Goldman Sachs Exchanges

Why most Americans aren’t saving enough for retirement

Mike Moran, Pension Strategist,
Asset & Wealth Management, Goldman Sachs
Allison Nathan, Senior strategist,
Goldman Sachs Research

Date of recording: September 27, 2023

Allison Nathan: An improving economic backdrop is helping to bolster retirement savings, but an ever-mounting raft of financial challenges remain. So what do those saving for retirement and those already in retirement need to do to stay on track?

Mike Moran: The reality that those who have a plan are better prepared for retirement, they feel more confident in their retirement journey, they feel less stress. But at the same time, they are also more acutely impacted by the financial vortex, the impact of other financial obligations.

Allison Nathan: I'm Allison Nathan, and this is Goldman Sachs Exchanges.

For today's episode, I'm speaking with Mike Moran, pension strategist in Goldman Sachs's asset management business, to discuss the state of retirement for both savers and retirees. Mike and his team are also out with a new report that breaks down what they describe as a financial vortex that derails the best-laid retirement plan and what to do about it. Mike, welcome back to the program.

Mike Moran: Good to see you, Allison. Thanks for having me back.

Allison Nathan: Mike, Americans retiring today are the first to rely solely on private savings instead of pensions. We call them the 401(k) Generation. What's the significance of that?

Mike Moran: It's very significant, Allison. If you think about the history of retirement in this country, many older generations were covered in private employment by a defined benefit pension plan. So they were getting a monthly check in retirement from their former employer. They were covered by Social Security. And then they had private savings.

Now, as we've transitioned in this country to more of a defined contribution system, a 401(k) system, as being your primary retirement vehicle, the onus is really more on the individual for saving for retirement, investing their money for retirement, and then making sure they don't outlive their assets in retirement. So this is really a very significant moment in time, to your point, where we're starting to see more and more individuals retire that are solely covered by a defined contribution plan.

Allison Nathan: And how would you describe the state of their retirement readiness?

Mike Moran: It's a bit of a mixed bag, Allison. So the good news is that, when we think about over the past year, equity values are up so many individuals are feeling better about their retirement prospects. Their balances are higher in their 401(k)s and their IRAs. But the bad news is that many are still not saving enough for retirement. And in particular, when we look at how much income they think in retirement they're going to be able to generate as a percentage of their current income, it can be pretty low.

So as a back of the envelope, the industry, we often talk

about 70%. 70% income replacement ratio. When you're in retirement, you should have about 70% of your pre-retirement income. Now, that's not a one-size-fits-all answer obviously. Everyone's situation is going to be unique and different.

But our work would say that many individuals have less than 50% of their pre-retirement income in retirement. And that's pretty low. Now, why is that? A lot of that comes back to what we call the financial vortex. It's these other competing financial priorities that crowd out saving for retirement. If you think about having credit card debt, if you think about having some sort of emergency expense, your car breaks down, you have a home repair that you didn't anticipate, or maybe you have to take time out of the workforce to care for a young child or maybe even an elderly family member. Those can all constrain the amount you're saving for retirement, and therefore people are sometimes getting to retirement without enough assets.

We actually did some modeling that said, if an individual was impacted by multiple parts of the financial vortex, maybe you had a couple of those things that I mentioned, collectively, those could impact your retirement savings or

reduce your retirement savings by up to 40%. And so it's a very significant number that potentially could impact your quality of life in retirement.

Allison Nathan: And if you think about the current macroeconomic backdrop, obviously we are all experiencing very high inflation, which is a challenge. But at the same time, interest rates are also high, so how is that impacting savers and retirees?

Mike Moran: Yeah. So when we think about the current economic environment, we think about the current market environment, again, it's a bit of a mixed bag, right? On one hand, as we mentioned earlier, equity prices are higher, so I feel better about that when I look at my 401(k) statement or my IRA statement. Interest rates are higher, which means savers for the first time in a long time are actually getting a return. We think about that long period of low interest rates that we had. For those who were just saving, they weren't getting any return. Well, now, when we look at what we're getting on money market funds, on stable value funds, on certificates of deposit, we're actually getting a return, which is great.

But the other side of course to higher interest rates is the borrowing costs are higher. So for those who are currently working, some are experiencing higher mortgage rates when they either refinance their mortgage or they go to buy a new home. And obviously more money going towards that crimps their budget and there's less left over to save for retirement. Auto rates are higher as well for those who are purchasing a new automobile. So again, from a budget perspective, higher borrowing costs are crimping budgets and maybe making it less easy to save for retirement.

The other side of course then is inflation. And again, coming back to a working individual, costs are higher for food, for gas, for other items. That's going to again have an impact on my budget. And then for those in retirement, obviously inflation is a huge risk because the purchasing power of their assets decreases. So it's a little bit of good news/bad news in terms of the current economic environment.

Allison Nathan: So as I mentioned at the start, you and your team recently released your third annual retirement and insights report, and it's entitled “Diving Deeper into the Financial Vortex: A Way Forward.” What were your

key findings this year?

Mike Moran: So Allison, I would highlight four key findings. And the first is that, yes, retirement sentiment has improved, but the financial vortex remains. The financial vortex, those competing financial priorities, continue to make it harder for some individuals to save for retirement. As I like to say, the financial vortex is undefeated. It is immune to improving economic and financial market activity.

The second thing that we would highlight is that the financial literacy in this country is low, which is not necessarily surprising. But what we find in our survey results is that, despite the fact that financial literacy is low, many individuals continue to manage their retirement assets by themselves. They don't seek professional advice. And given low financial literacy, that feels like that's something that needs to change.

The third key finding was the benefits of having a plan. If you had a plan for retirement, you were much more likely to be confident in your ability to meet your retirement goals, your stress levels were much lower. It's the old

"failing to plan is planning to fail." So having a plan, there were clear benefits. But even those with a plan were not immune to the impacts of the financial vortex. So having a plan by itself was not enough.

And I'd say the fourth key finding was the reality that many employees look to their employer and in particular their employer-sponsored retirement plan to help them with other financial challenges that they face. When we look at plan design features, the number one plan design features that employees wanted added to their employer-sponsored retirement plan was an emergency savings account. So that way it could help them as they manage other unexpected financial obligations.

Allison Nathan: And just to clarify, when you mean "have a plan," are you talking about a budget? What are you talking about when you say "have a plan"?

Mike Moran: Yeah, so our definition of a plan in the survey was not too complicated. It basically said have you thought about how much you're going to need in retirement? And have you thought about how much you need to save along the way and how you're going to invest

those assets along the way to meet that goal? So it was a very simplistic plan. It wasn't anything too complicated.

Our results showed that 60% of working respondents actually did have a plan. And there are clear benefits to having a plan. If you had a plan, your stress levels were lower. You were more likely to feel like you're going to meet those retirement goals. And so there's a clear benefit to having that. But again, coming back to the financial vortex, it was interesting to us that those who had a plan were more likely to say they were impacted by financial vortex attributes than those who didn't have a plan. So that was a little almost counterintuitive, right? And this is what we call actually the planning paradox.

Allison Nathan: Well, their plan -- sorry, to interrupt -- but their plan didn't include these unexpected events.

Mike Moran: Or because they have a plan, they have heightened awareness of these events, right? So if you think about those who don't have a plan, it's almost like they're ignorant to it. They don't understand or maybe don't appreciate that having credit card debt impacts their ability to save for retirement. Or that time out of the

workforce means they're going to have to stop saving for retirement when they're not working. So it comes back to there are benefits to having a plan. Those that have a plan are more acutely aware of the financial vortex, but that's not necessarily a bad thing because being better educated about those financial vortex items will hopefully help them as they go through their retirement journey.

Allison Nathan: And did anything else surprise you about the survey results you received this year?

Mike Moran: I'd say the other thing was coming back to last year versus this year. That reality, that retirement sentiment has improved. People feel better because equities are up, their balances are up. They feel like their stress levels are down, which is always a good thing. But that impact of the financial vortex did not change. We had a similar number of respondents this year versus last year who said that various financial vortex items like credit card debt, saving for a child's college education, financial emergencies are impeding our ability to save for retirement. So even though things have gotten better in the economy -- it feels like maybe we're going to avoid recession, inflation is moderating, equity prices are higher than they were a

year ago -- that financial vortex is still there.

Allison Nathan: And talking about unexpected expenses within this financial vortex, one of them is student loans. Student loan repayments are starting up again. What are the implications of that?

Mike Moran: So when we think about an individual's budget, having to repay a student loan is a line item in the budget. And as an individual is thinking about what assets they have for their different line items in the budget, more money to those items may mean less items to retirement. So maybe someone who's working is in a 401(k) plan or not, but they may not be saving in that 401(k) plan because they have these other financial obligations.

So one of the things that Secure Act 2.0 did, which was a very significant piece of retirement legislation, is it allowed employers to provide a matching contribution to a defined contribution plan for employees that are making a student loan repayment. So that way, if that individual themselves isn't deferring money into their 401(k) plan, it still allows them to build up retirement assets because now their

employer can make a contribution as part of a matching contribution to their student loan repayment.

Allison Nathan: So these loan repayments shouldn't be as big of a hit hopefully to their retirement plans.

Mike Moran: Hopefully, this amendment in Secure Act 2.0 provides a way to continue to see retirement savings grow while you're still paying off the student loan debt.

Allison Nathan: So if people are already struggling to manage their finances and these unexpected events, what solutions can help them stay on track?

Mike Moran: So I think a lot of this, Allison, comes back to what plan design changes can employers implement that will help their employees? And some of this ties into recent regulatory activity. So if we think again about Secure Act 2.0, one thing that it did is it allowed plan sponsors to embed an emergency savings program in their 401(k) plan. So that way, as employees are saving for retirement, they could also be building up an emergency savings account so that way, when they have those unexpected financial obligations, they don't have to stop saving for retirement.

They already have money to help with that.

Allison Nathan: Let me ask a follow-up on this emergency fund. How does that work exactly? Are you saving or putting money into that at the expense of putting money into your 401(k) retirement?

Mike Moran: So hopefully not, right? So we want individuals to do both. We want them to start funding several months worth of emergency expenses in addition to their retirement savings. Now, there's no reason why you can't have an emergency savings account outside your 401(k) plan. Just have, you know, the old cookie jar, for those of us who are old enough to remember when we used to put money in the cookie jar. There's no reason you can't. But this is a way to automate it and make it easier for employees. It takes advantage of the power of inertia.

Think about your retirement savings when you're putting into your 401(k). You say I want to put -- pick a number -- 10% of my check into a 401(k) count every pay period, and it just happens. I don't have to think about it every time, right? So that's the benefit of the emergency savings also within a 401(k) plan. It allows for that automation that

should make it easier for employees to save within that. And therefore, they don't have to make a decision about it, and the power of inertia takes over. It just happens.

Allison Nathan: Right. But the check they're getting every month is lower as a result of it.

Mike Moran: The check they're getting, their take-home pay is lower.

Allison Nathan: Yes.

Mike Moran: We will tie that into there's a lot of benefits to having a plan. There's also a lot of benefits to having an emergency savings account in terms of being able to reduce stress, make people feel like they're more in control. That's a big part of this, Allison. It's also the psychological aspect. As we all know, when we feel like we're in control, we feel better about things. If I'm out of control, every time my car has a flat tire or something broke in my house and now I'm scrambling for money, I don't have control and my stress levels go higher.

Allison Nathan: And the financial services industry in

itself has also evolved. It's offering new investment options. There's now target date funds and different kinds of tools like the automatic enrollment into 401(k) plans that you were just discussing. And all that is designed to make it easier to save for retirement. So are those options having an effect? Is that helping people save?

Mike Moran: I would say absolutely, Allison. And a lot of the evolution of the defined contribution market and the 401(k) market does tie back to regulatory changes in the past that allowed things like auto enrollment. If you join a company and you decide you're not going to sign up for the 401(k) plan, the company under auto enrollment features can actually default you into the 401(k) plan.

Now, you as an employee always have the ability to opt out, but by auto enrolling individuals, it's a way to increase participation in the plan. Then we have auto escalation. We're going to default you into the plan. We're going to start deferring a certain amount of your paycheck into this account, and we're actually going to increase that over time. We're allowed to do that. That's auto escalation. So that way it helps you get more people in the plan, have them saving more, take advantage of the power of inertia.

Once they're in the plan, they're likely not to opt out or to change that deferral rate. And so those are all helping to save and build up retirement savings.

And then target date funds are a great initiative to provide employees with a more diversified way to save for retirement. If we think back to the old days when we used to default participants into a money market account, which is obviously very safe and secure but not a way to grow assets over a long time period, target date funds were a great way to provide employees with a diversified, professionally managed account that is rebalanced periodically and let them grow their assets for the long term.

Allison Nathan: Let me just take a step back though. What exactly does a target fund do?

Mike Moran: Sure. So a target date fund will say, "Allison, when do you think you're going to retire?" And let's say that is 2060. And so the target date provider will come up with an asset allocation based on your expected retirement age. The further you are away from retirement, the more risk it will have in that portfolio, more equity

exposure. The closer you get to retirement, the professional manager will rebalance and restructure that portfolio to start to maybe bring down equity exposure, increase exposure to fixed income, reduce the volatility of that. And then along the way, that professional manager will rebalance that portfolio because, when we think about the equity allocation, certainly some of that may be US equities but some of it is non-US equities. As those markets move, we rebalance back to strategic targets. So it's a diversified portfolio that's tied to your expected retirement age, which is, again, an improvement to what we had.

I think as we think about the next evolution of the retirement market, it's how do we make that experience even more personalized? We may both have the same expected retirement date, but that doesn't mean we have the same financial situation, the same financial goals. Retirement planning as we think about how it evolves in the future has to become more personalized to the individual's unique situation.

Allison Nathan: And as individuals are taking advantage of more of these options and tools, are we actually seeing

savings rates increase?

Mike Moran: So I'd say our survey report say that, yes, we're seeing more people increase their savings to retirement, which is a good thing. I think the question for a lot of them going forward is: How do we maintain that savings? And then again, the other challenge, as we get into an environment of a generation of people who are starting to retire that are only covered with a defined contribution program, how do we think about the decumulation phase? The fun part of the structure is the accumulation phase. What are we saving? How are we investing?

But now, coming back to again the history of retirement in this country, many individuals in previous generations were covered by a defined benefit pension plan. When you retired, you got that check from your employer every month. Now, in the defined contribution world, the onus was on me to save and invest. Now I get to retirement. Now the onus is on me to figure out how I'm going to live on that over the rest of my life, hopefully not outliving my assets.

Decumulation is the other part of it's not just about how do we get them to save more, it's then how do we make sure that they can live off those assets in retirement?

Allison Nathan: And Mike, you mentioned earlier that financial literacy is something that's lacking. But at the same time, a lot of people aren't getting help thinking about these decisions and how to save for retirement. What do you make of that? And how is the industry addressing that challenge?

Mike Moran: So a couple things on this, Allison. First, yes, financial literacy is low, and we saw that in the results of our survey. Within our survey, we asked working respondents five commonly used questions to assess financial literacy, and less than 15% of those respondents got all five questions right. 20% of the respondents got either only one question right or zero questions right. So between zero and one, those two answers only about 20%. So that's really not good, right? So financial literacy is low in this country.

Part of it comes back to, again, thinking about do we teach financial literacy in this country? We think about high

schools and colleges. Historically, many of them have not actually had that as a part of the curriculum. And we're starting to see that change. So part of it's coming through the education system in this country. When I'm done with my day job here at Goldman Sachs, I actually at night help to teach a personal financial planning class at a local university. And you can see the students are really excited about it because they recognize this is really important, and they're not getting this education elsewhere.

So financial literacy is a huge part of the problem in terms of retirement planning. What's also interesting about financial literacy, comes back to our survey, is our results showed that, if you scored higher on financial literacy, you are more likely to use a financial advisor for retirement planning than if you scored poorly. So if you did not score highly on financial literacy, you are more likely to do it on your own. That's a problem we need to change, right?

So obviously the people who need the most help are not the ones who are seeking out that through professionally managed advice. And I think as an industry, there's a couple things we have to do. One is to provide employers with more tools to help their employees become more

financially literate in terms of coaching and more financial education. The other is making sure they understand the benefits of professional advice and the professional advice that a financial advisor can provide.

Allison Nathan: But isn't there a cost to using a financial advisor, and that's a key impediment to people seeking out one?

Mike Moran: I think this comes back to what I said earlier. People who scored higher in financial literacy were more likely to use a financial advisor. So they're financially literate, and yet they're recognizing how important this is and what the cost is of getting this wrong, right? So it's not just the cost you're paying for the service; it's then understanding what if I actually don't manage this correctly? And how is this going to impact my retirement savings, the growth of those assets? And how is it going to impact my ability to draw those assets down in retirement?

So you have to think about not just the cost but also what's the cost of not doing it correctly?

Allison Nathan: And are we seeing how expenses are

managed, how retirement plans are managed differentiated between different generations? Are different generations thinking about this and approaching it differently?

Mike Moran: The generational aspect is really interesting, and we've seen this really over the course of the three years that we've done the survey. When we think about how ready do you think you are for retirement, how on track you are for retirement, younger generations like Millennials and Gen Z tend to feel like they are more on track for retirement than older generations like Boomers and Gen X.

I would parenthetically add that a lot of younger generations think they need less money in retirement than older generations and also think they're going to retire earlier than some of the people actually do retire, so there may be a resetting of expectations that has to happen there. But I think part of that also comes back to the financial vortex, right? When you're younger, yes, you may come out of college with student loan debt and there's financial obligations, but as your life and your career goes on, life happens and it becomes more complicated. You get married. You buy a house and now you have a mortgage payment. You have kids and now you have dependents.

You have elderly parents. Maybe you have to take time out of the workforce to care for them. That causes you stop saving for retirement. Or maybe you actually have to financially support them.

So life tends to get more complicated as we go along the way. So retirement readiness seems to go down as people age and as they get closer to retirement as more of these financial vortex factors come into play. But even for younger generations, we talk about the impact of the financial vortex, they score very highly in terms of feeling the impact the financial vortex items like credit card debt, student loan debt, and so forth. So even with younger generations, you're feeling that impact.

Allison Nathan: I know we spoke about this a bit, but if we take a 50,000-foot view and think about how the industry has evolved to help people retire more comfortably, what are the few main points you would make?

Mike Moran: So I think what they've done great so far in terms of getting more people into retirement plans, right? We think through auto enrollment, auto escalation, getting

them to save more. I think we as an industry have to think about not only how do we help people save more for retirement and invest more for retirement, but also how do we help them so that they're not stressed out about that, right? There's been a lot of work that would say that employees are very stressed about a number of financial items, including retirement. And stressed employees tend to be less productive employees. They tend to have increased absenteeism.

So there's a real financial cost to employers for not delivering these to their employees. So as we think about going forward, what are the things we need to do as an industry? I mentioned this earlier, but the next phase is probably going to be a more personalized phase. Everyone's journey is different. And so a target date fund may be appropriate for someone who's just starting out and saving for retirement. It's a way to get professional management. It's a way to have a portfolio professionally rebalanced. But as you get older, as your balance increases, and as other things in life happen -- you get married, you buy a house, you have kids -- and it becomes more complicated, that's where we need a more personalized journey. And that's where something like

potentially a managed account can be very helpful to an employee as their situation becomes more complex. It's not just about what date am I going to retire, what else is going on in my financial life? So something more personalized.

And then also thinking about that retirement income journey. We talked about defined contribution plans are a great accumulation vehicle, but now, as more and more employees are retiring with only the DC plan as their employer sponsored retirement plan, how do we turn them into decumulation vehicles so that they can draw down a steady stream of income in retirement and make sure they're not going to outlive their assets?

Allison Nathan: Mike, thanks as always for sharing your insights.

Mike Moran: Thanks for having me, Allison.

Allison Nathan: Thanks for listening to another episode of Goldman Sachs Exchanges, recorded on Wednesday, September 27th, 2023. If you enjoyed this show, we hope you follow on your platform of choice and tune in next week for another episode. Make sure to share and leave a

comment on Apple Podcasts, Spotify, Google, or wherever you listen to your podcasts.

Speaker: The opinions and views expressed in this program are not necessarily the opinions of Goldman Sachs or its affiliates. This program should not be copied or published without the express written consent of Goldman Sachs. Each brand mentioned in this program is the property of the company to which it relates and is not used to imply any ownership or license rights. Goldman Sachs is not providing any financial, economic, legal, investment, accounting, or tax advice through this program. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty as to the accuracy or completeness of any information contained in this program.

This transcript should not be copied, distributed, published, or reproduced, in whole or in part, or disclosed by any recipient to any other person. The information contained in this transcript does not constitute a recommendation from any Goldman Sachs entity to the recipient. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this transcript and any liability therefor (including in respect of direct, indirect, or consequential loss or damage) are expressly disclaimed. The views expressed in this transcript are not necessarily those of Goldman Sachs, and Goldman Sachs is not providing any financial, economic, legal, accounting, or tax advice or

recommendations in this transcript. In addition, the receipt of this transcript by any recipient is not to be taken as constituting the giving of investment advice by Goldman Sachs to that recipient, nor to constitute such person a client of any Goldman Sachs entity. This transcript is provided in conjunction with the associated video/audio content for convenience. The content of this transcript may differ from the associated video/audio, please consult the original content as the definitive source. Goldman Sachs is not responsible for any errors in the transcript.