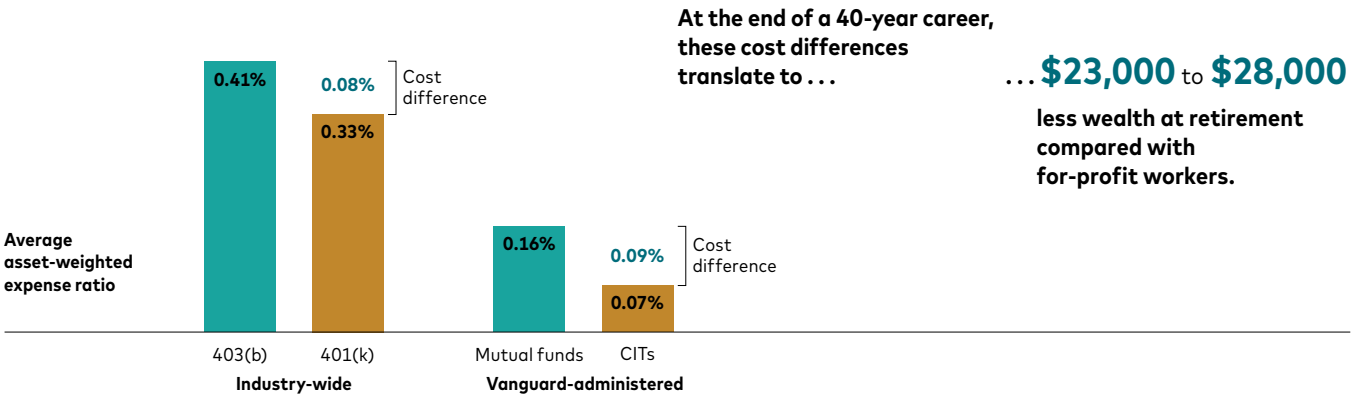
How to lower costs for teachers and health care workers saving for retirement

Takeaways

Roughly 10 million teachers and health care workers saving for their retirement are at a disadvantage compared with workers in the private sector because their retirement plans generally charge higher fees on investments. The reason for this is simple and structural: Unlike the 401(k) retirement plans offered to private sector workers, the 403(b) plans that nonprofit workers use typically cannot access low-cost collective investment trusts (CITs). As a result, these workers generally face 0.08%–0.09% higher investment costs. Compounded over a 40-year career, the cost gap results in about $23,000–$28,000 less retirement wealth at age 65 (see **Figure 1**). Legislative action is needed to remedy this gap and improve retirement security for nonprofit workers.

FIGURE 1

The higher costs of retirement plans for nonprofit workers take a cumulative toll



Notes: The cost difference shown next to the "industry-wide" bars is the difference between the average asset-weighted expense ratio paid by investors in 401(k) plans and that paid by investors in 403(b) plans. The cost difference shown next to the "Vanguard-administered" bars is the difference between the average asset-weighted expense ratio paid by investors in CITs within Vanguard DC plans and that paid by investors in mutual funds within Vanguard DC plans. Industry-wide data are from Brightscope and contain 76,006 plans, 53.8 million participants, and $7 trillion in assets. Vanguard proprietary data are from Vanguard and contain 1,433 plans, 4.6 million participants, and $710 billion in assets. We calculated that, with all else being equal, over 40 years this cost difference would result in an estimated $23,000–$28,000 in forgone wealth at retirement for a typical participant in a 403(b) plan compared with a typical participant in a 401(k) plan. Our calculations incorporated projections made using the Vanguard Capital Markets Model (VCMM). See Appendix 1 for more information about the VCMM. For more information about the assumptions used in our calculations, see Appendix 2.

Sources: Vanguard calculations, using data from Morningstar, Inc., Vanguard, and Brightscope Defined Contribution Plan Database. Vanguard data are as of December 31, 2024; Brightscope data are as of the fourth quarter of 2024.

IMPORTANT: The projections and other information generated by the VCMM regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of November 30, 2024. Results from the model may vary with each use and over time. For more information on the VCMM, see Appendix 1.

Vanguard

For-profit retirement plans offer lower-cost investments than nonprofit plans

About 10 million Americans save for retirement in 403(b) plans, which are the nonprofit world's equivalent of 401(k) plans.[1] Crucially, while 401(k) plans offer a wide range of investment options, including CITs and mutual funds, 403(b) plans and their participants generally do not have access to CITs. Although CITs are similar to mutual funds in their underlying investments, they typically carry lower fees for investors. This is because CITs are less costly to administer, allow employers to negotiate for lower prices, and can be customized for individual participant bases because they are not retail products.

Higher costs add up to lower retirement wealth

The restriction on holding CITs puts nonprofit workers at a financial disadvantage compared with for-profit workers. Industry-wide, the average 401(k) plan investment (including CITs) costs 0.33%, while the average 403(b) plan investment (typically excluding CITs) costs 0.41%, a 0.08% gap (see Figure 1). We find a similar gap of 0.09% in Vanguard-administered plans, where the average cost of a CIT is 0.07% and the average mutual fund costs 0.16%. Notably, the gap widens to 0.11% for larger retirement plans (those with over $4 billion in assets), as CITs allow employers to negotiate for better pricing.

For a median worker with an annual salary of $74,000, a 0.08%–0.09% cost difference results in $23,000–$28,000 in forgone retirement savings by age 65 (see Figure 1).

This difference in retirement wealth matters for retirement outcomes. Vanguard has found that the typical U.S. worker is not on track for retirement and will either need to cut spending or work longer to match their pre-retirement lifestyle.[2] Having an additional $25,000 in retirement wealth could allow a retiree to delay claiming Social Security or pay for about six months of expenses in retirement.[3] If CITs were allowed in 403(b) plans, creating greater cost parity with for-profit plans, retirement wealth for nonprofit workers could increase by approximately $525–$590 million annually.[4]

The solution: Allow CITs in 403(b) plans

To lower costs in retirement plans and enhance retirement security for nonprofit workers, legislative action is necessary.

Vanguard urges support for and passage of the bipartisan Retirement Fairness for Charities and Educational Institutions Act (S. 424/H.R. 1013, 119th Congress, 2025). We thank Senators Katie Britt (R-AL), Raphael Warnock (D-GA), Bill Cassidy (R-LA), and Gary Peters (D-MI), and Representatives Frank Lucas (R-OK), Josh Gottheimer (D-NJ), Andy Barr (R-KY), and Bill Foster (D-IL) for their leadership in introducing this critical legislation.

Allowing 403(b) plans to include CITs as fund options will level the playing field for all retirement savers. Enabling nonprofit employees to access the same low-cost funds as their for-profit peers will decrease their investment fees and increase their ability to successfully save for retirement.

1 Number of 403(b) plan participants is as of 2022. See the 2024 U.S. Department of Labor publication *Private Pension Plan Bulletin Abstract of 2022 Form 5500 Annual Reports*, available at https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2022.pdf.

2 Tan et al. *Vanguard Retirement Outlook: A National Perspective on Retirement Readiness*. Vanguard, 2023.

3 Assuming a 75% target-spending-needs replacement rate for a median worker with an income of $74,000.

4 Our calculations assume that costs on $655 billion in assets under management in 403(b) plans would be cut by 0.08–0.09%. Our source for the $655 billion figure: Release: Quarterly Retirement Market Data, Fourth Quarter 2024, Investment Company Institute, 2025, available at https://www.ici.org/statistical-report/ret_24_q4.

Appendix 1

About the Vanguard Capital Markets Model

IMPORTANT: The projections and other information generated by the VCMM regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. VCMM results will vary with each use and over time.

The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

The VCMM is a proprietary financial simulation tool developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. Those asset classes include U.S. and international equity markets, several maturities of the U.S. Treasury and corporate fixed income markets, international fixed income markets, U.S. money markets, commodities, and certain alternative investment strategies. The theoretical and empirical foundation for the VCMM is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk (beta). At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available monthly financial and economic data from as early as 1960. Using a system of estimated equations, the model then applies a Monte Carlo simulation method to project the estimated interrelationships among risk factors and asset classes as well as uncertainty and randomness over time. The model generates a large set of simulated outcomes for each asset class over several time horizons. Forecasts are obtained by computing measures of central tendency in these simulations. Results produced by the tool will vary with each use and over time.

Indexes for VCMM simulations

The long-term returns of our hypothetical portfolios are based on data for the appropriate market indexes through November 30, 2024. We chose these benchmarks to provide the most complete history possible, and we apportioned the global allocations to align with Vanguard's guidance in constructing diversified portfolios. Asset classes and their representative forecast indexes are as follows:

- **U.S. equities:** MSCI US Broad Market Index.
- **Global ex-U.S. equities:** MSCI All Country World ex USA Index.
- **U.S. cash:** U.S. 3-Month Treasury—constant maturity.
- **U.S. bonds:** Bloomberg U.S. Aggregate Bond Index.
- **Global ex-U.S. bonds:** Bloomberg Global Aggregate ex-USD Index.

Appendix 2

About the assumptions used in our calculations

In the scenarios described in this paper, we use the standard glide path used by Vanguard Target Retirement Funds. The asset allocation is 90% stocks/10% bonds until age 40, glides to 60% stocks/40% bonds until age 60, then to 50% stocks/50% bonds thereafter. Stocks are weighted 60% domestic/40% international; bonds are weighted 70% domestic/30% international. All projections are in today's dollars. For all scenarios, we assumed a single investor who begins working at age 25, retires at age 65, has an income of $74,000 at age 25, experiences annual income growth matching inflation, contributes 11% of their income to their DC plan with contributions invested in target date funds, and remains in either a 401(k) plan or a 403(b) plan for the entirety of their career. Worker income and contribution rates are based on medians described in Vanguard's publication *How America Saves 2024*.

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