Q&A: A Specialist's Take on New Retirement Savings

By ZAHER KARP

Targeted News Service

WASHINGTON, Oct. 14 -- President Obama has announced new steps that would make retirement saving easier for American households. Many of these new policies are based on proposals developed by the Retirement Security Project, led by William Gale and supported by The Pew Charitable Trusts in partnership with Georgetown University's Public Policy Institute and the Brookings Institution.

Gale is the Arjay and Frances Miller Chair in Federal Economic Policy in the Economic Studies Program at Brookings and has co-edited a number of books, including the recently published Changing the Way America Saves. He has also served on advisory boards for the Government Accountability Office, Internal Revenue Service and the Committee on Taxation. Prior to joining Brookings, he was an assistant professor in the Department of Economics at the University of California, Los Angeles, and a senior staff economist for the Council of Economic Advisers under President George H.W. Bush.

The following is an interview with Gale:

TNS: How does the Retirement Security Project work to improve retirement prospects for Americans?

Gale: The Retirement Security Project is dedicated to promoting common sense solutions to improve the retirement income prospects of millions of American workers with a special emphasis on those with moderate incomes. The project was launched in response to the compelling need to strengthen retirement income security for millions of workers and their families, deepen interest on the issue, and undertake research and analysis that will help point the way to practical solutions.

Two specific policy solutions that RSP has championed include automating enrollment in 401(k) and IRA plans to increase participation and the creation of tax credits and incentives that allow taxpayers to easily save part of their tax refund. We are also actively work to increase the number of retirees who choose guaranteed lifetime income products to protect against out living their savings.

TNS: How are opportunities for automatic 401(k) (and other retirement savings plans) being expanded by President Obama's proposals?

Gale: In his budget outline, President Obama included two RSP initiatives, the Automatic IRA, a way for small business employees who are not covered by any type of employer-sponsored pension or retirement plan to save some of their own money in an IRA, and improvements to the Savers Credit, under which moderate income workers could receive a tax benefit for saving that is deposited directly into their retirement savings accounts.
In a September 5th weekly address, President Obama announced additional new steps to make it easier for American families to save for retirement. These include: 1) streamlining the process for 401(k) plans to adopt automatic enrollment by issuing pre-approved automatic enrollment language via the IRS; 2) making it easier to increase saving by gradually increasing automatic worker contributions over time, with option to maintain current contribution or opt out altogether; 3) allowing automatic enrollment in SIMPLE-IRAs; 4) allowing taxpayers to purchase U.S. savings bonds through their tax refunds by checking a box on their tax return; 5) allowing unused leave to be converted to 401(k) savings either by the employee or employer; and 6) explaining saving options for employees changing jobs via a plain-English road map and website that outlines benefit options, including a tax-free rollover.

TNS: How will small businesses benefit from these proposed changes?

Gale: Nearly half of American workers are employed by a company that does not offer any type of pension or retirement savings plan. The Automatic IRA is designed to be simple for both companies and their employees, and does not require small businesses to make an employer contribution. Research and polls show that workers strongly support this proposal, and even if every company offers the Automatic IRA or another type of retirement savings plan, workers in those companies will fell greater loyalty to the employer.

TNS: How will families be assisted in saving some or all of their tax refund?

Gale: RSP has been very active in designing and promoting Split Refunds, under which workers can send part of their income tax refunds to a retirement savings account and the rest to their checking accounts. In addition, the Administration has proposed that, starting in early 2010, taxpayers will have the ability to use their refunds to purchase U.S. savings bonds simply by checking a box on their tax return.

They can take advantage of this option without having to open an account at Treasury or take any other action, and without having a bank account. The savings bonds would be mailed to the taxpayer. Taxpayers will be able to purchase bonds in their own names beginning in 2010 and to add co-owners such as children or grandchildren beginning in 2011. This policy builds on the already successful Saver's Credit, which offers a tax credit for middle- and low-income taxpayers who take advantage of qualified retirement saving accounts such as 401(k)s or IRAs.

TNS: Is Social Security in need of further policy attention?

Gale: Yes, both the long-term financing of the program and the structure, incentives, and equity of the program could usefully be addressed. However, RSP's focus is on improving non-Social Security retirement savings.

TNS: Pension systems are suffering funding concerns--will these be addressed?
Gale: RSP does not deal with under funding of traditional defined benefit pension systems, although we are concerned that pending congressional actions may result in less funding of those plans and the increased potential for greater under funding of the Pension benefit Guarantee Corporation. In the case of retirement savings plans, we know that automatic enrollment boosts participation in 401(k) retirement plans from about 70 percent to more than 90 percent. By boosting participation in existing 401(k)s and adopting automatic enrollment in IRAs for the 78 million workers who don't have access to an employer-sponsored plan, many of the funding concerns will be addressed.

TNS: How will employees benefit under employer programs with the new retirement plan feature?

Gale: In addition to enhanced participation, key plan features include automatic escalation, which gradually increases employee contributions over time. Automatic enrollment also helps direct assets into balanced, prudently diversified, and low-cost vehicles and discourages over concentration in employer stock or in money market or stable value assets. All of these features are designed to benefit retirement security and make saving simpler and easier for employees.

TNS: How will the legislative proposals work to build accessibility for employees to understand the dense language of tax-favored retirement savings options?

Gale: The Automatic IRA is a very simple, easy to understand retirement savings system. In addition, Treasury and the IRS are issuing a plain-English road map to help employees better understand things like rollovers to help workers keep their savings in tax-favored retirement plans or IRAs until they are ready to retire, rather than withdrawing cash earlier, subject to tax penalties.

The road map is an updated model notice for plans to give departing employees. It clearly explains how to roll over plan balances, the key decisions, and the tax consequences. In addition, the IRS has created new user-friendly web site materials to help employers select an appropriate retirement plan and to help employees better understand the benefits of saving for retirement.

TNS: How will the Retirement Security Project's role be evolving as these new changes are brought to Congress?

Gale: The Retirement Security Project will continue to work on a nonpartisan basis to promote policy initiatives that make it easier and increase incentives for middle- and lower-income Americans to save for a financially secure retirement. Another innovation on the horizon: automatic enrollment into a lifetime guaranteed income plan through annuity-like products that help retired workers have access to a steady paycheck throughout retirement. These products have the potential to make consumers better off because they mitigate the risk of outliving retirement savings. Despite the potential benefits, few retirees purchase lifetime income products today through the private market
(private annuities account for less than 2 percent of total household income).

There has been some recent interest in shifting from state insurance regulation to an optional fed charter system coupled with some form of federal annuity guarantee, which could smooth the way for greater availability of annuity products moving forward. RSP will also be working on issues related to financial literacy and other attempts to increase saving, such as Individual Development Accounts.

TNS: Are these changes sufficient to deal with the trillions in retirement savings that have been lost?

Gale: As the federal government and policymakers move quickly to adjust to the new realities of the global economy and financial markets, and guide our evolving regulatory system, one thing remains clear. American workers cannot afford to do nothing. Workers, except those very close to retirement, who continue to contribute to their 401(k) or similar plan will both make up their losses and come out ahead. However, those who defer retirement saving for later are heading down a much riskier path than that offered by today's stock market.

Despite the hit that retirement and pension plans have taken, analysts all agree that a successful retirement strategy means staying the course even during volatile times in the market. Saving for retirement is a long-term issue - a marathon, not a sprint. Investors who cash out when the market is at a low point will only lock in short-term losses and miss out on the rebound to come. In fact, many financial advisors see this as the best time to invest since investors' dollars can buy more today than they could yesterday. These changes are designed to help make the saving process, easier and simpler and to enhance participation and therefore, overall retirement security.

TNS: How will these new proposals affect families and individuals under companies that have invested retirement funds in company stock, such as Fannie Mae?

Gale: These proposals enhance participation in balanced, prudently diversified, and low-cost vehicles and discourage over concentration in employer stock or in money market or stable value assets.


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