Why Are 401(k)/IRA Balances Substantially Below Potential?

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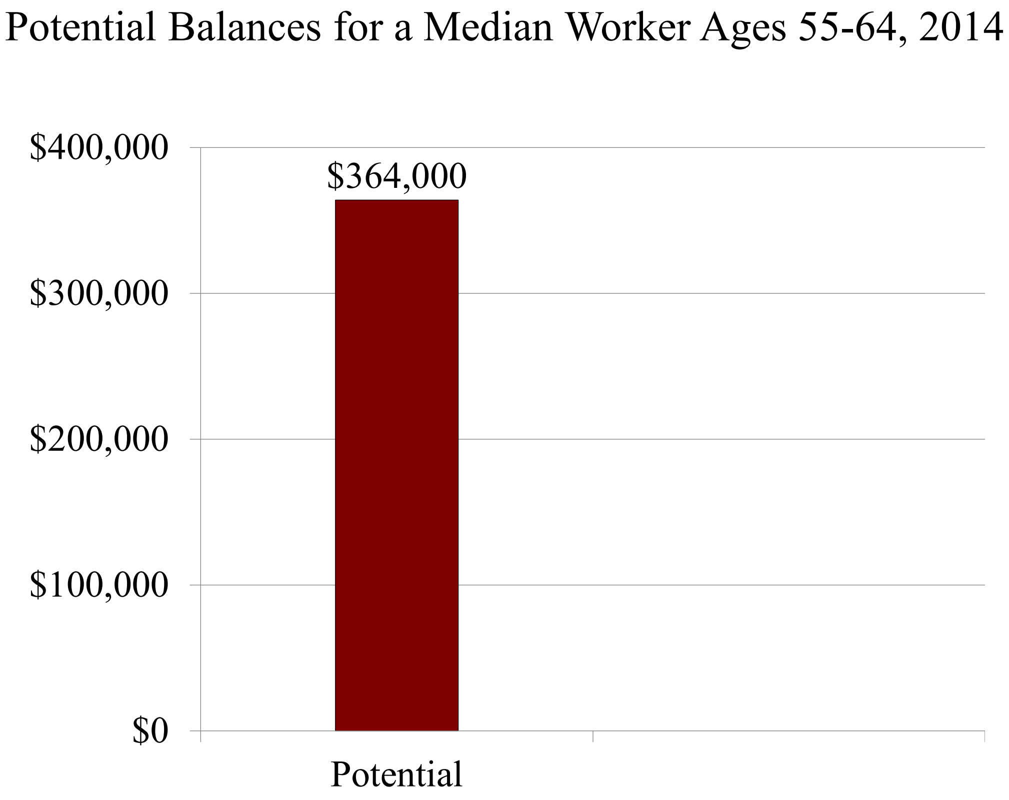
An excel spreadsheet shows that the average worker could have close to $350,000 in their 401(k)/IRAs.



Notes: Excludes money contributed directly to IRAs. Assumes the average worker earns $58,000 near retirement, consistently contributes 9 percent of earnings, and earns average market returns.
Source: Authors' calculations.

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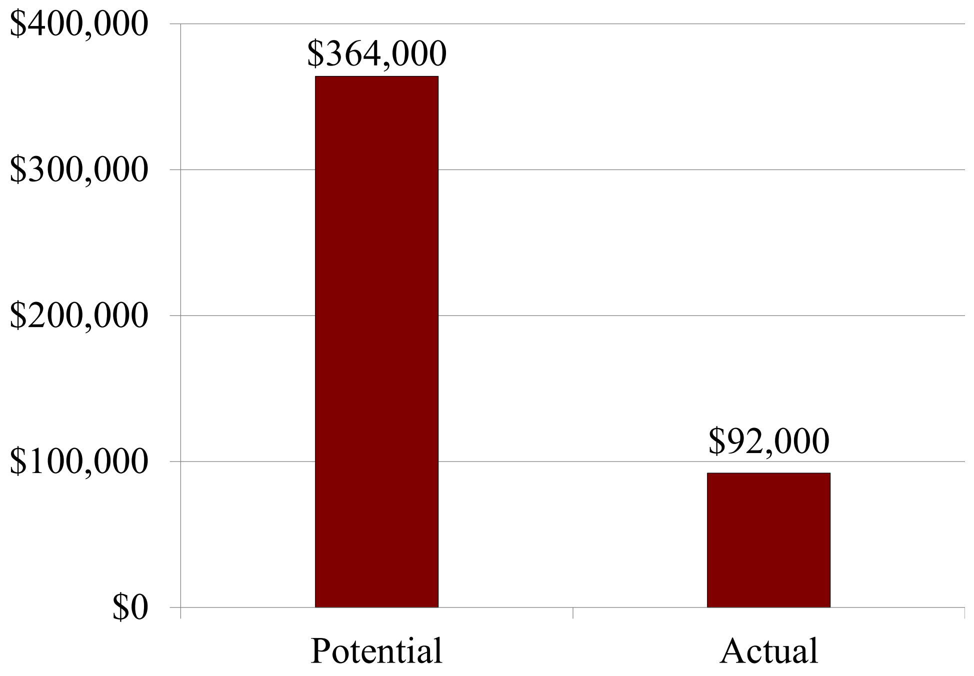
But in reality, the average worker has only accumulated $92,000 in their accounts.

Potential vs Actual Balances for Workers Ages 55-64, 2014



Note: Excludes money contributed directly to IRAs.
Source: Authors' calculations using U.S. Board of Governors of the Federal Reserve System. *Survey of Consumer Finances* (SCF), 2016.

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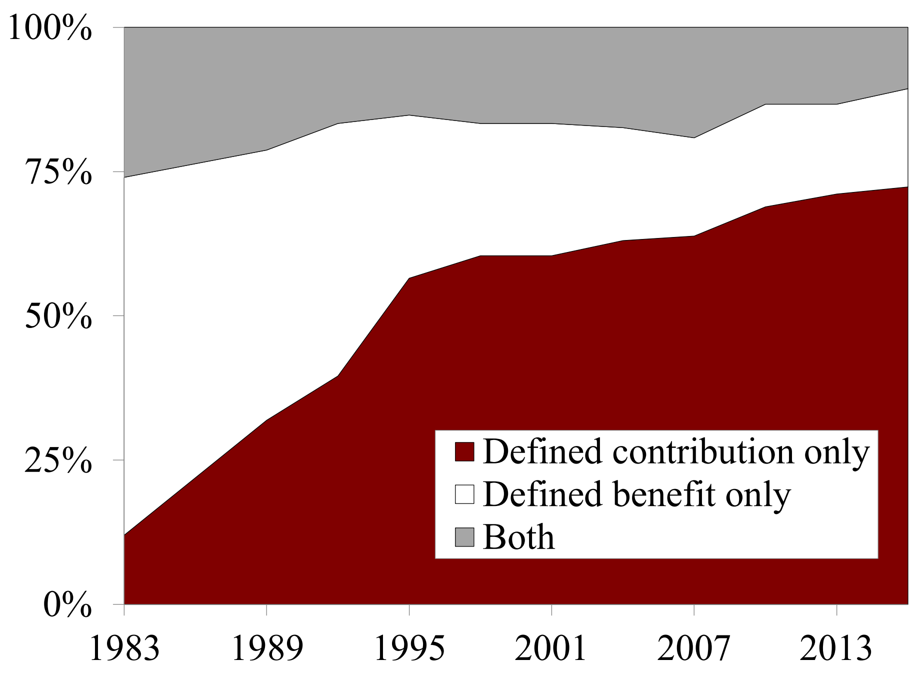
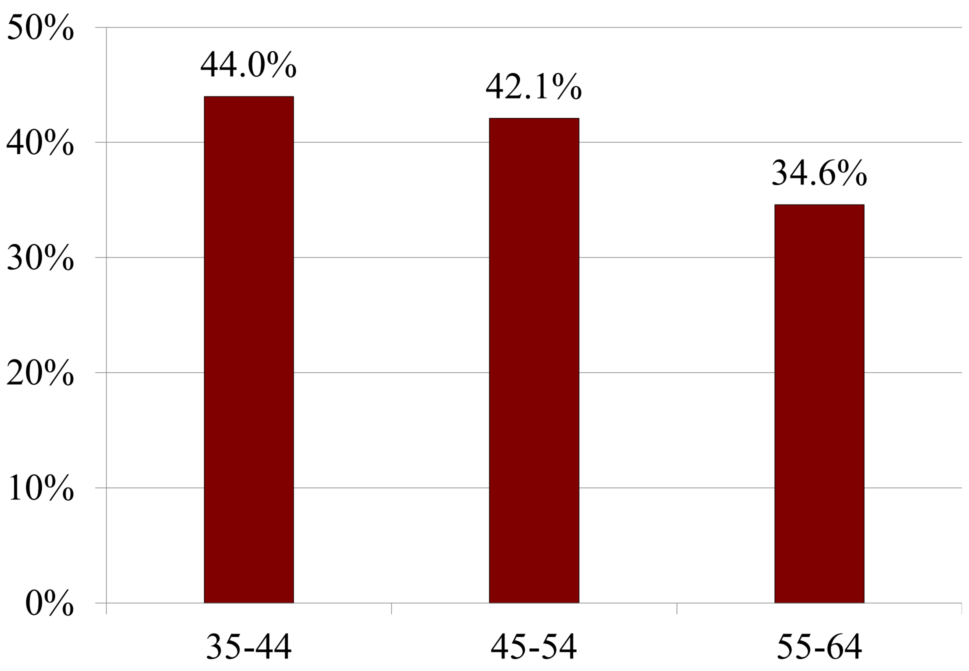
One reason for this gap is that those approaching retirement today were covered by an immature system.

Workers with Pension Coverage by Type of Plan, 1983-2016



Source: Authors' calculations based on SCF (1983-2016).

Percentage of Time Workers Spend Contributing to a Retirement Account, By Age Group



Note: Contributions are projected for younger cohorts.
Source: Authors' calculations using SIPP-linked Administrative Tax Data.

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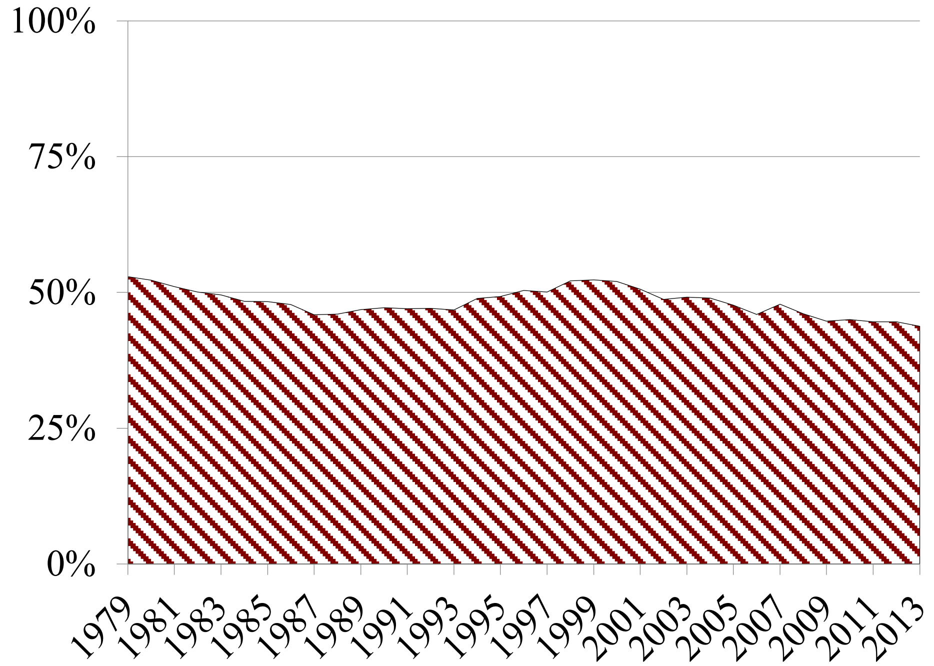
A second reason is that, even while 401(k) plans have expanded, workers move in and out of coverage.

Percentage of Private Sector Workers Ages 25-64 Participating in an Employer-sponsored Plan, 1980-2013



Source: Authors' calculations from U.S. Census Bureau, *Current Population Survey* (1980-2014).

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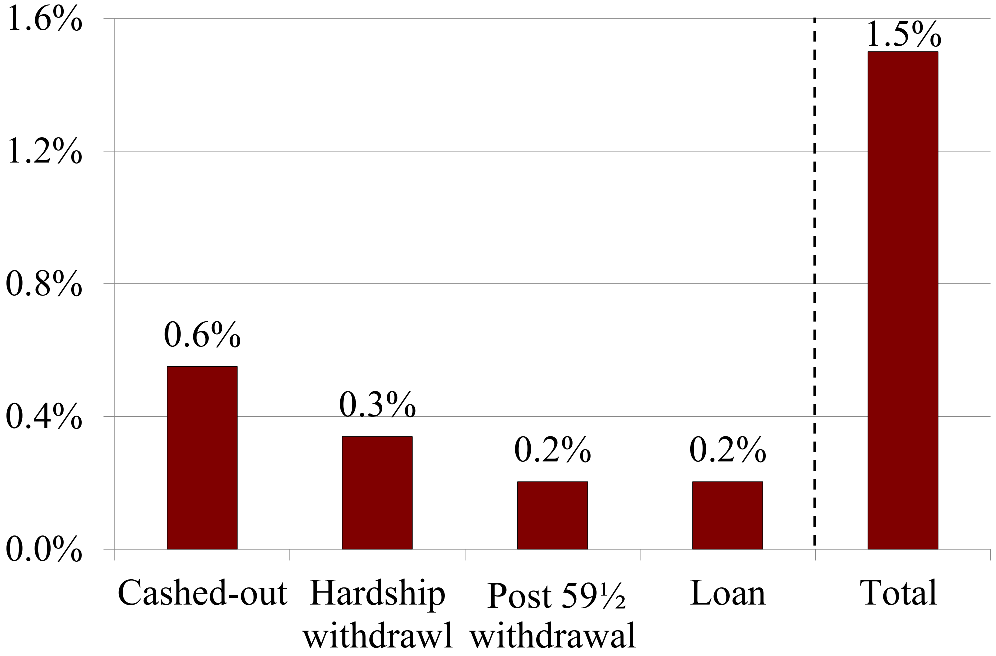
A third reason for the gap is that workers have the ability to tap accounts before retirement.

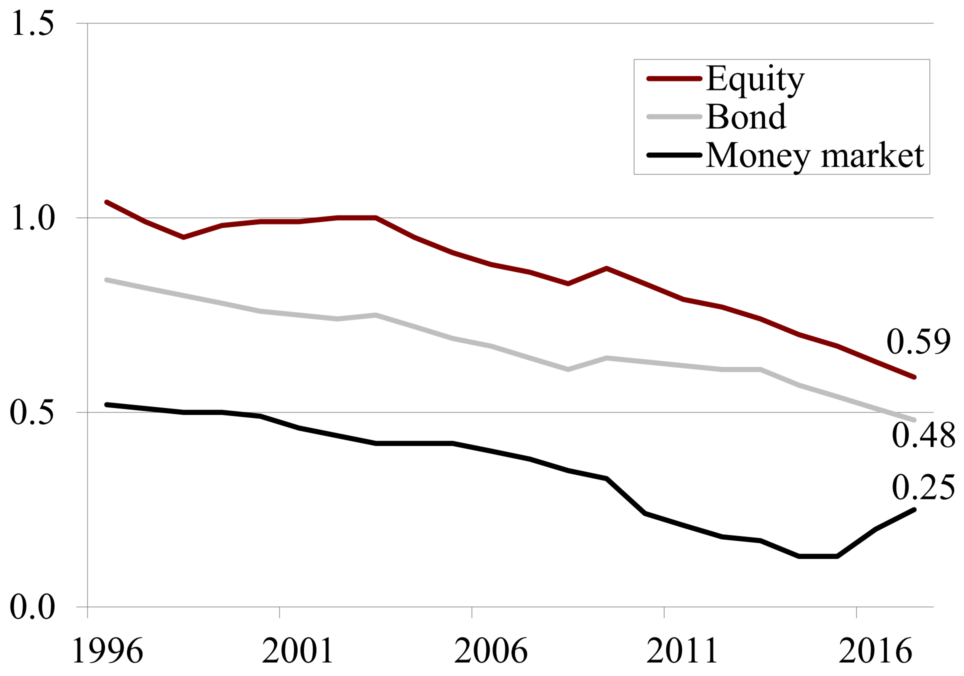
Annual Leakages Out of Defined Contribution Accounts as a Percentage of Assets, 2013



Sources: Authors' estimates based on Vanguard (2014); and Munnell and Webb (2015).

A fourth reason is that fees erode net returns on investments.

Average Expense Ratios for Long-Term Mutual Funds, By Asset Type, 1996-2017



Source: Investment Company Institute (2018).

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This paper explores the relative importance of each factor.

- Factors like the system's immaturity will dissipate, while inconsistent contributions are likely to continue.

- Understanding the role of each factor can provide insight into the best ways to encourage more saving.

Data

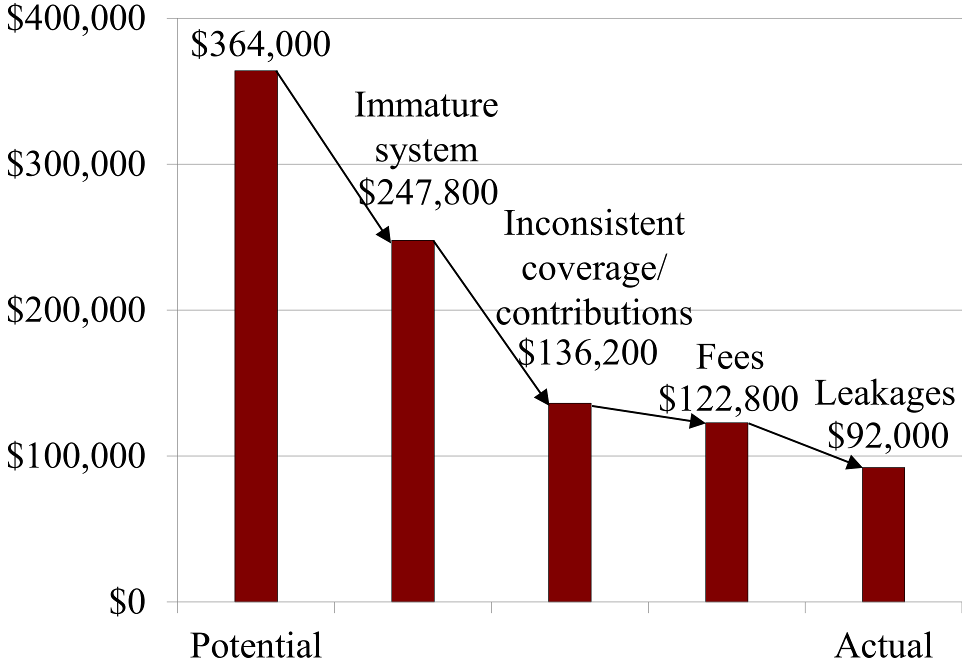
- The analysis uses *Survey of Income and Program Participation* (SIPP) linked to W-2 and Schedule C records on earnings and contributions.
- The focus of the analysis is workers from the 2008 SIPP panel who were ages 55-64 in 2014 and made a tax-deferred contribution.
- Account balances include 401(k)s and rollover IRAs.

Methodology

- Step 1: Estimate potential balances based on universal coverage and consistent contributions of 9 percent of earnings (6 percent employee plus 3 percent employer).
- Step 2: Document actual balances, as reported in the SIPP.
- Step 3: Calculate actual lifetime contributions and accumulated balances for each individual in the SIPP sample, assuming no leakages or fees.
- Step 4: Use the contributions of younger cohort to separate the lack of contributions from the immaturity of the system.
- Step 5: Divide remaining difference between fees and leakages using ICI fees data.

The main culprits are the immaturity of the system and inconsistent coverage/contributions.

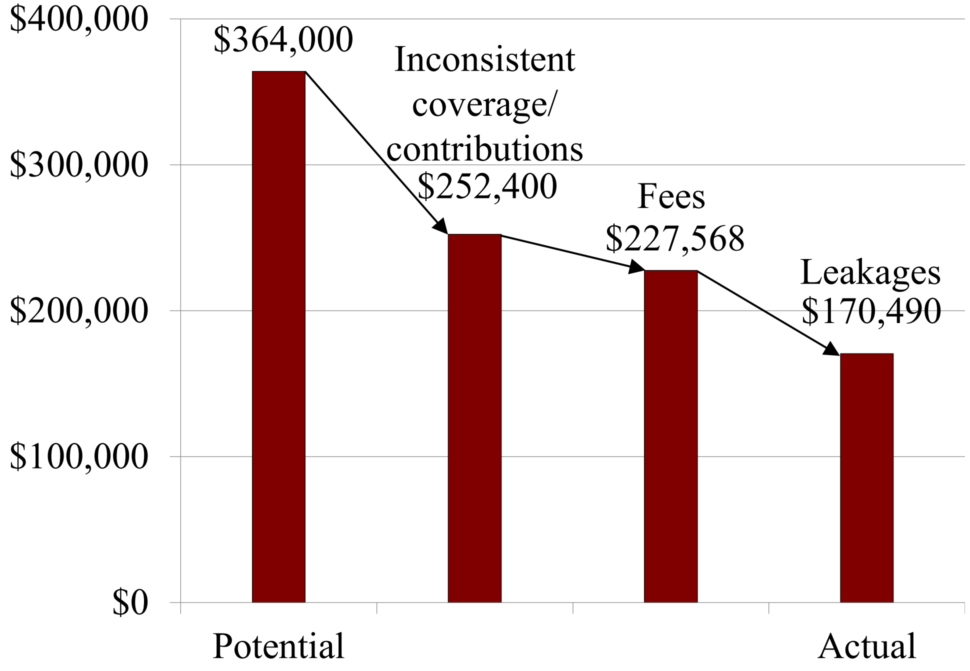
Impact of Various Factors on 401(k)/ IRA Balances for a Typical Worker Ages 55-64 in 2014



Note: Individuals must have worked at some point between ages 55-64 and contributed at least $1 to a 401(k) plan over their careers.
Sources: Authors' calculations using SIPP (1984-1986); and SIPP-linked Administrative Tax Data.

In a mature system, inconsistent coverage/contributions is the main reason for the gap.

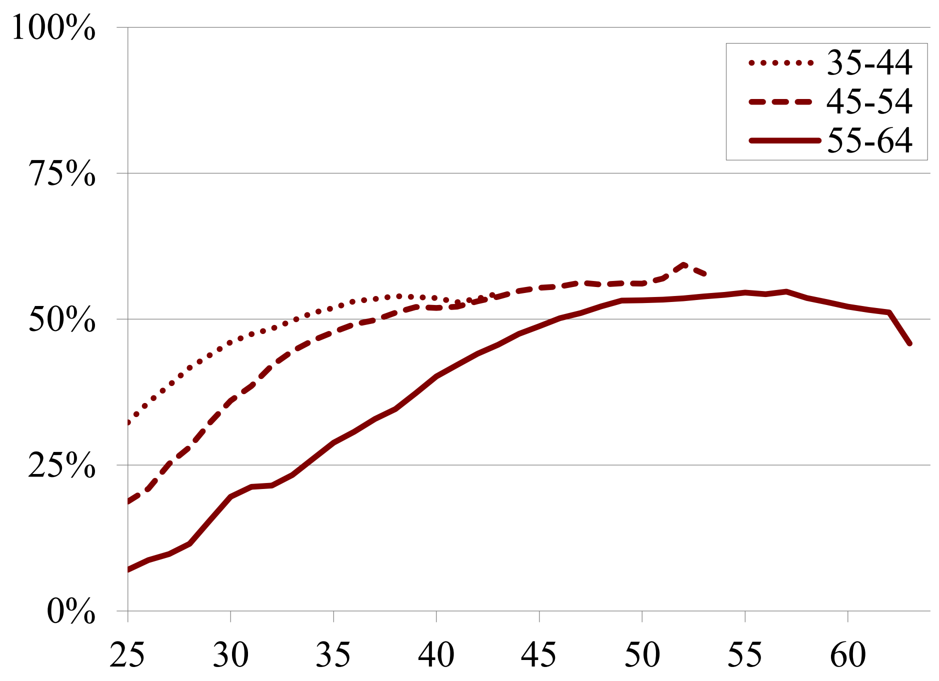
Estimated Impact of Various Factors on 401(k)/ IRA Balances
for a Typical Worker Ages 55-64 in a Mature System



Note: Individuals must have worked at some point between ages 55-64 and contributed at least $1 to a 401(k) plan over their careers.
Sources: Authors' calculations using SIPP (1984-1986); and SIPP-linked Administrative Tax Data.

Even in a mature system, young workers still are not contributing earlier in their career...

Percentage of Workers Contributing Over Working Lives, By Age Group in 2014



Note: Individuals must have worked at some point and contributed at least $1 to a 401(k) plan over their careers.
Sources: Authors' calculations using SIPP (1984-1986); and SIPP-linked Administrative Tax Data.

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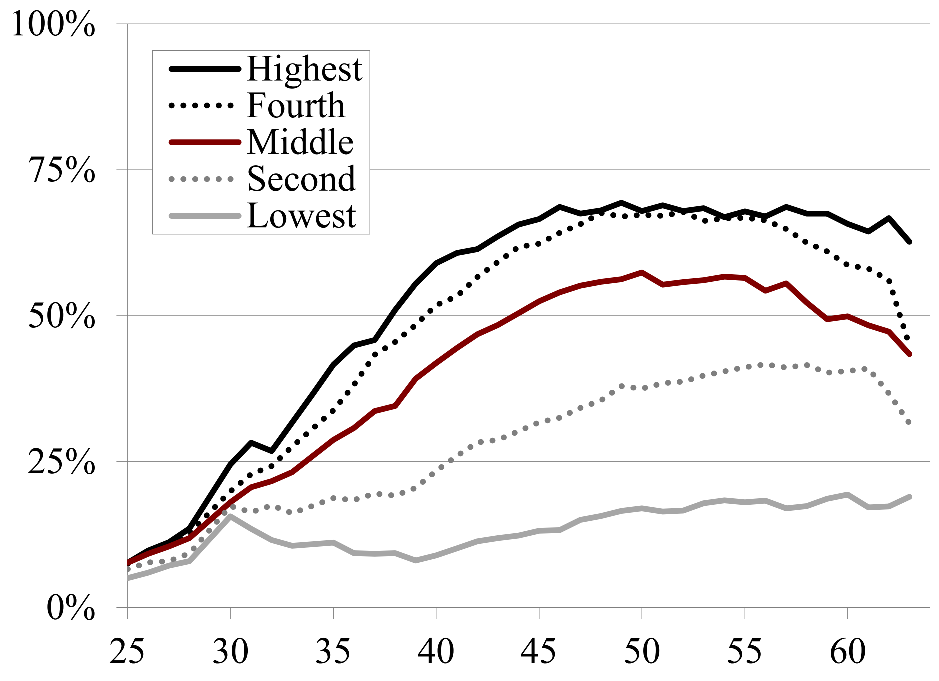
…and workers in lower quintiles may still fall short.

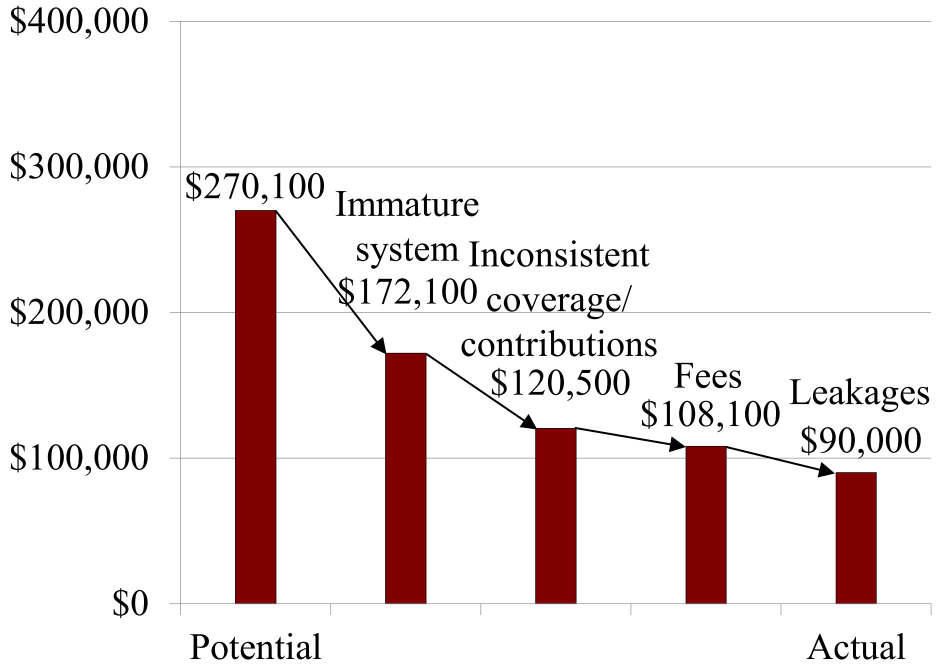
Percentage of Workers Ages 55-64 Contributing, By Income Quintile, 2014



Sources: Authors' calculations using SIPP (1984-1986); and SIPP-linked Administrative Tax Data.

One could question whether all workers need to save aggressively. Sensitivity analysis, excluding workers with a DB and the very young, still shows a large gap.

Impact of Various Factors on 401(k)/ IRA Balances for a Typical Worker Ages 55-64 in 2014



Note: Assumes contributions start at age 30 and excludes workers with DB plans between ages 55-64.
Sources: Authors' calculations using SIPP (1984-1986); and SIPP-linked Administrative Tax Data.

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Conclusion

- 401(k)/IRA plans give households the potential to accumulate substantial retirement assets.
- But, in reality, the typical worker has less than $100,000 in 401(k)/IRA assets, instead of the $364,000 from an excel spreadsheet.
- The immaturity of the system and inconsistent contributions are the main culprits, followed by leakages and fees.
- Today's near-retirees typically spent only about one third of their working careers participating, and the portion of workers without coverage has stagnated and remains large.
- The lack of universal coverage means that – even once the system matures – 401(k)/IRA plans will continue to fall substantially below their potential.