The right savings rate? Russell has a rule-of-thumb

By Editor Test Wed, Sep 14, 2011

Russell Investments recommends that each year a defined contribution plan participant should be saving a percentage of salary equal to 30% of his or her final income replacement rate, net of Social Security income.

Russell Investments has proposed a new rule of thumb, which it calls Target Replacement Income 30 (TRI 30), to help defined contribution (DC) plan sponsors better answer the question "Are my participants saving enough?" and to re-design plans to improve participant behavior.

"Describing one's retirement savings rate in terms of target replacement income (TRI) can greatly simplify the retirement savings puzzle," said Josh Cohen, defined contribution practice leader.

The savings rate suggested by Russell turns out to be higher than the 7% average participant deferral rate (for Vanguard plans) or the 10-11% that a survey by the Defined Contribution Institutional Investment Association recently showed that most plan sponsors recommend.

According to one example in a recent Russell report, "What's the Right Savings Rate?" a person with a final pre-retirement income of \$90,000 would need to replace 78% of that in retirement. If 36% of that came from Social Security, the remaining TRI would be 42% of \$90,000. According to TRI 30, a participant would need to save 12.6% a year (combined deferral and match) each year for an entire career in order to have a 90% chance of achieving the replacement rate.

How does Russell define "achieving the replacement rate?" According to its report, "We define success in meeting that goal as purchasing a nominal fixed annuity that provides the desired income replacement. We choose this method because it mitigates longevity risk, simplifying the 'how much is enough?' question."

Russell also outlines additional considerations for determining an individual's TRI in the paper, including the volatility of health care expenses and the challenges faced by lower-income participants.

"Once a plan sponsor has decided on a reasonable TRI for their participants, the next step is to imbed that knowledge into the plan's design through the company match and auto-features," Cohen said.

Russell Investments has about \$163 billion in assets under management (as of 6/30/11) and works with 2,300 institutional clients, and 530 independent distribution partners globally. As a consultant, Russell has \$2 trillion in assets under advisement (as of 12/31/2010) and traded \$1.5 trillion last year through its implementation services business. The Russell Global Indexes calculate over 50,000 benchmarks daily covering 85 countries and more than 10,000 securities.