With Paycheck-to-Paycheck Living More Common, a Defined Benefit Plan Provides a Secure Retirement Path

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A large majority of Americans are living paycheck to paycheck — 78%, according to a 2023 survey conducted by Payroll.org.[1] Moreover, immediate financial difficulties are not limited to low earners. A MarketWatch survey found that close to half of people earning at least $100,000 annually and more than one-third of people earning $200,000 or more reported the same.[2]

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One concerning finding is that half of Baby Boomer respondents (in or near retirement) say they're living paycheck to paycheck. Specifically, they report having outsized challenges from inflation but are less affected by unexpected emergencies. For millennials, lack of budgeting and planning is the most challenging issue. A 2023 article by the Aspen Institute stated that after paying the rent/mortgage and then almost $700 on food, followed by about $100 for out-of-pocket health expenses, almost 85% of median take-home pay has been spoken for (excluding other essential expenses such as transportation, childcare, and debt payments).[3]

Living paycheck to paycheck focuses personal finances on immediate concerns, making saving for retirement a low and distant priority.

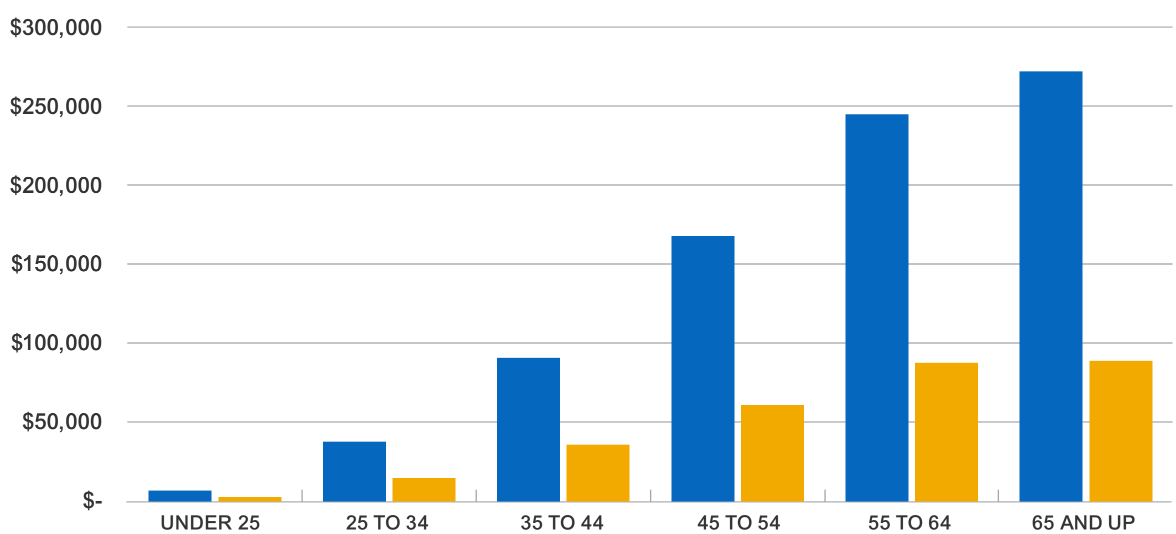
By all accounts, retirement savings look low

Analyzing defined contribution (DC) plan balances shows some startling results. In general, they don't appear to be enough to sustain even modest retirement income levels.

Although 403(b) and 457(b) plans are more common in the public sector than 401(k) plans, data is more widely available for 401(k) plans, so they are often used as a proxy for all DC plans. Like housing price statistics, the median account balance is a more accurate measure than average because the average is skewed upward by very high outliers. In 2023, the average overall 401(k) account balance was $134,128, but the median was only $35,286.[4] The following graph shows average and median DC account balances by age bands.

People lower on the income spectrum generally have built smaller balances in proportion to their salary than people higher up

DC Account Balances by Age Bands

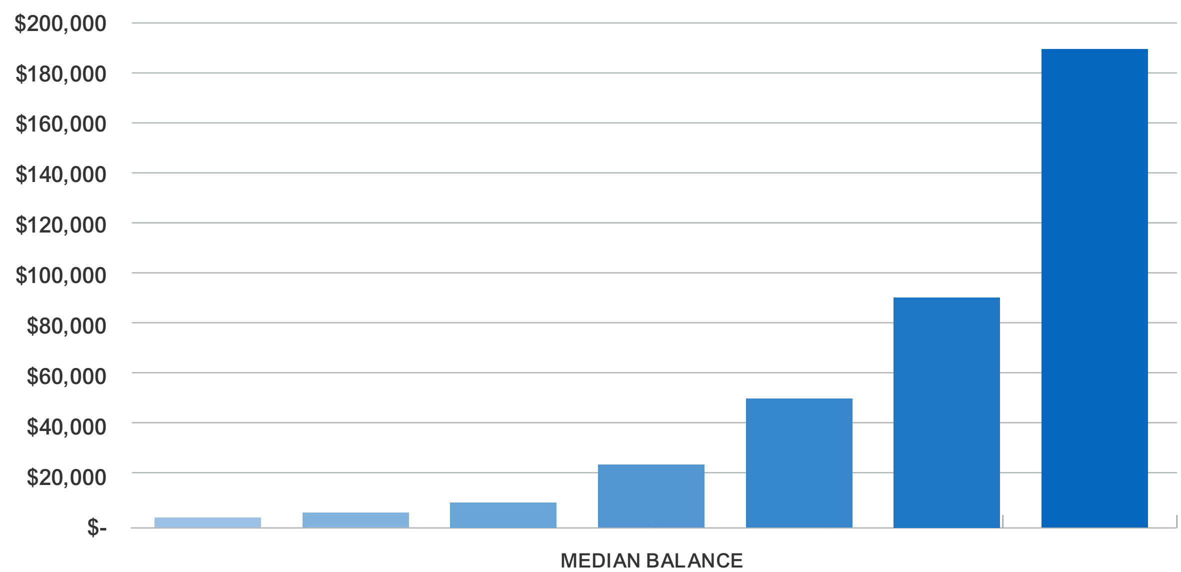


	Under 25	25 to 34	35 to 44	45 to 54	55 to 64	65 and up
Average Balance	$7,351	$37,557	$91,281	$168,646	$244,750	$272,588
Median Balance	$2,816	$14,933	$35,537	$60,763	$87,571	$88,488

Sources: Segal graph created using data from Vanguard's How America Saves report with permission

Not surprisingly, DC plan balances are correlated with income. People lower on the income spectrum generally have built smaller balances in proportion to their salary than people higher up. Other than the lowest band, comparing DC balances to the midpoints of income bands results in larger percentages as the income level increases, as illustrated in the following graph.

DC Account Balances by Income Bands



	Median Balance
Under $15,000	$3,691
$15,000 - $29,999	$6,142
$30,000 - $49,000	$10,072
$50,000 - $74,999	$24,939
$75,000 - $99,999	$51,073
$100,000 - $149,999	$91,323
$150,000 and over	$188,678

Sources: Segal graph created using data from data from Vanguard's How America Saves report with permission.

While some articles tout the number of increasing DC-balance millionaires, that's missing the point. We need retirement plans to work at all income levels, especially lower ones. Participation in DC plans is not guaranteed either as, even with more prevalent automatic enrollment, only 42% of members get auto-enrolled.[5] We have decades of data related to DC plans' inadequate impact on retirement readiness.

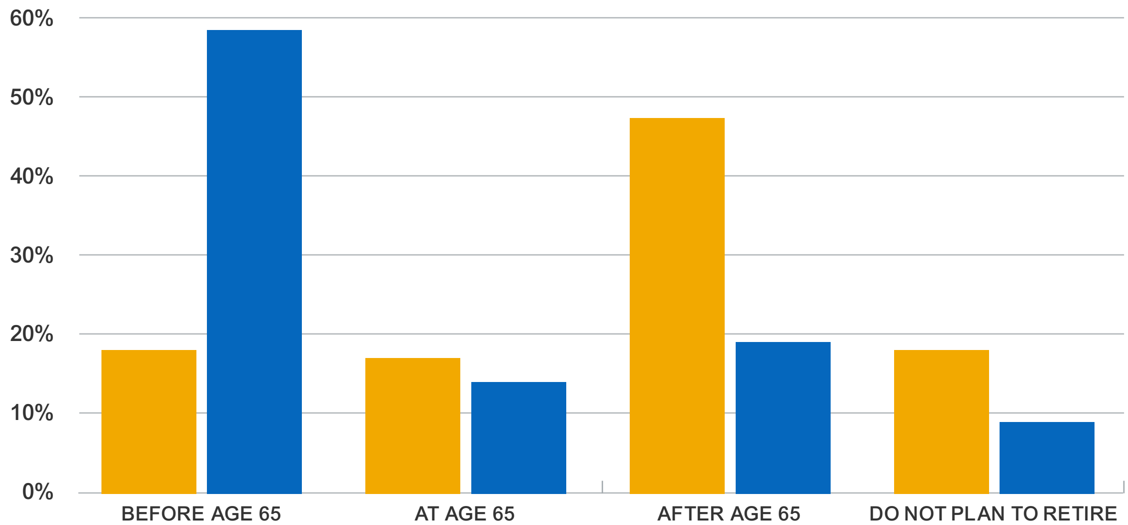
One criticism made with analyzing DC account balances like this is, due to potential job movement without electing rollovers, some people may have more than one account. But even quadrupling the highest median account balances shown results in amounts lower than the present value at retirement for a standard defined benefit (DB) plan lifetime annuity.

A DB plan present value of a $3,000 monthly annuity with no cost-of-living adjustment (COLA) has a present value near $400,000, depending on the underlying assumptions. This is greater than summing four median 401(k) balances of $88,000 at age 65 and up. Adding a COLA can add hundreds of thousands of dollars in value. Approximately half of public sector DB plans offer some form of COLA.[6]

Fear of the great (and not so great) unknown

When surveyed about their retirement fears, the primary concern for workers age 50 and older was "outliving my savings and investments," at 45% of respondents. Additionally, many people don't work as long as originally planned for a variety of reasons. Cutting short a savings horizon in this manner further hurts already low account balances. Expected and actual retirement patterns are illustrated in the following graph.

Expected vs. Actual Retirement Ages



	Before Age 65	At Age 65	After Age 65	Do Not Plan to Retire
Expected Retirement	18%	17%	47%	18%
Actual Retirement	58%	14%	19%	9%

Sources: Transamerica Center for Retirement Studies, "Life in Retirement: Pre-Retiree Expectations and Retiree Realities," September, 2023

Only 9% of those retiring earlier than expected said they "had saved enough money and could afford to retire." Among those retirees, 45% retired early for health reasons and 42% listed unhappiness, organizational changes, job loss and/or burnout.[7] Someone pressured by financial difficulties to delay retirement savings in a DC plan may lose additional key saving years by retiring unexpectedly. Contrast that experience with that of participants in DB plans for whom funding for retirement happens over an entire career.

The DB advantage

The DC plan "experiment" has been running for several decades and it appears it's not going great — especially for those at the lower end of the income spectrum. How can we ask a country largely living paycheck to paycheck to live from an account balance upon retirement that is often nowhere near sufficient?

The most secure form of retirement is one that pays meaningful benefits with dependability and consistency. DB plans do this by:

- Effectively having 100% election rates (participation is not optional)
- Providing funding that covers employees' entire working lifetimes
- Having professionally managed assets throughout working careers and retirement
- Providing a stream of retirement payments that mimics the way many workers are living while employed

Even if workers eventually escape the paycheck-to-paycheck lifestyle, a DB plan is still likely to supply them with the most reliable, consistent, and efficient source of retirement income. ◆

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Endnotes:

[1] Emily Batdorf, "Living Paycheck to Paycheck Statistics 2024," Forbes Advisor, April 2, 2024

[2] MarketWatch, "Paycheck to Paycheck Statistics: 66.2% of Americans Report Struggling Between Paydays," August 9, 2024

[3] Juhohn Lee, "Here's why Americans can't stop living paycheck to paycheck," Aspeninstitute.org, August 17, 2023

[4] Business Insider: "Average 401(k) Balance by Age: Benchmarking Your Retirement Savings in 2024", September 2024

[5] CRS Report: Defined Contribution Plans: Automatic Enrollment, September 5, 2024

[6] National Conference on Public Employee Retirement Systems, NCPERS 2024 Public Retirement Systems Study: Trends in Fiscal, Operational, and Business Practices

[7] Transamerica Center for Retirement Studies, "Life in Retirement: Pre-Retiree Expectations and Retiree Realities," September 2023