



NEW AMERICA
FOUNDATION



Expanding Saving & Retirement Security

Policies & Opportunities

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The State of Retirement Preparedness

- United States private pension system contributes mightily to saving
- Largest pool of investment capital in the world
- Half the working population has access to employer plan – 65 million benefit

The State of Retirement Preparedness

- Big Picture: Social Security, private pensions, personal savings
- Health of pension system tied inextricably to state of health care system
- Medicare, private health care, Social Security, private pensions

The State of Retirement Preparedness

- \$100b + tax expenditure for retirement saving
 - Yet national saving rate negative
- Pension benefits and pension tax benefits skewed to upper income
- Defined benefit pensions slowly imploding
- Median account balances in 401(k)s and IRAs paltry

The State of Retirement Preparedness

- Half the working population has no employer-sponsored retirement plan
- California no exception: more than half uncovered
- By some measures, California ranks 48th among the 50 states in percentage of work force covered

Basic Strategy

- Make saving more rewarding
- Make saving easier

Making Saving More Rewarding

- Target financial incentives to middle- and lower-income families
 - do well, do good
- Reform current tax subsidy to “level the playing field” for the majority of Americans
 - expanding the saver’s credit: refundable, deposited
- Increases saving, makes saving more rewarding for most – like 401(k) employer match
- Presidential candidates’ endorsement

Making Saving Easier

- For those eligible for employer plans, make plans automatic
- Defined benefit, money purchase, profit sharing plans funded by employers
 - “pensions” vs. do-it-yourself saving
- Retirement savings plans - 401(k), 403(b), 457
 - Replicate cardinal virtues of pension plans through automatic enrollment, automatic investment
 - For those leaving money on the table, automate
- California should consider automating its deferred compensation 457 plan

Making Saving Easier

- For the half of us who have no access to an employer plan, IRAs are designed to fill the gap
- But only 1 out of 10 contribute to IRAs
- 7 or 8 out of 10 contribute to 401(k)s
- 9 out of 10 contribute to 401(k)s when automatically enrolled

Making Saving Easier

- Hurdles to saving in standalone, do-it-yourself IRAs
- What works better?
- Payroll deposit saving in the workplace (like 401(k), direct deposit of paychecks)
 - How payroll deposit IRA would help
- Also: automatic enrollment: intelligent use of defaults

Making Saving Easier

- 3 varieties of individual retirement account
- Standalone IRA
 - Self-employed and others
- Payroll deposit IRA
 - For employees at workplace
- SIMPLE-IRA plan
 - Mini-401(k) for employees of small employers
 - Employer contributions

Why the Market Failure?

- Why don't we have more universal ease of saving now?
 - Lack of demand: many don't plan for long term future, don't analyze the risks - myopia
 - Saving requires decisionmaking, discipline, taking initiative to overcome inertia
 - Perception of complexity, too many choices
 - Key easy options are obscure or not well known to employers: payroll deposit IRA, SIMPLE-IRA
 - saver's credit and tax credit for small employers adopting new plans

Why the Market Failure?

- Pension tax incentives poorly designed for majority of US workers
- Per capita cost of plan higher for small employer; must deal with financial services industry “retail”
- Financial services industry has less profit interest in small accounts of new savers
 - Average account balance often a driver
 - Less interest if no employer contributions
 - Providers uninterested in serving small accounts or moderate/lower-income customers need not prevent them from being served by others (e.g., government)
- Fees and expenses vary, can be high, not transparent (price comparison hard): discourages trust and participation by small employers

Solutions: Exploring a Possible Role for the States

- Various Federal proposals
 - Presidential candidates endorse payroll deposit IRA
- Could the states also play a useful role?
- States already sponsor
 - college tuition savings plans (section 529) in partnership with private financial institutions
 - large defined contribution plans for public employees, often with similar partnerships

Potential Interest of States

- Avoid future expansion of public programs needed to support citizens in poverty
- Help in-state employers recruit and retain valuable employees, making state more attractive to business
- Help citizens achieve greater economic security/independence
- Should be self-sustaining without long-term cost to state
 - Recover costs over time through investment returns

How Might States Add Value?

- Catalyst/facilitator for private-sector retirement (and other long-term) saving
- Experience/expertise in designing, managing, administering retirement plans/investments (and possible leverage with financial institutions that currently have the contracts for State business)
- Outreach – bully pulpit to educate, publicize and make available easy options for saving

How Might States Add Value?

- Aggregate rather than regulate: pool smaller employers to achieve economies of scale and use state's bargaining power to negotiate better (wholesale) prices for them
- Cut through plethora of options by offering a salient alternative, vetted by state, with its imprimatur
 - Payroll deposit IRA; perhaps SIMPLE-IRA
 - Best practices, no frills

How Might States Add Value?

- Incubator for accounts too small to be profitable to financial services industry
 - possibly including orphan accounts they would like to dump
- Make federal tax benefits available to small in-state employers and employees

State-Assisted Saving: How It Might Work

- Payroll deposit IRAs
- Voluntary for employers unwilling to sponsor a 401(k) or other retirement plan
- Voluntary for employees
- \$5,000 employee contribution limit
- Tax-favored like 401(k) but no employer contributions
- Employer might choose private-sector IRA provider to receive all employee contributions or use standard alternative designated by state (e.g., contracting entity)

How It Might Work

- Universal/broad access, portable
- Standardized/uniform design
 - Possible standard default investment and limited, simple menu of options
- Low-cost/no frills
- Emphasize electronic administration and funds transfer

How It Might Work

- Possible stand-alone IRA option
 - State facilitate IRA setup with automatic debit for self-employed
- Possible SIMPLE-IRA option
 - Lets employer contribute to “mini-401(k)” for small employers
 - Employers minimize compliance/administrative tasks by avoiding nondiscrimination testing, IRS approval, IRS reporting, complex plan provisions and plan documents

How It Might Work

- Public-private partnership
 - Allocate specific functions efficiently to various entities
 - Competitive bidding on best practices payroll deduction IRAs designed by State with private-sector input
 - Maintains employer incentive to adopt 401(k) and does not curtail any other option on the market
 - Springboard/affirmative state efforts to encourage adoption of pure private-sector 401(k)s and IRAs

If We Build It, . . .

- Outreach/publicity – central web site
- Create the infrastructure
- Consider automatic enrollment or other “behavioral” strategies to promote participation
 - Small cash bonuses for first employer/employee participants?
- Success defined as substantial increase in participation/saving