and 403(b)) participants in the US. Second, these initial findings provide strong motivation for us to continue this work into 2024 and beyond. Or perhaps another way to stay motivated is this: there are good reasons for hope and real opportunities for action.

Our key takeaways to date:

1. *Account Balance Disparities:* The analysis reveals significant race and gender disparities in account balances, persisting even after adjusting for salary and tenure. These differences are attributed to variations in contribution, loan, and withdrawal behavior.

2. *Income and Tenure Impact:* Controlling for income and tenure does not fully explain the observed differences in account balances. Disparities widen for workers closer to retirement, emphasizing the need for targeted interventions.

3. *Contribution Disparities:* Black and Hispanic females contribute lower percentages of their salaries than their counterparts after controlling for age, salary, tenure and plan design variables, influencing long-term retirement savings outcomes.

4. *Preretirement Withdrawals:* Black and Hispanic workers exhibit higher frequencies of preretirement withdrawals, affecting the overall accumulation of retirement savings.

5. *Loan Usage Disparities:* Black participants are more likely to have outstanding loans compared with their white counterparts, likely contributing to disparities in account balances.

6. *Mitigating Disparities:* Simulation results indicate that eliminating preretirement withdrawals would substantially mitigate race and gender disparities at retirement, particularly for early- and mid-career 401(k) participants.

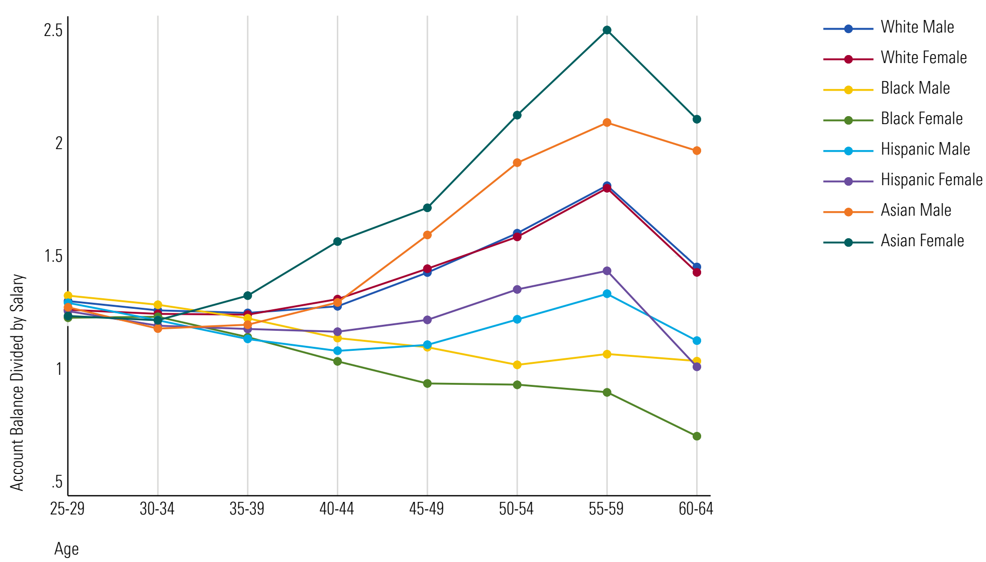
We See Significant Differences in the Way 401(k) Participants of Different Races and Genders Use and Benefit From Their Retirement Plans

Income and tenure differences do not fully explain the reasons that Black and Hispanic workers in our dataset save less than their white counterparts, after controlling for age, salary, tenure, and plan design variables, nor do they fully explain the gender differences that we see in the data. Simply put, the differences in account balances across races and genders do not appear to be solely a result of differences in economic circumstances.

How big are the differences between race, ethnicity, and gender? They are large, particularly for workers approaching retirement age, when those who have saved less than their peers have little time to close the gap, as illustrated by Exhibit 1.

An easy way to understand these differences in savings is by considering participants' average account balances as a ratio of salary. For example, among Black men nearing retirement (ages 55-59) the average ratio of account balance to salary is about one to one, and among Black women the average ratio is lower than that. This means that, on average, Black women have less saved than they earn in our database even as they approach retirement. In sharp contrast, their white counterparts have average account balances of 1.81 and 1.80 times their salaries, for men and women, respectively. Hispanic workers fall in between 1.33 times salary for men and 1.43 times salary for women. Of course, this balance does not represent all of a worker's savings. We do not know about savings outside the workplace plan, but we control for a worker's tenure and income to make the comparisons as comparable as possible. Exhibit 1 shows the predicted account balances as a ratio of salary, meaning this is the expected ratio holding all else constant. (Please see the paper for full methodological details.)

Exhibit 1: Predicted Account Balances Divided by Salary for Each Race and Gender at Different Ages



Source: Collaborative for Equitable Retirement Savings 2022 data.

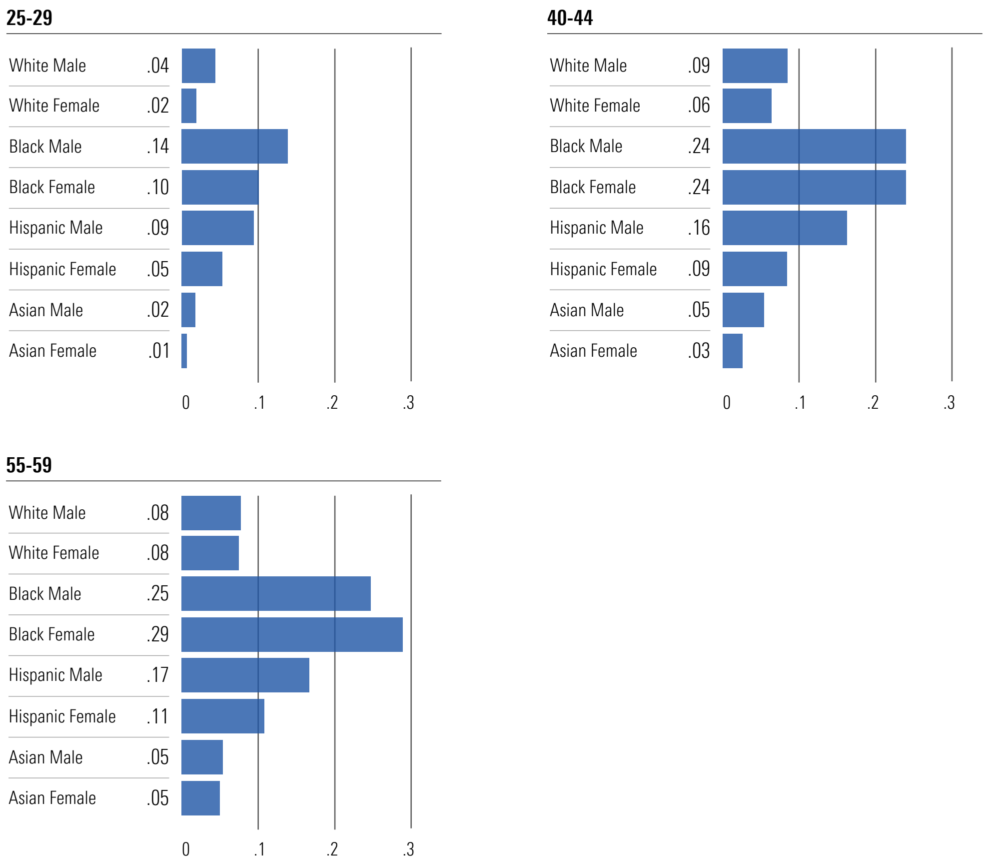
What are some possible reasons for the gaps between white workers compared with Hispanic and Black workers? First, some of the gap is probably because Black and Hispanic women contribute a lower percent of their salaries to their accounts, although to be clear, we did not have the data to perform a longitudinal study following these individuals across their careers earlier this year, and we plan to start this analysis in late 2024. For now, we have only a single year of contribution data. Still, white men, white women, Black men, and Hispanic men all contribute similar percentages of their salaries on average. We must continue to look for other reasons that could help explain the gaps in account balances. In fact, in our dataset, it appears one of the key differences we observe between people of different races and genders is people taking withdrawals before retirement rather than failing to contribute at similar levels.

Black and Hispanic workers withdraw more of their account balances before retirement, and take these preretirement withdrawals more frequently, than their white counterparts. These differences grow more extreme the closer people get to retirement. For example, in our 2022 dataset, 29% of Black women between the ages of 55-59 withdrew money, far larger than any other group except Black men. That group was the second most likely to do so with a 25% probability of taking a withdrawal in 2022. Furthermore, Black workers were more likely to withdraw money than their white counterparts, as shown in Exhibit 2.

Not only are Black workers more likely to take withdrawals, the average withdrawal, as a percentage of account balance, is also somewhat higher for Black workers than their white counterparts, as discussed in more detail in the full paper. We also found that Black participants have a higher probability of taking a loan, but as those loans are often paid back, this finding is less concerning with respect to retirement outcomes.

There is a larger split by gender among Hispanic workers: Hispanic men are more likely than their white counterparts to take preretirement withdrawals, while Hispanic women are slightly more likely to do so among only the cohort approaching retirement.

Exhibit 2 Probability of Taking a Withdrawal in 2022 by Race and Gender for Early, Mid-Career, and Late-Career Workers



Source: Collaborative for Equitable Retirement Savings 2022 data.

Addressing Preretirement Withdrawals Could Mitigate Race and Gender Disparities We See in 401(k) Account Balances

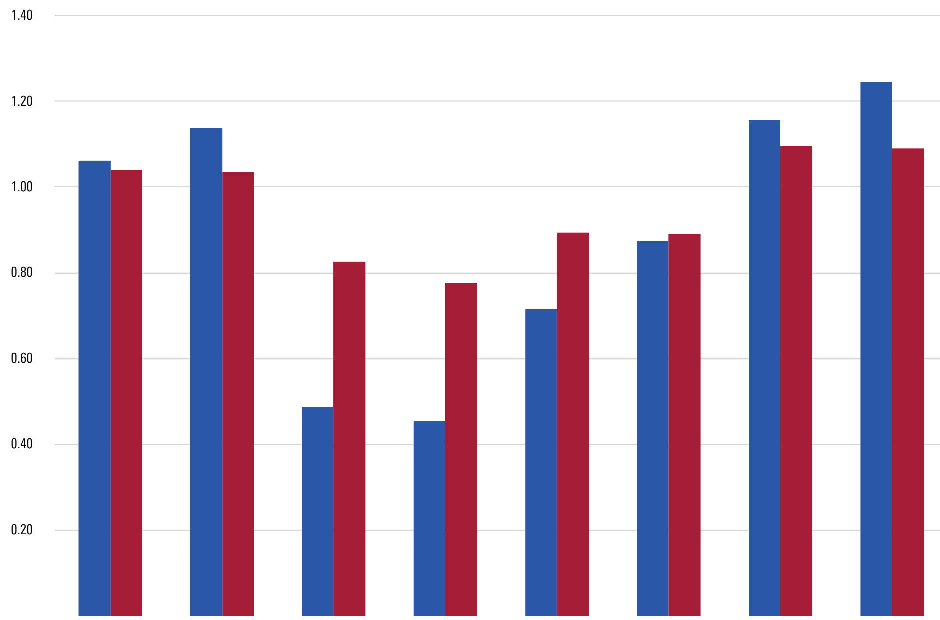
Our findings, while troubling, could also be good news: interventions that could help workers avoid using their retirement savings for preretirement expenses could also help reduce the racial gap in retirement savings. The hard work will be studying different approaches to see which ones work and for whom. For example, workplace emergency savings accounts, more education on the problems with hardship withdrawals, or follow-through to re-enroll workers in plans after an emergency has passed could all potentially help.

Still, if employers could find interventions to significantly reduce preretirement withdrawal frequencies, such an intervention would substantially mitigate race and gender disparities for early-career 401(k) participants and would have a noticeable impact on the disparities for mid-career 401(k) participants.

While there are several retirement plan initiatives that could theoretically help with this situation, there is little data to predict how much of an impact they would have on preretirement withdrawals. But it is worth understanding the opportunity that current withdrawal patterns offer if they could be addressed. Therefore, we have decided to illustrate a hypothetical situation in which all preretirement withdrawals are eliminated without any secondary effects on participation, contributions, loans, or asset allocation.

Exhibit 3 shows the extent to which addressing and reducing preretirement withdrawals could help close the gaps in the ratio of account balances to salary between Black, Hispanic, and white savers. In each case the average of the projected account balance to salary ratio at age 65 by race/gender relative to the overall average under two preretirement withdrawal scenarios is shown for workers aged 25-29. For example, the average simulated account balance to salary ratio for Black males is only 49% of the overall average for the age cohort if the actual preretirement withdrawal probabilities are used. However, if the preretirement withdrawals are excluded from the simulation, the value for Black males increases to 83% of the overall average. Similar results are shown for Black females, with their average ratio of account balance to salary at age 65 equal to 46% when preretirement withdrawals are included but 78% when they are excluded. In contrast, although white and Asian workers' account balances also increase when there are no preretirement withdrawals, they do not increase as much as those for Black and Hispanic workers on a percentage basis.

Exhibit 3: Average of Projected Account Balance to Salary Ratio, at Age 65, Relative to Overall Average by Race and Gender Under Two Preretirement Withdrawal Scenarios: Participants Currently Ages 25-29



	White Male	White Female	Black Male	Black Female	Hispanic Male	Hispanic Female	Asian Male	Asian Female
With withdrawal	1.06	1.14	0.49	0.46	0.71	0.87	1.16	1.25
Without withdrawal	1.04	1.03	0.83	0.78	0.89	0.89	1.10	1.09

Source: Collaborative for Equitable Retirement Savings 2022 data.

Table Notes: For each participant younger than age 60 in the sample, a stochastic simulation of their 401(k) account balance and salary at retirement age (65) is generated under two scenarios. In the first scenario, the actual estimates from the probit regression of annual preretirement withdrawal frequencies as a function of race, gender, age, wage, tenure, and plan-specific factors is used. The second scenario is exactly the same with the exception that the probability of a preretirement withdrawal is assumed to be zero in each year.

Obviously, as people age, we see less time for the interventions to have an impact before retirement, but in every age cohort, we see a similar pattern to the one shown in Exhibit 3. Please see the complete paper for more details.

In 2024, We Aim to Provide Much More Robust Analysis on Other Solutions to Make the 401(k) System Work for Everyone Who Has Access to a Plan

This project is just getting started. In the coming years, we intend to examine the effect of other options for mitigating the differences in account balances—and ultimately retirement outcomes—between savers of different races and genders. We plan to examine:

- Moving from voluntary enrollment to automatic enrollment
- Automatic escalation
- Changing default deferral rates
- Changing employer matching incentives and/or nonelective contributions
- Managed account programs
- Emergency savings programs

In 2022 Congress passed, and President Biden signed into law, a retirement reform package colloquially called Secure 2.0. Branding aside, it creates a new "Saver's Match," essentially a government contribution to retirement accounts for low- and moderate-income savers. This is a race-neutral program. But, depending on assumptions, our preliminary analysis strongly suggests this new Saver's Match could partially mitigate existing disparities at retirement across racial groups. We will follow up with a complete analysis soon.

We are also planning to add several additional retirement plans when year-end 2023 data is analyzed later this year. As we continue to add plan sponsors, we can start providing peer comparisons for the data providers as well as extrapolations to the universe of 401(k) plans.

As we continue to collect additional years of data, the analysis will add time-series analysis to the cross-sectional analysis described above. This will be particularly useful for plans that adopt design changes that will allow us to compare the race/gender differentials before and after the modifications and project their impact to retirement age. It will also allow us to better understand the relative race/gender impact of proposed and enacted legislative and regulatory reforms.

Disclosures

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This commentary contains certain forward-looking statements. We use words such as "expects", "anticipates", "believes", "estimates", "forecasts", and similar expressions to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results to differ materially and/or substantially from any future results, performance or achievements expressed or implied by those projected in the forward-looking statements for any reason.