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CONGRESSIONAL TESTIMONY

Pursuing Universal Retirement Security Through Automatic IRAS and Account Simplification

**Testimony before
The Committee on Ways and Means
United States House of Representatives**

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Chairman Camp and Ranking Member Levin, I appreciate the opportunity to testify before you on ways to increase retirement savings opportunities for all Americans. With the continued decline in the number of Americans covered by employer sponsored defined benefit plans, millions of individuals whose employers don't offer any way for them to save for retirement at work, and Social Security's continued financial problems[1], it is crucial that the Congress develops a common strategy to expand retirement savings in a manner that transcends ideological and partisan differences.

In 2006, a bipartisan majority in Congress eliminated barriers to the use of automatic enrollment and similar automatic techniques in retirement savings plans with the result that millions more Americans are both saving and building retirement security. The results have been stunningly good. With automatic features, enrollment in 401(k)-type accounts has grown to average over 80 percent of eligible employees. In addition, every major income, age, racial or ethnic, and gender has shown an increase in participation rates.

However, the job is not complete. As I will discuss in a moment, there are still millions who do not have access to a payroll deduction retirement savings account, the best and most effective way to build a retirement nest egg. It is true that these workers could save in an IRA, but studies show that only about 5 percent to at most 10 percent of those workers who have access only to a non-payroll deduction IRA actually have such an account and make regular contributions to it.

Meeting this challenge will require some hard decisions, and the longer those decisions are delayed, the harder they will become. While Social Security provides a benefit that is sufficient to meet the retirement income needs of most lower income retirees, it only provides a fairly modest proportion of the retirement income needs of average and above average income retirees. Even if Social Security was fully funded and had all of the resources necessary to pay all of its promised benefits, which it does not, those benefits would still provide only about half of what the average income retiree needs for a comfortable retirement.

Most retirees will need some other means of additional retirement income, and given today's realities, that means it will be either come from an expanded and improved retirement savings system or from additional government-provided benefits. In a future

[1] For a discussion of Social Security's finances, see "Social Security 2011 Trustees Report Shows Permanent Deficits" by David C. John, Heritage Foundation Webmemo #3256, May 16, 2011 at: http://www.heritage.org/research/reports/2011/05/social-security-2011-trustees-report-shows-permanent-deficits.

where massive deficits will remain commonplace, it will be difficult to impossible for the government to provide additional retirement benefits. But, as it takes time for savings to accumulate to the point where they can finance a decent level of income, delay makes it much more likely that a future Congress will face a demand for additional government benefits.

With the looming retirement security crisis facing our country, policy-makers from both parties are focused on ways to strengthen pensions and increase savings. The proposal developed by Mark Iwry, who was then at Brookings, and I for Automatic IRAs would provide a relatively simple, cost-effective way to increase retirement security for the 75 million Americans working for employers (usually small businesses) that do not offer a retirement plan. Many of these workers are part-time employees of smaller businesses, women, members of minority groups, or all three. The Automatic IRA would enable these employees to save for retirement by allowing them to regularly transfer amounts from their paycheck to an IRA.

This fact, a national saving rate that has been too low since the 1980s, and the expectation that Social Security is unlikely to provide increased benefits, make inadequate retirement saving a major national problem. Research and experience both point to a simple and effective solution, the Automatic IRA.

The Automatic IRA is certainly not the only step that should be taken to expand retirement savings for small business workers or others, but it would be a good start. In fact, both Mark Iwry and I have long believed that employer-sponsored retirement plans including 401(k)-type retirement savings accounts are the best way for individuals to build retirement security. Additionally, both The Heritage Foundation and the Retirement Security Project continue to advocate strongly for expanded participation in employer sponsored retirement savings accounts through automatic features in 401(k) and similar retirement savings plans and for several other initiatives designed to expand retirement security, especially for the moderate- and lower-income households that comprise a majority of the U.S. population.

Making saving easier by making it automatic has been shown to be remarkably effective at boosting participation in 401(k) plans, but they are of no use to the millions of US workers who are not offered a 401(k) or any other type of employer-sponsored plan. We could and should extend the benefits of automatic saving to a far wider array of the population by combining several key elements of our current system: payroll deposit saving, automatic enrollment, low-cost, diversified default investments, and IRAs.

The Automatic IRA offers most employees who are not covered by any form of employer-sponsored retirement plan the opportunity to save through the powerful mechanism of regular payroll deposits that continue automatically. The employer's administrative functions are minimal and under our proposal should involve no out of pocket cost for the employer. In addition, the arrangement is market-oriented and realistic: it uses a well established and familiar vehicle, IRAs, provided by the same banks, mutual funds, insurance carriers, brokerage firms, credit unions, and other private financial institutions that have provided them for decades. As a fallback, if individuals or employers could not find an acceptable Automatic IRA on the market, they would be able to use ready-made, low-cost automatic IRA accounts provided by a consortium or pool of private-sector financial institutions.

Automatic enrollment is a key part of the Automatic IRA because it especially helps those groups who are most likely to undersave: women, minorities, younger workers, and low- to moderate-income workers. Experience shows that these groups move from very low participation rates that range in percentages from the mid-teens to the mid-twenties to participation rates that reach the mid-eighties. This is equal to those of all workers. Overall, 401(k) participation rates under automatic enrollment increase participation rates from roughly two-thirds of eligible workers to the mid-80 percent level. A key improvement is that individuals start to save earlier than they would have otherwise, which opens the door to their accumulating much higher amounts by the time they are eligible to retire.

While many focus on the value of the Automatic IRA to new savers, it would be equally valuable to older workers who change jobs from a company that offers a 401(k) plan into a smaller company that currently has no type of retirement savings plan. These workers tend to now have savings gaps, which can cripple their ability to build retirement security. However, under the Automatic IRA, those workers could combine his or her old 401(k)-type accounts into an Automatic IRA and to continue saving. Data shows that most workers change jobs as many as 10 times during a career, and without the ability to continuously save throughout their careers using payroll deduction, many Americans will have less than they need for a comfortable retirement.

This is not a partisan or ideological proposal. In 2008, the Automatic IRA won the endorsement of both the Obama and McCain campaigns, and it has continued to enjoy support from all sides of the ideological spectrum. Earlier this year, Rep. Richard Neal of the committee introduced HR 4049, the Automatic IRA Act of 2012. While the Heritage Foundation as a 501(C)3 nonprofit does not and can not endorse any legislation, let me say that the policy contained in his bill would significantly improve our retirement savings system. In the Senate, a similar bill was introduced last September by Sen. Jeff Bingaman as S. 1557. Previous versions were either sponsored or co-sponsored by former Rep. Phil English (R-PA) and former Sen. Gordon Smith (R-OR), and the concept has been endorse by such varied publications as the National Journal and the New York Times. It has also been endorse by significant conservative and liberal officials and former officials.

While my testimony will focus on the Automatic IRA, a second part will discuss simplifying the current confusing series of retirement account types and tax treatments so that both ordinary Americans and employers can better understand their savings options. Rather than the current system of multiple account-types named after sections of the tax code, past legislators and others, there could be a couple of simple savings options available to all, and structured so that they can be combined and rolled over from one employment situation to another as the saver progresses through his or her career.

Finally, I will end with two modest proposals to use tax information to encourage taxpayers to consolidate their retirement accounts if they desire to, and to include Social Security information on an annual 401(k) or IRA statement so that the account owner has information about their expected total retirement income, the need to enable multiple employers to share a retirement savings platform, and a thought about the tax treatment of retirement savings.

The Automatic IRA

The Automatic IRA is intended to help households overcome the barriers to saving by building on the success 401(k) plans with automatic features. Both automatic enrollment and automatic escalation encourage employees toward sensible decisions while still giving them complete control over their retirement savings choices. The Automatic IRA features direct payroll deposits into a low-cost, but simple IRA structure that offers diversified investments. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years but do not sponsor a 401(k) plan or any other retirement plan for their employees would be asked to facilitate their employees saving – without the need to sponsor a formal ERISA-regulated plan, without making employer matching contributions, and without complying with plan qualification or fiduciary standards. They would simply act as a conduit, remitting a portion of their employees' pay to an Automatic IRA, preferably by direct deposit.

The Automatic IRA is also designed to address the concerns of financial providers that have found it less profitable to serve groups of people with a small average account balances. The proposal would provide an optional R-Bond arrangement that uses a Treasury bond account to enable new and small savers to build a nest egg large enough to interest private sector providers, and a private sector backstop arrangement that enables any employer unable to find a local financial institution interested in offering them an Automatic IRA to use one of a series of private sector providers who have agreed to accept any business in any location.

The Automatic IRA Is Simple for Employers

The Automatic IRA would not impose a burden upon employers. They need do little more than they do now with the income and payroll taxes they deduct from an employee’s paycheck and send to the IRS. In this case, employers will deduct some of the employees’ own money and send it to the private sector funds manager that administers the employer’s Automatic IRA. The employer would select that private sector manager from an online list located at a central website, and if the employer does not wish to choose a provider, that company would be assigned at random to a funds manager that is willing to accept all comers.

Because an IRA is personal savings, employers would not be required—or even allowed—to match these savings in any way. Employers would also have no liability for determining if employees are eligible for the program or face the complexity of ERISA and other regulations that govern a 401(k) plan.

Little or No Cost to Employers

Direct deposit to IRAs is not new. In the late 1990s, Congress, the IRS, and the Department of Labor all encouraged employers not ready or willing to sponsor a retirement plan to at least offer their employees the opportunity to contribute to IRAs through payroll deduction.[2] However, employers did not respond to this option. Very few employers have ever adopted direct deposit or payroll-deduction IRAs – at least in a way that actively encourages employees to take advantage of the arrangement.

With this experience in mind, the Automatic IRA is an improved strategy designed to induce employers to offer, and employees to take up, direct deposit or payroll deposit saving. For employers, offering an Automatic IRA would involve little or no cost or regulatory burden. The employer would not be maintaining a retirement plan, and employer contributions would be neither required nor permitted. Firms would ***not*** be required to

(1) comply with plan qualification or ERISA rules,

(2) establish or maintain a trust to hold assets,

(3) determine whether employees are actually eligible to contribute to an IRA or are complying with the limits on contributions,

(4) select investments for employee contributions,

(5) select among IRA providers, or

(6) set up IRAs for employees.

These simplifications eliminate almost all of the costs associated with a 401(k)-type plan. As discussed below, any remaining cost of establishing and operating the Automatic IRA would be reimbursed through a tax credit. Employers would be required simply to allow employees to make a payroll-deduction deposit to IRAs. This dovetails with what employers are already required to do by way of withholding income and payroll taxes from employees' pay and remitting those amounts to the federal tax deposit system. Another factor in avoiding cost is the fact that virtually all employers who would be subject to the Automatic IRA already utilize either an outside payroll processor or use

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[2] In the Conference Report to the Tax Reform Act of 1997, Congress stated that "employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction [IRA] system to help employees save for retirement by making payroll-deduction contributions to their IRAs" and encouraged the Secretary of the Treasury to "continue his efforts to publicize the availability of these payroll deduction IRAs" (H.R. Rep. No. 220, 105th Cong., 1st Sess. 775 [1997]). IRS and Labor guidance was given in IRS Announcement 99-2, "Payroll Deduction IRAs," and Department of Labor Interpretive Bulletin 99-1 (June 18, 1999), 29 C.F.R. 2509.99-1(b).

payroll software. Companies that provide both types of payroll services indicate that the Automatic IRA would simply be another component in services they already offer.

Employer Tax Credit to Cover Automatic IRA Expenses

The Automatic IRA has been designed after lengthy consultations with many small businesses, retirement savings providers, consumer groups, and government agencies to have very low costs for both employers and employees. We recognize that small businesses already have plenty to deal with just to stay in business. As a result, after discussions with many small businesses, designed a tax credit to cover the remaining small costs, if any, of establishing and operating the Automatic IRA.

Unlike some other government-required programs, the Automatic IRA is not an unfunded mandate, and it would be a serious mistake to consider it as such. Unlike health care mandates and similar programs, employers under the Automatic IRA are essentially being hired to provide a service that will benefit them as employers. A detailed survey of employers and employees who would come under the Automatic IRA showed that even if every other firm also offered the Automatic IRA, the fact that their employer does so would increase employees' loyalty to the employer. This can be a great help in attracting qualified employees and retaining them. Further, the same survey showed that the more an employer heard about the Automatic IRA, the more they liked the program and were willing to support it. Many employers want to provide retirement benefits to their employees, but they are simply too busy with keeping the doors open to be able to take any action, are confused by the complexity of 401(k)-type plans, and are worried about the cost. The Automatic IRA deals with all of these concerns.

Businesses and others should also take very seriously the consequences of taking no action. As I mentioned earlier, retirement savings take time to build to an amount that can provide a significant amount of income, and millions of Americans currently have no way to save at work, and don't do so on their own. Failure to improve this situation will lead to demands for additional government-provided benefits either through Social Security or another new program. Those benefits would almost certainly be financed in whole or in part through higher taxes on businesses. Another equally disturbing approach would be a government managed contributory system that would eventually crowd out the private system that provides jobs, tax revenues to all levels of government, and is so innovative that it constantly improves its services at lower costs to employers and employees.

The Automatic IRA would provide a temporary tax credit designed to cover reasonable costs of establishing Automatic IRAs. As described in HR 4049, the tax credit would be in two parts, both of which the firm would receive. The first would be available to a firm for the first two years in which it offered Automatic IRAs and would provide $500 the first year and $250 for the second year to cover any reasonable startup costs. In addition, the firm would receive $25 per employee for up to 10 employees (a maximum of $250) for six years to cover the costs of adding employees to the system or removing them if they leave. After six years experience, Congress could re-examine the tax credit and continue or adjust it as needed. This tax credit structure would be designed to avoid competing with the tax credit available under current law to small businesses that adopt a new employer-sponsored retirement plan. Also, it would be available both to those employers required to offer the accounts and to very small or new firms that are not required to offer the Automatic IRA, but do so voluntarily.

Increase theTax Credit for Employers that Adopt a New Employer-Sponsored Retirement Plan

Under current law, an employer with 100 or fewer employees that starts a new retirement plan for the first time can generally claim a tax credit for startup costs. The credit equals 50 percent of the cost of establishing and administering the plan (including educating employees about the plan) up to $500 per employer per year for three years. To maintain employer incentives to adopt an employer plan, this tax credit should be increased to at least $1,000, and preferably $1,500. Employers could not claim both the new plan startup credit and the proposed Automatic IRA credit.

Simple and Low Cost for Employees

An employee does not need an MBA to understand and participate in an Automatic IRA. As discussed below, most employees will be automatically enrolled into their employer's Automatic IRA, a process that is proven to build participation, which employees like, and under which employees have complete control over their savings decisions. To avoid confusion and to keep costs low, all Automatic IRAs will offer three and only three investment choices.

For most employees, their money would go into a target date fund that provides a diversified mixture of investments that gradually change as the employee get closer to retirement. This is the same default investment choice for 401(k) plans. However, the financial markets are constantly innovating, and when a better or lower cost investment choice comes along, the regulators will have the ability to substitute it for the target date funds.

A second fund choice would be directed at new and small savers. Depending on the wishes of the employer and/or provider, it would be either a stable value fund or an R-Bond account within the Treasury Department. An R-Bond account would be invested in Treasury securities and would be expected to pay about the same rate as a 5-year T-Bond. It would not have any maturity as it would be an account instead of a specific security, and would be a temporary way for small savers to build up a high enough balance to interest many private funds managers. When the account reached $5,000, it would either be automatically rolled over into the employer's choice of private funds manager or rolled over at the request of the account owner.

The third choice could be either a balanced fund or a slightly more aggressive target date fund. It would only be available at the request of the saver. And of course, the employer also has the option to allow their employees to make payroll deductions into an account they already have. Finally, if an employer does not allow this, the employee always has the option to roll his or her Automatic IRA into a private IRA at an institution of their choice invested whatever they choose. However, if the employee chooses an account that is outside the Automatic IRA structure of their employer, he or she would be responsible to make additional contributions on their own.

Direct Deposit and Automatic Fund Transfers

The Automatic IRA would capitalize on automated or electronic fund transfers. Many employers retain an outside service provider to manage payroll, including withholding, federal tax deposits, and direct deposit of paychecks to accounts designated by employees or contractors. For the numerous firms that already offer their workers direct deposit, direct deposit to an Automatic IRA would entail no additional cost, even in the short term. As mentioned earlier, virtually every employer that still processes their payroll by hand would come under the exception for very small employers. As a result, the proposal focuses chiefly on those employers that already use electronic payroll but have not used the same technology to provide employees a convenient retirement saving opportunity. The tax credit should cover the cost of providing this service to their employees.

Employees Covered

Employees eligible for the Automatic IRA would include those who have worked for the employer on a regular basis (including part-time) for a specified period of time and whose employment there is expected to continue. Employers would not be required to offer Automatic IRAs to employees who are already covered by a retirement plan or are excludable from coverage (such as recently-hired employees, those who work less than 1,000 hours a year, union-represented employees or nonresident aliens without US source income) under the qualified plan rules. Accordingly, the proposal is not intended to apply to employers that offer 401(k), SIMPLE, pension or other qualified retirement plans to their employees.[3]

Portability of Savings through Choice of Roth or Traditional IRA

Like a 401(k) contribution, the amount elected by the employee as a salary reduction contribution would go to either a Roth IRA, which receives tax-favored treatment upon distribution, or to a traditional, tax-deductible IRA. To spare households the need to undertake the comparative analysis of Roth versus traditional IRA, after examining the income levels of the target population, Automatic IRAs would be Roth IRAs unless the saver chooses to have a traditional IRA at the time of enrollment, an option that he or she would have. In either case, the use of IRAs as a savings vehicle maximizes the portability of those savings. IRAs generally continue in existence without

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[3] The only exception would be an employer that sponsored a retirement plan but excluded a major portion of its workforce – for example, excluding an entire division or subsidiary that is not union-represented or foreign – in which case the employer would be required to offer payroll deposit saving to the rest of the workforce.

regard to changes in the owner's employment status and, in general, are freely transferable by rollover to other IRAs or qualified plans.

Expanding Saving through Automatic Features

Today, individuals who want to save in an IRA must make a variety of decisions that they may not feel they are ready to make in order to open an account. In addition, they must overcome a natural tendency to delay making important decisions until they have "enough information" to make a decision, a time that almost always never arrives. At least five key questions are involved:

- whether to participate at all;
- which financial institution to use to open an IRA (or, if they have an IRA already, whether to use it or open a new one);
- whether the IRA should be a traditional or Roth IRA;
- how much to contribute to the IRA; and
- how to invest the IRA.

These obstacles can be overcome by making participation easier and more automatic. Under automatic enrollment, an employee would be enrolled in an account, contribute a set percentage of income into it, and have that money invested in a safe, diversified investment at a reputable financial services provider. However, the employee would also have the ability to have complete control over all of those decisions.

Further, employees like automatic enrollment. An October 2009 survey by Prudential Insurance found that 74 percent of American workers would rather be automatically enrolled into a 401(k) plan than use the traditional method; while 65 percent support automatic contribution escalation.

Even more telling, a 2007 study by Retirement Made Simpler -- a coalition including AARP, the Financial Industry Regulatory Authority (FINRA), and the Retirement Security Project (RSP) – shows that workers who have been automatically enrolled strongly support the mechanism and start saving before they would have otherwise. According to the study, 97 percent of workers who had been automatically enrolled and remained in the plan were satisfied with the procedure, while 90 percent of those who had been automatically enrolled and then opted out due to individual circumstances felt the same way. Eighty-five percent of those participating in the 401(k) plan said that they had started to save for retirement earlier than they had otherwise planned, while 95 percent felt that automatic enrollment made saving for retirement easy. Finally, 98 percent of those who were automatically enrolled and remained in the plan were glad their company offered automatic enrollment, as were 79 percent of those who had opted out. This last number is key, as it shows that even if workers decided that their specific circumstances did not allow them to remain in the company's 401(k) plan, they still valued automatic enrollment.

This does not mean that automatic features are perfect. A continuing concern that Congress needs to address is whether the current automatic choice for the amount of the initial contribution is too low. Currently, that is set at three percent of income, and while employers have the ability to set a higher rate, most use the three percent level. Unless this low level is paired with automatic escalation, a procedure where the percentage climbs usually when the employee's salary goes up, employees may find that they still have insufficient savings when they retire. Evidence suggests that employees see the initial contribution level as the one recommended by the employer, and many fail to increase it. Further, there are indications that lower income employees are more likely to stick with the initial levels than those with higher incomes. For this reason, Congress should consider increasing the initial contribution level. Several studies suggest that if the three percent is increased to five percent or more, the participation rates will remain nearly the same as they are today.

The Automatic IRA Uses Automatic Enrollment or an Explicit "Up or Down" Employee Election

As shown earlier, automatic enrollment (more often applied to newly hired employees but now increasingly applied to both new hires and other employees) has produced dramatic increases in 401(k) participation among all income and other employee groups. In view of the basic similarities between employee payroll-deduction saving in a 401(k) and under the Automatic IRA, the law should, at a minimum, permit employers to automatically enroll employees into Automatic IRAs.

However, simply allowing employers to use automatic enrollment with Automatic IRAs may not be enough. Requiring employers to use automatic enrollment in conjunction with the Automatic IRA would almost certainly increase participation dramatically while preserving employee choice and control over all saving decisions. However, in some situations, such as small business owners who work with all of their employees closely each day, the employer might regard automatic enrollment as unnecessary or a potential disruption of the existing relationship between employer and employee.

Accordingly, while automatic enrollment would be the presumptive or standard enrollment method, employers could opt out of it in favor of an alternative approach, which is in effect a variation on automatic enrollment. The alternative requires all eligible employees to submit a form where they explicitly either accept or decline participation in an Automatic IRA. Requiring an "up or down" election picks up many who would otherwise fail to participate because they do not complete and return the enrollment form due to procrastination, inertia, inability to decide on investments or level of contribution, and the like.[4] Any employee who fails to comply with the election requirement is automatically enrolled. In either case, to maximize participation,

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[4] James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick, "Optimal Defaults and Active Decisions," NBER Working Paper No. 11074 (January 2005).

employers would receive a standard enrollment module reflecting current best practices in enrollment procedures.[5]

Compliance

Whether using automatic enrollment or explicit "up or down" elections from employees, employers would be required to obtain a written (including electronic) election from each nonparticipating employee. That way, no one would be left out by reason of inertia. Employers using automatic enrollment would use a notice that also informs employees of that feature (including the automatic contribution level and investment and the procedure for opting out), and the employer's records would need to show that employees who failed to submit an election were in fact participating. Employers would be required to certify annually to the IRS that they were in compliance with the payroll deposit saving requirements.

The Importance of Protecting Employer Plans

The Automatic IRA is designed carefully to avoid competing with or crowding out employer plans. Probably the most important protection for employer plans is the use of IRAs, which have maximum permitted contribution levels of $5,000 with an additional $1,000 if the contributor is age 50 or older. This is sufficient to meet the demand for saving by millions of households but not high enough to satisfy the appetite for tax-favored saving of business owners or decision-makers, who can contribute up to $17,000 of their own salary to a 401(k) (or $22,500 if age 50 or older) plus matching or non-matching employer contributions that can bring the total annual 401(k) contributions on their behalf to $50,000 a year. In addition, by design, the employer tax credit for providing access to Automatic IRAs is significantly less than the proposed increases to the small employer tax credit for sponsoring a new 401(k), SIMPLE or other retirement plan.

In fact, the Automatic IRA is designed to actually promote more employer plans. First, any employer that wants to match its employees' contributions must adopt a qualified plan or SIMPLE. To preserve that incentive, the Automatic IRA is structured around the IRA, a retirement savings option that does not allow employer contributions. Second, experience with the Automatic IRA will give most employers of all sizes sufficient experience with payroll deduction retirement savings that they will be open to considering moving up to 401(k)s, SIMPLEs and other tax-favored employer plans. Because these plans can now be purchased at very low cost, it would seem natural for many small businesses – especially those whose owner would like to save more or to match employees' saving – to graduate from payroll deduction saving and complete the journey to a qualified plan.

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[5] A national website could provide firms these standard enrollment and election forms, as well as provide an opportunity to promote employee education and best practices as they evolve, such as automatic enrollment and potentially, lifetime guaranteed income.

Encouraging Contributions by the Self-Employed and Independent Contractors

For the self-employed and others who have no employer, regular contributions to Automatic IRAs would be encouraged in three principal ways:

- Expanding access to automatic debit arrangements, including through professional and trade associations that could help arrange for automatic debits into an Automatic IRA. Automatic debit essentially replicates the power of payroll deduction insofar as it continues automatically once the individual has chosen to initiate it.
- Extending the Automatic IRA to many independent contractors through direct deposit with firms from which they receive regular payments (without affecting the individual's status as an independent contractor); and
- Enabling taxpayers to direct the IRS to make direct deposit of a portion of their income tax refunds to an Automatic IRA or other similar savings vehicle. This mechanism has existed for several years, but is under utilized.

Guaranteed Lifetime Income

The Automatic IRA could also serve as a natural platform or proving ground for best practices in retirement savings, possibly including perhaps at some point in the future, an expanded use of lifetime guaranteed income. There is reason to believe that many households with savings but no lifetime income stream to supplement Social Security would be better off if they converted a portion of their savings to appropriately priced guaranteed lifetime income.

Yet most consumers are reluctant to do so. One approach would be to use the same automatic strategy that has so successfully improved enrollment and sensible investment could also encourage more workers to obtain the security of an annuity or other guaranteed lifetime income[6], including perhaps "longevity insurance" that provides a deferred annuity beginning at age 80 or 85, for example. The uniform default investment and the backstop Automatic IRA for any employees who cannot find an appropriate IRA in the market may also lend themselves to exploring means of encouraging greater use of low-cost guaranteed income in IRAs generally as well as in 401(k) and other employer plans.

In the interim, interim steps such as the draft regulations proposed by the Treasury Department and Department of Labor would be a good start at reducing the regulatory impediments that discourage employers from offering annuity-like products as part of their plans. Further incremental steps should follow, and both Congress and the regulators should continue their efforts to completely catalogue the remaining impediments faced by employers and employees and understand their effect. Among

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[6] As an example, see "Increasing Annuitization of 401(k) Plans with Automatic Trial Income" by William Gale, Mark Iwry, David John and Lina Walker at: http://www.brookings.edu/papers/2008/06_annuities_gale.aspx

other issues, innovation should be encouraged both in product offerings and pricing with all industry or industry segment being given advantages over another.

Part II: Simplifying Retirement Savings Accounts

About ten years ago, the Bush Administration proposed simplifying the several types of retirement savings accounts into two accounts: the Retirement Savings Account (RSA) and Employer Retirement Savings Accounts (ERSA). In addition, the 2005 Bipartisan Tax Reform Panel[7] proposed a modified version of these ideas. These ideas are worth revisiting although with changes from what they proposed. (The reforms also included the creation of a Lifetime Savings Accounts (LSAs), but those are beyond the scope of this testimony.)

Given the widespread knowledge of the IRA and public support for it, there is no compelling reason to change it into an RSA. In addition, the proposed RSA would have had a higher $7,500 contribution limit, but as Congress has increased the IRA limit since the RSA was proposed and could do so again, that is not really a reason for such a reform.

On the other hand, the ERSA would be a good idea. The original proposal would have consolidated 401(k), thrift, 403(b), and governmental 457 plans as well as SARSEPs and SIMPLE IRAs into one simple account, which could be sponsored by any employer. The existing structure is confusing to employees, most employers, many tax professionals, and many financial services firms that don't specialize in the specific account in question. In addition, because each account type has specific tax incentives and restrictions, it can be difficult to consolidate differing types of accounts.

At the time, three improvements to the retirement savings system were expected from the ERSA. First, the expected coverage and participation to increase because firms that were not currently offering retirement plans because of the complexity and compliance costs were expected to be more likely to offer ERSAs. Second, they expected that more small businesses would offer ERSAs because the reduction in red tape would make it easier and cheaper to do so. Finally, employees were expected to benefit from reduced compliance costs.

To some extent, all three of their expectations remain realistic. After a transition, which could be handled by grandfathering existing accounts with the voluntary option to consolidate existing accounts of differing types into an ERSA, the new system should have much lower administrative costs. As providers focused on the new account type competition should put serious pressure on its administrative costs.

In addition, the simplified structure should encourage more employers to offer an ERSA to their employees or to upgrade their Automatic IRA to an ERSA. This would

[7] The final report of the President's Advisory Panel on Federal Tax reform is available at: http://govinfo.library.unt.edu/taxreformpanel

almost certainly include greater coverage by small businesses. The ERSA would expand coverage, but would not eliminate the need for an Automatic IRA. In fact, the presence of the Automatic IRA would actually increase the number of smaller businesses that offer an ERSA as they would still have to offer the Automatic IRA, and the difference between an ERSA and an Automatic IRA would be much smaller than under the current account structure.

The simplified account structure would have many benefits, but it would be a mistake to completely eliminate the anti-discrimination tests. An ERSA that resulted in low to moderate income employees receiving a less favorable employer contribution than their better paid co-workers or were not encouraged to participate would be a serious mistake. Unless low to moderate income employees are able to build sufficient retirement savings, they will put increasing pressure on Congress for either higher Social Security benefits or some other form of government paid benefits.

Part III: Use Tax Information to Consolidate Retirement Accounts

Today, millions of Americans have more than one retirement savings account. While some have additional accounts because of a conscious decision, most of them come from past jobs where the account owner failed to take the necessary actions to roll the money into accounts sponsored by their current employers or rolled them into IRAs that the owner has lost. Many of these accounts are “orphaned” because the current account administrator does not have current information about the owner’s address, and many of these are consumed by administrative fees, leaving nothing for the saver’s retirement.

This is not an inevitable side effect of the existing retirement savings system. Account owners can consolidate most types of retirement savings accounts, but many do not. Few know the procedure, and many lack the needed information, such as the current address or contact information of a former employer. Moreover, employers may go out of business, and former employees may not know who administers them or how to recover their accounts. These “orphaned” accounts hurt both employees and employers. Some employers send the accounts to custodians who try to trace the account owner, but custodians often impose annual fees that can consume the entire balance. Even when employers retain accounts and employees can find them, owners may pay more in fees than if their accounts were consolidated.

One way to deal with this problem would be to use tax information to help the account owner to identify what accounts they own. This change would help to make saving simpler and minimize the losses associated with lost or duplicate accounts. At the same time, some account holders may want more than one account, and this proposal would allow them to continue to do so.

If this reform was adopted, when an individual files a 1040 or other tax form with a current address, the Internal Revenue Service (IRS) would check its records to see whether the individual’s SSN is associated with more than one tax-preferred retirement savings account. Information from past employers is already available to the IRS. Rolling 401(k) balances into an IRA after an employee leaves triggers an annual IRA Form 5498 that lists fair market value plus any contributions or withdrawals. For money that remains in 401(k) accounts, the details of former employees are found on Form 8955 SSA in the year they leave the employer. Both forms include information on the accounts owners that could be used to provide the information needed for such a cross-check.

Once individuals with more than one tax-favored account have been indentified, they would receive a letter detailing the number of accounts they own, the value of consolidating accounts, and the process they could use to consolidate. The letter would also include a method that would allow the account owner to access account numbers, names and addresses of custodians, and a copy of the form to use for consolidation. A taxpayer who wishes to retain several accounts could notify the IRS perhaps through a simple check form or online that they do not wish to either consolidate accounts or to be reminded in the future.

This measure would help to reduce the number of "orphaned" accounts and the cost they pose to employees and employers by creating a way to consolidate accounts that is efficient and reliable.

Part IV: Combine Social Security and 401(k) Statements

Individuals must have better information in order to make appropriate decisions about how much to save for retirement and to have realistic expectations as they approach retirement. All too often, retirement savers are blinded by the aggregate amount of their savings, and fail to understand how that figure translates into a monthly income stream. In addition, individuals need to have an accurate idea about what level of Social Security benefits that they will receive and combine the two in order to have an idea of their full retirement resources. They also need this information in time to change their potential future by increasing saving; waiting until retirement is close is too late. Fortunately, there are simple steps that can go a long way to providing this data.

Currently, 401(k) and IRA statements inform accounts owners of their balances at regular intervals. In the near future, the Department of Labor will implement standards that will require 401(k) statements to include the annuitized value of those balances on those statements at least annually. Until recently, the Social Security Administration (SSA) issued annual Social Security statements that showed participants an estimate of their benefit levels. However, the agency has suspended the statements for anyone under age 60 citing its cost. Combining the information on retirement savings accounts – and in particular the annuitized value of those savings – with that formerly provided by SSA would go a long way towards helping individuals to prepare for retirement.

Retirement savings account providers should be encouraged to add estimates of the account owner's future Social Security benefits using information provided by SSA together with the annuitized value of retirement savings balances every year on either an annual statement in the case of IRAs or on one 401(k) quarterly statement. Distribution of the information would be paid for by the 401(k) administrator, just as quarterly statements are now, but SSA could pay the cost of providing the additional benefit information. This would both reduce the cost to SSA, but still ensure that the agency is meeting the requirements of legislation passed by Congress some time ago.

Some 401(k) providers already can and do simulate Social Security benefits and provide this information to account owners, but these providers lack the income and work history data to make a truly accurate projection. Collaboration between the Social Security Administration and 401(k) plan administrators would improve the accuracy of those providers that currently include this information and add the information to the statements of those providers that do not.

Two sets of concerns about using Social Security information would need to be addressed: concerns about privacy and concerns about accuracy. Previous discussions of this proposal have failed because of privacy concerns, as many individuals do not want employers to have access to their Social Security information. The privacy of account holders is a concern for 401(k) providers too, and they already go to great lengths to protect confidential data contained in the quarterly statements. To assuage concerns about the data from SSA, Social Security data could be provided to 401(k) administrators and included on an annual 401(k) statement only if the providers meet certain SSA-developed privacy standards. Plus, individuals could have control over whether their Social Security information is included either through the ability to opt in to the service or the opportunity to opt-out, if the service were automatic. This should preserve individual choice and satisfy those persons especially concerned about privacy.

Of course, the value of a 401(k)-type account can vary over time depending on market results and investment strategy while Social Security benefits are fixed assuming that the program is properly funded. For this reason, account owners should be strongly encouraged to review their statements every year to determine if they need to increase savings rates. In addition, the statements should include a clear and bold disclosure that savings balances can both increase and decline over time depending on market conditions.

To ensure accuracy and consistency annuitized balances in the 401(k) and SSA projections would need to be produced using roughly the same methodology. The utility of these statements would be increased if they included projected Social Security benefits plus both (1) current balances annuitized with payouts beginning at age 65 and (2) projections of annuitized future balances if the account owner continues either to save at their current level or increases the percentage of their salary that they save. The additional information will enable savers to have a better idea of how much they should be saving in order to have a comfortable retirement.

This simple reform would give taxpayers important information about how to plan their futures. Savers desperately need this information, and providing it should be fairly simple and cost effective.

Part V: Multiple Employer Plan

There is no one perfect platform for a 401(k)-type account, and both Congress and the appropriate regulators should encourage companies to develop innovative ways that would make it easier and cheaper for employers to offer these accounts to their employees. One way that definitely deserves consideration is the multiple employer plan that focuses on a modified version of the IRA SIMPLE. This idea originated with Prudential as a variation on a proposal from the Conversation on Coverage.

Like all IRA SIMPLE plans, this of the multiple employer plan would be limited to smaller employers with less than 100 employees. By adding the multiple employer structure, smaller businesses would be able to join together to negotiate the lowest possible administrative fees. Unlike the original IRA SIMPLE, this version does not require an employer contribution, a feature that should make it much more attractive to companies. In return, there is a slightly lower contribution limit.

The multiple employer IRA SIMPLE is not a substitute for the Automatic IRA. If only this idea was adopted, there would still be millions of employees without the ability to save to retirement at work. However, it would expand the options available to employers. Even if Congress does decide to simplify the current confusing system of retirement accounts as I discussed earlier, there would still be different structures under which employers can offer accounts to their employees.

Part VI: A Few Thoughts on Retirement Tax Incentives

The tax incentives that Congress has granted to employees and employers in return for sponsoring or contributing to a retirement savings account is a crucial part of the system, and should not be changed without serious consideration. That does not mean, however, that the current system is perfect and cannot be improved as part of a comprehensive tax reform. For instance, it would be very useful to find a way to enable lower and moderate-income retirement savers to receive higher tax benefits. In addition, it may be that upper income savers would be willing to accept slightly lower tax benefits in return for lower overall tax rates. However, let me reiterate that nothing should be done lightly, without a clear understanding of the complete consequences, or unless it is part of a comprehensive reform.

Conclusion

Thank you for allowing me to present several ideas for improving retirement saving. American households have a compelling need to increase their personal saving, especially for long-term needs such as retirement. This testimony summarizes several strategies for making saving more automatic – hence easier, more convenient, and more likely to occur. In particular, by adapting to the IRA universe practices and arrangements that have proven successful in promoting 401(k) participation, the Automatic IRA holds considerable promise for improving the retirement security of millions of workers.

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