The Savings Gap

What can plan sponsors do to help bridge the gap in retirement readiness for people of color?

By Judy Ward

This article is adapted from the cover story in the Spring 2021 issue of NAPA Net the Magazine, Breaking the Barriers.

Many Black and Hispanic families have a starkly different retirement-savings reality than white families. Median balances for those who have a defined contribution plan account averaged $30,000 for both Black and Hispanic families in 2019, about half the $55,000 median for white families, according to an Employee Benefit Research Institute (EBRI) analysis of data from the Federal Reserve Board's Survey of Consumer Finances.

Among working family heads, just 48.3 percent of Black people and only about a third (31.8 percent) of Hispanic people were eligible for a defined contribution plan at their workplace, versus 59.6 percent of white people. Participation rates also differ, averaging 70.2 percent for Black family heads and 62.8 percent for Hispanic family heads, compared to 81 percent for white family heads.

The savings gap for people of color likely has become even worse in the past year, says Chief Diversity and Inclusion Officer Cecilia Stanton Adams of Minneapolis-based Allianz Life Insurance Company of North America. "I think that COVID has played a huge role in making these disparities continue to grow," she says. And with 2020's renewed reckoning with civil rights issues, she says, "We're at a point now where we can't look back; we can't say that these things aren't happening. It's important that we take steps to act now — we can't just sit with this for another decade or two."

Savings "Account"

Most prime working-age (age 32–61) Black and Hispanic families in the United States have no retirement savings, according to economist Monique Morrissey of the Washington, D.C.-based Economic Policy Institute (EPI). Just 32 percent of Hispanic families and 44 percent of Black families had any retirement account savings, compared with 65 percent of white families, based on Morrissey's analysis of 2019 Survey of Consumer Finance data.

With the pandemic and economic downturn of the past year, it's unlikely that those percentages have improved, Morrissey says. "The basic story stands," she says. "The pandemic's job disruptions have disproportionately, negatively affected persons of color. It's safe to say that the average working-age household of color has virtually no benefits outside of Social Security on which to rely in retirement."

Like many other workers, people of color often don't have a clear understanding of their retirement savings shortfalls. Fifty-five percent of Americans who identify as people of color believe they are currently saving enough in a retirement account, according to the "2020 Retirement Risk Readiness Study" released by Allianz in September. But the same survey finds that fewer than half say they have any type of retirement savings account or assets. "About half of people of color say they're feeling good about their retirement, but when you dig deeper, you find that there may be some disconnects about their financial situation," Stanton Adams says.

Cultural beliefs about retirement play a role as well. Luisa Blanco, professor of public policy at Pepperdine University in Malibu, California, has done in-depth research on planning for retirement among minorities. Many Hispanics, for example, have what she calls a "denial of retirement" attitude toward their working future. "I did qualitative research, and I found that a lot of Latinos say, 'I will always work; I will work until I die,'" she says. "They say, 'my parents never talked about retiring.' Often, the culture of saving and preparing for retirement is not there — it's just not a social norm."

It's important to put retirement savings in the broader context of racial equity challenges, says Joshua Dietch, Boston-based vice president and group manager-retirement thought leadership at T. Rowe Price. "When you look at retirement savings through a race and ethnicity lens, you're looking pretty far downstream from the source of the inequality," he says. "There are all these things that tend to influence the outcome. What we see correlated with income is education. What we see correlated with wealth is home ownership. By the time you get to retirement, your level of education is often reflected not only in how much you're able to earn, but the employment opportunities available. It is not surprising that we see these things reflected in retirement savings, because we see them reflected in general financial wellness."

The Coverage Conundrum

Anqi Chen, assistant director of savings research at the Center for Retirement Research (CRR) at Boston College, points to two main reasons for the savings gap among people of color. "One is the lower coverage base they have in 401(k) plans, and the other is their lower earnings," she says. "Only about half of American workers are covered in an employer plan, and typically it is the higher earners who are more likely to have coverage."

"What we know is that retirement plan coverage is lower among three groups: people who work for smaller employers, lower-income employees, and people who work part time rather than full time ... and people of color disproportionately fall into those three groups."
Jeffery Brown, Gies College of Business, University of Illinois

The lack of opportunity to participate in a workplace retirement plan is the most urgent issue to tackle, Chen says. "Looking at uncovered workers, our (CRR) research finds that 74 percent are not covered because there is no retirement plan offered at their workplace," she says. "Another 12 percent do have a plan offered at their place of work, but they don't qualify to participate. And the remaining 14 percent of uncovered workers are self-employed. So the first step is to get the coverage up."

In many ways, the realities of today's retirement system reflect inequitable policies that have been in place in the U.S. employment system for decades, says David Mitchell, director of government and external relations at the Washington Center for Equitable Growth in Washington, D.C. "The evidence shows workers of color face discrimination in the labor market that restricts access to high-quality jobs with good retirement benefits. The lack of access to retirement accounts is a huge problem."

In recent years, Black and Hispanic workers have seen declines in workplace retirement plan coverage, while white workers actually have seen a slight increase, according to an Urban Institute paper published in October 2020, "How Can Policymakers Close the Racial Gap in Retirement Security?" Coverage for Black workers declined from 56 percent to 52 percent between 1998 and 2016, the paper says, and from 46 percent to 37 percent for Hispanic workers. Coverage for white workers inched up in the same time period, from 58 percent to 60 percent.

"We know that most retirement savings is done through the workplace, so if people don't have the opportunity to save for retirement through their workplace, they're probably not going to save," says Richard Johnson, director of the Program on Retirement Policy at the Washington, D.C.-based Urban Institute, and the paper's author. "Savings tend to accumulate when they're on automatic pilot. If you have a workplace retirement plan and the money is taken out of your paycheck each period, you don't have to think about saving for retirement — it just happens. If you don't have a workplace retirement plan, you have to deliberately think about it every time. With everything else going on, it's hard for people to exercise that discipline."

Jeffrey Brown, dean of the Gies College of Business at the University of Illinois Urbana-Champaign, sees the coverage shortfall as a result of a deeper set of issues related to employment. "What we know is that retirement plan coverage is lower among three groups: people who work for smaller employers, lower-income employees, and people who work part

time rather than full time," he says. "And people of color disproportionately fall into those three groups."

As an economist, Brown says, he likes open, competitive markets. "If there's a market solution to something, I want to let the market work. But the 'market,' in this case, is what led to this situation: We've developed a set of institutions and structures that have disadvantaged some groups," he says. "And I don't think we can just take our hands off the wheel and assume that the situation will correct itself. To overcome it, I think we have to rethink how we do this. It's a series of policy choices that led to where we are today, and if we don't like it, it likely will take some changes in policies to fix it."

A Policy Fix: An Employer Mandate?

The savings gap is getting more attention in Washington now, EBRI Senior Research Associate Craig Copeland says. "With the new (Biden) administration, there certainly is more discussion about it, and more examination of what is causing it," he says. "I do think there is a better recognition of the issues at the policy level, and at the employer level, and there is a much broader discussion now about how to address it. If you go back even two years ago, you would not have seen that."

> *"Eighty million people have accumulated $9 trillion of wealth in those plans. Is that a failure? What we need to do is to create the ability for more people to get access to that, not dump the whole thing and start over..."*

Momentum appears to be building in Congress for legislation requiring employers that have more than a specified number of employees to offer them access to a retirement plan. "Access is the place that you have to start," Dietch says. "All the other considerations come into play after people have access to a retirement savings plan, and it will do a world of good to get people on that path."

Creating greater access for savings through existing plan structures is a better option than eliminating the employer-based plan system in favor of a single, federal government-run plan, Dietch believes. "Every so often, I see articles that say the 401(k) system is broken, and needs to be scrapped," he says. "Eighty million people have accumulated $9 trillion of wealth in those plans. Is that a failure? What we need to do is to create the ability for more people to get access to that, not dump the whole thing and start over. Do we want to start over again, or do we want to build on what we know works?"

Morrissey says the Economic Policy Institute's first preference to help people of color with their retirement is to expand Social Security benefits, on which many heavily depend. "But we have been very pleased that people who are not necessarily there yet are now willing to consider an employer mandate," she says. "There have been some very centrist groups talking about it that, in the past, never would have touched it. A decade ago, there would have been zero chance of it. Now, we're seeing people converge on a middle ground, to expand access to employer plans."

Just offering access to a plan won't be enough, Blanco says. "You still need behavioral nudges. Research has shown that when it comes to retirement savings, one of the most effective nudges is automatic enrollment. Automatic enrollment is definitely the way to go," she says. Even if these new employer plans have modest initial deferral rates, she says, they would succeed in getting people in the habit of saving for retirement. As she says, "The issue is, how do we get people to start saving for retirement on a regular basis?"

Previous experience confirms that usually, the clear majority of those auto-enrolled in a plan continue to save, Chen says. "There's a lot of research on the behavioral side showing that default options are really important: defaulting people into participating in a plan, and having a diversified default investment. That's because default options are 'sticky,'" she says. "So if you automatically enroll people and give them the option to opt out, most will stay in, and that will help them start to increase their retirement savings."

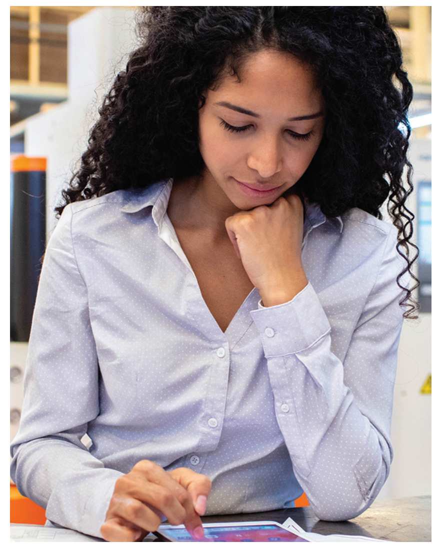
Five Ways Plan Sponsors Can Help

For employers that already have a retirement plan, here are five suggestions to help:

- **Utilize plan design to assist under-savers:** "If there's something employers could do to fix this that's cheap and easy, I like to think that they would have done it already," Brown says. "But if I were leading a company and were really concerned about issues of equity and access in my workforce, if I didn't already have automatic enrollment in my plan, I would do it." And employers looking at plan design through a lens of diversity and inclusion should consider moving to immediate participation eligibility and shorter vesting. "In some cases, I wouldn't be surprised if that would have a big impact," he says.
- **Use demographic data to target messages:** It's helpful for employers to break down data on their employees' retirement-savings behavior by demographics including ethnic backgrounds, Stanton Adams says. "How many employees are actually using this benefit, and are certain populations more likely to use it than others?" she says. "Once you know that, there is a lot of opportunity to help people figure out their situation, and some easy steps to take to improve it. Sometimes people don't know that they could start by having even $15 come out of their paycheck for retirement savings, and that comes out pre-tax, so they don't feel it as much. Then they can increase their deferral by 1 percent (of their pay) the next year, then another 1 percent the next year, and they'll start to see real progress in how much they have saved — which is motivating for anyone."

"… if I were leading a company and were really concerned about issues of equity and access in my workforce, if I didn't already have automatic enrollment in my plan, I would do it."

- **Offer financial literacy basics:** Employers also could help by facilitating more financial literacy education, Copeland says, to teach their employees about basics such as how to budget, and how to pay off credit card debt. "The reason that a lot of people of color are not saving for retirement now is because their current finances are not in order," he says. An analysis published in a December 2020 EBRI *Issue Brief* found that families with African American or Hispanic heads have much higher debt-to-asset ratios than families with white heads. "And these families are more likely to have credit card debt or other consumer debt, versus white families that are more likely to have mortgage debt," he adds.
- **Facilitate emergency savings:** The inability to save for retirement and the lack of rainy-day savings are intertwined issues that need to be looked at holistically, Mitchell says. It would help if more employers were to adopt the "sidecar" savings account concept, and allow their employees to defer money for emergency savings, he thinks. "To ask lower-wage workers to save for when they are 70 years old, but not to have enough on hand to fix their car if it breaks down, does not seem logical," he says. "It is reasonable for folks to build up an emergency savings account at the same time they are saving for the long term." Facilitating emergency savings "is not going to solve the whole savings issue in one fell swoop, but it would make a meaningful difference," he adds.



- **Make education culturally sensitive:** There's a lot of work to be done in making retirement-savings education more culturally sensitive to people of color, and those who don't speak English as their first language, Blanco says. "For them, the informational barriers are huge," she says. "A lot of the information about retirement plans that is out there is not in their language or culturally accessible, and it's complicated. For a lot of them it seems like, 'Oh, saving for retirement? I can't do it.' It's very important for these education programs to be culturally and linguistically appropriate, if we want to truly address the retirement-savings gap."

Judy Ward is a freelance writer and frequent contributor to NAPA Net The Magazine.