

Automatic IRAs: Extending Retirement Saving Opportunities to 78 Million More American Workers

This policy fact sheet describes the steps that employers can take to facilitate employee saving for the nearly 1 out of every 2 workers—78 million working Americans—who have no employer plan and thus no effective way to save at work. This fact, a steadily declining saving rate since the 1980s, and the expectation that social security will not provide increased benefits, exacerbate the problem of inadequate retirement saving. Research and experience both point to a simple and effective solution: the Automatic IRA.

Under the Automatic IRA, employers above a certain size (e.g. more than 10 employees), that have been in business for at least two years, but that still do not sponsor any retirement plan for their employees, allow their employees to use the employer's payroll system to channel their own money to an IRA. Employees choose how much and where to save.

The policy fact sheet is based on the Retirement Security Project paper by J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security Through Automatic IRAs," available at www.retirementsecurityproject.org.

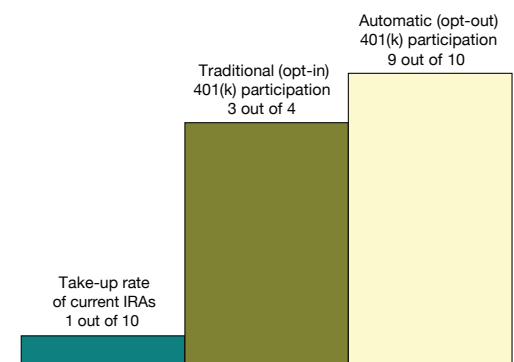
The Benefits to Employers and Employees of the Automatic IRA

The Automatic IRA would extend payroll-based saving opportunities to those not currently covered by allowing them to automatically direct regular payroll deposits into IRAs. Under this approach,

- Firms will receive a temporary tax credit for offering automatic IRAs, to offset any administrative costs of implementation.
- Automatic IRAs are provided by existing financial institutions or funds managers. Employers will choose a provider, but may allow employees to contribute to an Automatic IRA at another provider instead.
- As a fallback, employers can select a provider from local financial institutions or through an online clearing house that connects employers with IRA providers. In addition to individual companies, providers will include multi-employer accounts and an Automatic IRA offered through financial services industry consortiums or nonprofit risk pooling arrangements.

- Saving becomes automatic. Automatic enrollment – enrolling employees unless they choose to opt out – and sensible default investments harness the power of inertia to increase saving.

The Power of Automatic Retirement Saving



The Automatic IRA proposal would extend payroll-based saving to the 78 million American workers not covered by an employer-based retirement plan. Participation in IRAs would increase by using payroll deduction and encouraging automatic enrollment.

The Power of Automatic Enrollment and Default Investment

- Automatic enrollment dramatically boosts 401(k) participation rates from a national average of about 75 percent of eligible employees to between 85 and 95 percent.
- The Automatic IRA will encourage employers to use automatic enrollment. Firms not using automatic enrollment must still get a written waiver from employees who don't want to save.
- Whether it's an employee- or employer-designated IRA, or the default account, participants will be offered an automatic default investment fund (initially an asset-allocated life cycle fund) and an additional limited choice of diversified, low-cost investment alternatives.
- IRA providers may include a very low cost "starter account" invested in government bonds or similarly to a bank IRA CD account that will receive funds until the account reaches a set size, after which it and all future contributions will go into the automatic default investment fund.
- A national website will encourage best practices and innovation (such as automatic enrollment and, potentially, annuitization).

The Automatic IRA initiative could increase net national savings by nearly \$8 billion annually (Retirement Security Project estimate).

Minimal Cost or Trouble to Employers

For the many firms that already offer their workers direct deposit of paychecks, direct deposit to an IRA should entail no additional cost, even in the short term.

- Employers facilitate employee saving without having to: (1) sponsor a plan; (2) make matching contributions; (3) comply with plan qualification or ERISA requirements; (4) set up an account for employees; or (5) determine employees' eligibility to contribute to an IRA.
- Many employers that still process payroll by hand will be exempted under the exception for very small employers. Firms not exempted will have the option of "piggybacking" the payroll deposits to IRAs using the same schedule that applies to the federal tax deposits they currently make, whether online, by mail, or by delivery to the local bank.
- A national website will provide employers with standard enrollment forms and procedure.

Increased Saving for the Self-Employed

The self-employed and independent contractors could contribute to Automatic IRAs by

- Automatic debit arranged through their professional and trade associations
- Direct deposit by the firms they work for
- Sending deposits at the same time as their quarterly estimated taxes
- Direct deposit by the IRS of their income tax refunds

Protecting and Encouraging Employer-Sponsored Retirement Plans

The Automatic IRA is carefully designed to avoid competing with or crowding out employer based retirement plans and employer contributions for employees.

- The maximum permitted contribution to IRAs (\$5,000) exceeds most employees' average 401(k) contribution but is not enough to satisfy the appetite for tax-favored saving of business owners or decision-makers (who can contribute up to \$11,500 in a SIMPLE plan or \$16,500 in a 401(k) plan).
- The Automatic IRA tax credit will be smaller than the tax credit small employers get for adopting a new retirement plan.
- In fact, expansive use of Automatic IRAs will provide new opportunities to market 401(k), SIMPLE, and other tax-favored plans to employers.
- To encourage employer plans, firms will not be asked (or allowed) to match employee savings to automatic IRAs. Employers wanting to contribute for employees will adopt 401(k)s or other plans.

Possible Matching Deposits as a Financial Incentive

While not a part of the Automatic IRA proposal, tax credits could be provided as a matching deposit to automatic IRAs for workers in lower tax brackets, giving them another powerful financial incentive to save, similar to a 401(k) match. The Obama administration has proposed such changes to the Savers Credit.

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