Savings Rate

ASSESSMENT GUIDE

Savings Rate (Sr) is the percentage of a client's annual gross income being saved for future use. This guide will help you understand more about it and how to use it for client assementment.

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Savings Rate

Assessment Guide

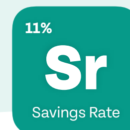
What is it?

Savings Rate (Sr) is the percentage of a client's annual gross income being saved for future use.

Calculation

Total Anual Savings
÷ Total Personal Income

Savings Rate



Example: Assume a client's annual gross income is $200,000. If they save $19,500/yr into a 401(k), $10,000/yr into a brokerage, and $5,000/yr into a 529, their Savings Rate (Sr) is 17.25%.

Why is it important?

Savings Rate tells an important story about your client's current financial wellness and preparation toward long-term financial security. It allows you to measure the overall flexibility in their plan (a higher Sr provides more cushion or unexpected liquidity needs). And it can help clients feel more prepared for financial setbacks.

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Setting a reasonable savings goal and sticking with it is highly correlated to financial independence. Set a goal, save the right amount of money each year, and don't give yourself a pass. It might be the most important indicator of long-term success for many clients. In reality, most clients struggle to save money for the future because humans, by nature, tend to have a behavioral tendency "to give stronger weight to payoffs that are closer to the present time" (it's called "Present Bias"). That bias often results in clients spending before saving.

As a result, lifestyle and consumption choices are by far the biggest variable in savings rates.

There are dozens of examples where increased lifestyle costs might result in fewer dollars to save (think housing, food, family size, education, etc.). Also in competition with our ability to save is a modern economy that continues to have more stuff to buy, more easily (think subscription services, doorstep delivery of anything, etc.).

All of these lifestyle considerations have tradeoffs. If you're going to have any money left to save, there are so many things to say "no" to. You just can't get the "best" of everything if you're going to maintain a healthy savings rate.

How do I use it?

Use this process to assess whether a client's Savings Rate is appropriate or if they need to make improvements:

1. **Score Accuracy**—ensure the accuracy of the Savings Rate inputs.
2. **Score Assessment**—assess whether the given Savings Rate is appropriate.
3. **Score Improvement**—identify areas of improvement.

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STEP 1

Score Accuracy

1. Confirm Recurring Contributions

Keep in mind that Elements scores, and Savings Rate in particular, are reflections of a client's behavior. A one-time bonus is typically not a predictably recurring contribution (though certainly positively impactful to net worth and will show up in the form of increased net worth in Elements). Focus on including and tracking consistently recurring savings contributions.

2. Add Employer Contributions

You should include all employer contributions in savings, but make sure to add the same amount back to current annual income. The income estimate your clients provide typically is not grossed up for employee savings contributions. Adding these back to income in Elements ensures the client's Savings Rate (Sr) will not be inappropriately inflated.

> **Example:** A client has a 401(k) plan where they contribute 6% of their $100,000 annual salary ($6,000/yr). Their employer match formula is 100% of contributions up to 3% of salary (or $3,000/yr). You will enter $9,000 total contributions into the 401k for the year, and you will also enter the annual income as $103,000.

3. Add Extra Debt Payments

If a cash outflow has a positive effect on net worth, Elements includes it as a savings contribution. This applies to extra debt payments.

A client may choose to make extra debt payments beyond the required minimum payment for a debt. This amount will generally go toward paying down principal, thus increasing the client's net worth.

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BEST PRACTICES

Any additional debt payments beyond the required minimum payment should be included in the Savings Rate Element by entering them as an “extra debt payment”.

Example: A client has a mortgage with an outstanding balance of $75,000 and a required monthly payment of $1,200. The client also contributions $300 per month as extra debt payments to reduce principal. $1,200 will be included in the Debt Rate (Dr) element, and the $300 will be included as an extra debt payment under Savings Rate (Sr).

STEP 2

Score Assessment

To assess this score:

1. **Determine whether the score is too high, too low, or just right.**
2. **Identify roadblocks to improvement.**

Score Ranges

Average savings rates generally fall between **10% and 30%**.

Generally, a client’s Savings Rate should **increase or remain the same** as their income rises. As a client’s Burn Rate has the potential to become a smaller percentage of their income during their high-earning years, a client will have greater cash flow to allocate toward savings contributions.

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CORRELATING FACTORS

Understanding the correlation between these factors and your clients' savings habits will help you determine if the given Savings Rate is appropriate or not.

Lower Sr Scores	**Higher Sr Scores**
Higher Future Retirement Income	Higher Income
	Higher Age
	Earlier Retirement Target
	Upcoming Purchases

Roadblocks to Improvement

Before you determine steps a client can take to improve their Savings Rate, you'll need to identify the functional and emotional hurdles holding them back.

Functional hurdles include quantitative reasons a client may not move forward. For savings some functional hurdles may include:

- **Cash Flow Restraints:** The largest hurdle with most clients is just not having enough free cash flow to allocate toward saving. This is often a result of over spending or allocating too much toward paying down debt.

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Emotional hurdles are qualitative reasons a client may not move forward. For savings some emotional hurdles may include:

- **Overspending:** Overspending can happen for a variety of reasons, so we suggest you reference the Burn Rate assessment guide for more guidance here. Often overspending is born from past experiences or lack of accountability.
- **Debt Aversion**: Clients who have an aversion to holding debt often disproportionately allocate cash flow toward paying down debt.
- **Fear**: Saving and investing can be a fearful thing. Whether it was an experience in the past, or fear of the unknown, many clients lack the courage and confidence to save more.
- **Naivete**: Whether it's the overwhelming amount of information out there, or just a lack of desire, many clients just don't understand where or how much they should save.

STEP 3

Score Improvement

After you identify functional and emotional hurdles that may be hindering the client from moving forward, you can start creating a plan to make improvements. As you create your plan, consider the following:

- What accounts should the client save to?
  - Is the client utilizing the full employer match?
  - Is the client maxing out pre-tax contributions?
  - What should be the allocation of pre- vs. after-tax contributions?
  - Should the client set up a retirement plan?

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- If the client wants to make extra debt payments, are they allocating enough toward long-term savings first?
- What should their savings frequency be?
    - You're trying to influence savings behavior. Consistency is key. The more frequent and transparent the savings contribution, the more salient the behavior of saving will seem to the client, and the quicker they will become comfortable with and adherent to saving.
- Do they have sufficient liquidity (i.e. emergency funds, upcoming purchases)?
    - Referring to Liquid Term (Lt) will provide good context.

As you review these questions, you'll be able to guide the client toward good financial behaviors that ultimately improve their financial health.

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Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

> **Example:** Given a Savings Rate of 11.3% and considering the following information, you begin your assessment of whether a client's Savings Rate is appropriate:

Annual Income	**$232,000**
Age	**36**
Target Retirement	**About 30 years away**
Upcoming Purchases?	**No**
Future Retirement Income?	**Only Social Security**

Step 1 – Determine Score Appropriateness

By first considering this client's income, you determine their score of 11.3% is low, but not below average ranges.

Then, considering the additional information you find that 3 of the 5 factors justify a low Savings Rate:

- **Young age**
- **Later retirement target**
- **No upcoming purchases**

However, the other two factors—limited future retirement income and a higher-than-average current income—indicate that the Savings Rate should be higher.

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From these you determine that the client's Savings Rate of 11.3% is just a little too low given their situation.

Step 2 – Identify Improvements and Roadblocks

Through conversations with the client you discover they have a deep aversion to debt, more specifically towards their student loans (where they already have a lower-than-average balance).

Knowing this, you decide to focus your time on understanding why debt is viewed so negatively with the client to help you ultimately determine what you can do to allocate more cash flow toward savings.

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