

Automatic Savings Vehicles: Pointing Workers and the Economy in a Pro-Saving Direction

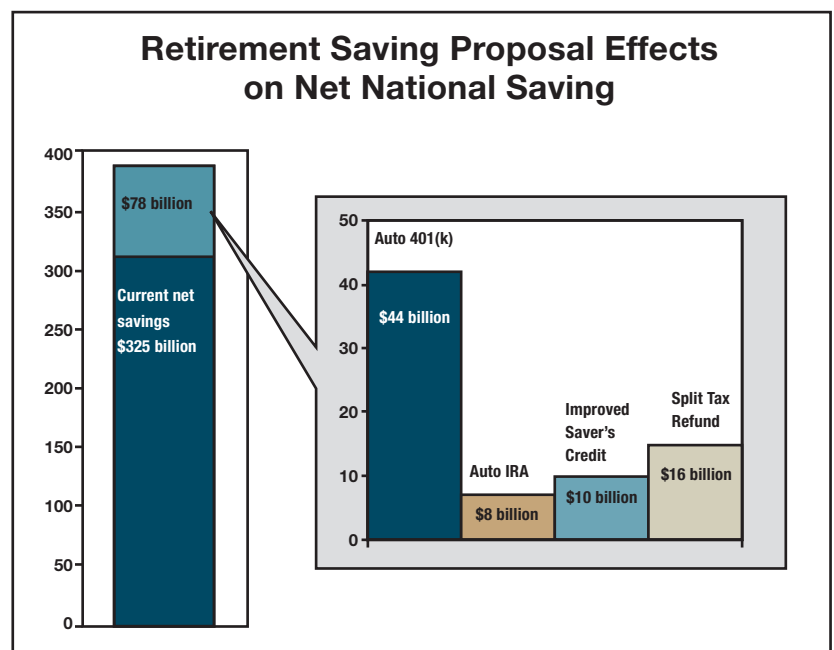
America's working families are increasingly reaping benefits from the growing ability and willingness of companies to automate participation in 401(k) retirement plans. Research has consistently shown that Americans will start saving for a secure retirement earlier if it is easier for them to save, as it is under an automatic 401(k) plan. A new paper from The Retirement Security Project estimates that making saving easier and increasing incentives to save for middle- and low-income households could increase net national saving by roughly **\$75 billion a year**.

Increasing retirement security is not just good for retirees – the macro-implications are significant as well. New research estimates that automatic saving vehicles and savings incentive programs could boost net national saving by about 0.6 percent of GDP, or roughly \$75 billion per year given today's levels of GDP. With the current net national saving rate at about 2.5 percent of GDP, these proposals have the potential to raise net national saving by almost a quarter.

J. Mark Iwry, William G. Gale, and Peter R. Orszag's paper "*The Potential Effects of Retirement Security Project Proposals on Private and National Saving: Exploratory Calculations*" examines five proposals aimed at making retirement saving more accessible and rewarding for middle- and low-income households.

The proposals would:

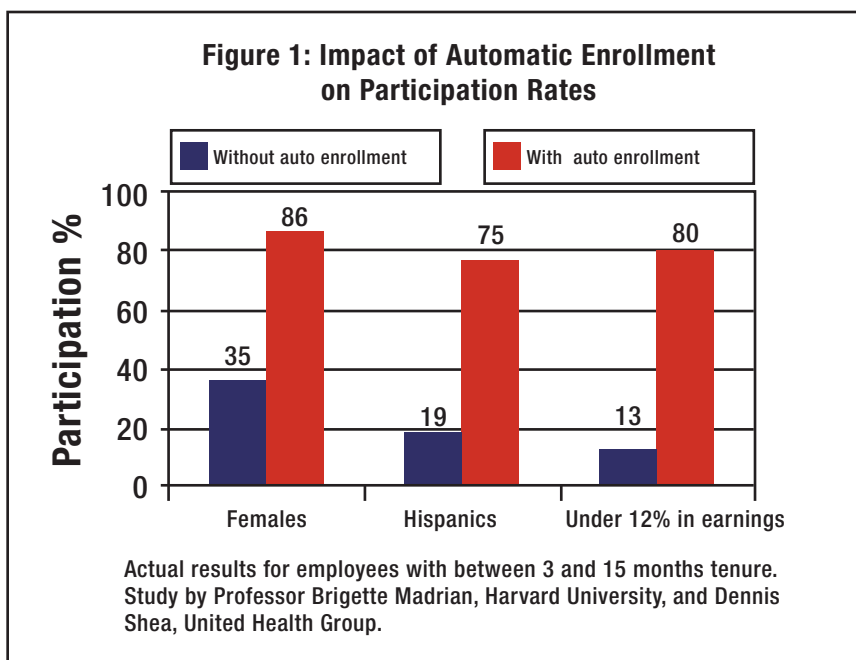
- promote the adoption of automatic features in 401(k) plans (e.g., enrollment, escalation, investment);
- establish Automatic IRAs for employees not covered by 401(k) plans;
- expand and improve the Saver's Credit;
- allow taxpayers to split direct deposit of income tax refunds into several accounts; and
- reform the asset eligibility tests for means-tested government programs.



Automatic 401(k): A net increase of \$44 billion a year in national savings. Workers are automatically enrolled in the plan unless they actively choose not to participate; they are assigned a reasonable contribution level, which rises over time, and a reasonable investment allocation, all of which they can choose to change.

Automatic enrollment, the most common of the automatic features, raises national savings by nearly \$8 billion.

A study found that adding automatic enrollment to a 401(k) plan boosted enrollment for new hires from 49 percent to 86 percent. The gains are even more striking for certain population groups least likely to save – females, Hispanics and low-income workers.



More and more firms are recognizing the power of automatic enrollment and are committing themselves to making retirement saving easier for their employees. In 2005, over 34 percent of companies with 5,000 or more participants used automatic enrollment, up from about 30 percent the year before and from virtually zero before 1996. The Retirement Security Project estimates that more than half of the larger 401(k)s will have decided to adopt automatic enrollment or other auto features effective in 2007 or 2008. A 2005 study by Deloitte Consulting found that a full 96 percent of employers were satisfied with automatic enrollment.

Policy changes at the federal level have been key to encouraging widespread adoption of automatic features. In August 2006, the Pension Protection Act was signed into law. The Act cleared several legal concerns that will make wider implementation of automatic 401(k) plans a reality:

- preempting state laws to the extent that they preclude or restrict automatic enrollment;
- providing a measure of protection against fiduciary liability for prudent default investments, with direction to the Department of Labor to issue regulations on the appropriateness of default investments; and
- allowing a penalty-free “unwind” period during which employees who opt out of the plan can recover their contributions without an early withdrawal tax penalty.

Adopting Automatic IRAs would increase net national savings by nearly \$8 billion. Making saving easier by making it automatic has proven to be remarkably effective at boosting participation in 401(k) plans, but nearly half the workforce is not offered a 401(k). Auto IRAs provide a new way to dramatically expand retirement savings in the United States by extending employer-based savings opportunities to the 71 million American workers not currently offered an employer-provided retirement plan. The Auto IRA would feature direct payroll deposits to a low-cost, diversified individual retirement account. The Auto IRA preserves low costs for employers by using their current payroll system and provides employees with an automatic vehicle to encourage saving.

Making split tax refunds a reality in 2007 is another low-cost, technology-driven government reform that will boost net national savings by \$16 billion. By allowing individuals to direct the nearly \$230 billion in federal income tax refunds to multiple accounts, American families will be more apt to save some of their refund in a retirement account while still using part of it for current expenses.

Expanding and improving the Saver's Credit would further increase net national savings by \$10 billion. Enacted in 2001, the Saver's Credit was made permanent in 2006. While this is an important step in creating powerful incentives to save for middle- and low-income households, making the Saver's Credit refundable (with a uniform 50% rate) would encourage saving among the 50 million lower-income Americans who pay payroll taxes but have no income tax liability.

This fact sheet is based on *"The Potential Effects of Retirement Security Project Proposals on Private and National Saving: Exploratory Calculations"* by J. Mark Iwry, William G. Gale and Peter R. Orszag, and is available at www.retirementsecurityproject.org.

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