

# America's IRA: Building Retirement Security for Working Americans

Building enough savings for a comfortable retirement is an essential part of the American Dream. Congress has put considerable effort into crafting a better national system for retirement saving. And yet, despite decades of work, most working Americans will not have saved enough to enjoy a financially secure retirement. The problem will only grow worse as 80 million baby boomers leave the workforce, stretching limited public resources.

America's IRA moves low- and moderate-income Americans toward greater income adequacy in retirement through good incentives for long-term saving. Its simple plan design allows the private sector to offer a profitable and simple savings vehicle through existing platforms.

## Basic Features

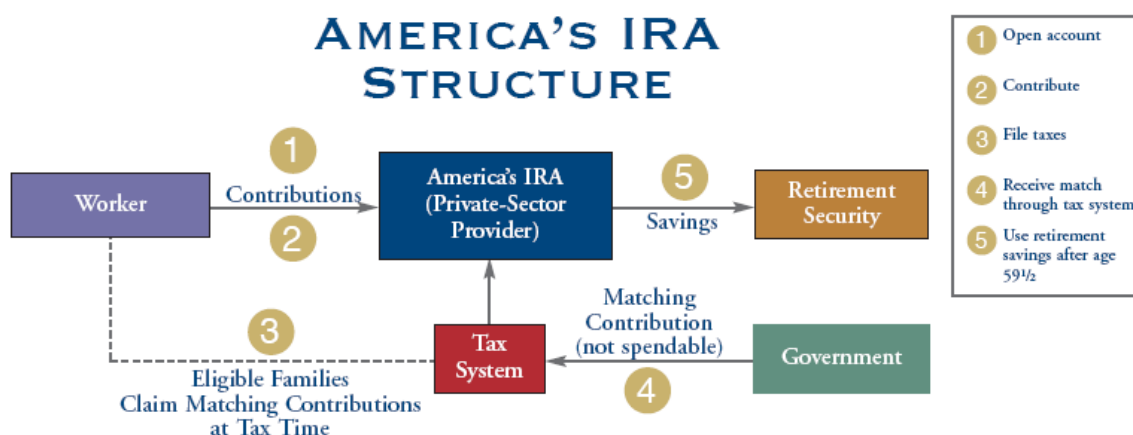
- The plan uses the existing IRA structure rather than creating another savings plan. The same financial services firms that offer IRAs today could easily offer America's IRA.

- America's IRA offers an annual dollar-for-dollar match, capped at \$2,000 to savers earning under \$40,000 (a partial match is available up to \$50,000).
- The plan would also offer a "toaster:" a one-time incentive of \$1,000 to those earning below \$12,500, with a partial payment for incomes between \$12,500 and \$30,000.
- Matching contributions are deposited directly to accounts through the tax system.

To make savings simple, America's IRA offers only two investment options: an age-based mutual fund, and a risk-free principal preservation product.

## Why America's IRA is Different—and Necessary

Recent studies from the Boston College Center for Retirement Research project that 43 percent of American households are at risk of an insecure retirement.<sup>31</sup> The basic American pension system—Social Security—by itself is insufficient, although it provides



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over 90 percent of the retirement income received by low- and moderate-income workers.<sup>32</sup> And in the future, Social Security will provide even less income as replacement for pre-retirement earnings over time, requiring workers to find additional sources of income when they leave the workforce.

The obvious solution is to “scale up” the private pension system. But that system has two structural problems.

The first is coverage. Only about 50 percent of the private-sector workforce has access to work-based retirement plans at any point in their working lives—a percentage that has varied little for decades.<sup>33</sup> This percentage is substantially lower for low- and moderate-income workers who tend not to have the kind of jobs, or the consistent work histories, that are rewarded with plan participation. For example, the percentage of low- to moderate-income workers with access to employer retirement plans decreases dramatically below 50 percent as annual income drops below \$40,000 per year.<sup>34</sup>

The second flaw in the current system is income adequacy. Over the last 20 years, the private pension system has shifted from defined benefit plans to defined contribution plans such as 401(k) plans. 401(k) plans put the burden of saving for retirement squarely on the shoulders of workers; employers usually only match worker contributions, if they contribute at all. Workers assume the risk of deciding whether to save, choosing the right amount to save, investing their funds in the right way, and spending down their accounts so they last a lifetime.

These are difficult assignments with no clear right answers that most workers are ill-equipped to handle. Many deal with the uncertainties inherent in 401(k) plans by failing to save at all, or by saving too little and by failing to invest appropriately.<sup>35</sup>

IRAs were created more than 30 years ago for workers without an employer-based plan.<sup>36</sup> However, few Americans actually contribute to IRAs. Most assets currently held in IRAs represent rollovers of accounts from employer-sponsored plans.

IRAs have failed to appeal because many potential

savers lack a connection to the financial services marketplace. In turn, the financial services industry hasn't aggressively marketed IRAs to savers with small amounts to invest.

Low- and moderate-income savers have few incentives to save in IRAs. Tax deductions are irrelevant, and IRAs don't offer the matching contributions that help raise participation in work-based plans. The federal government does offer a Saver's Credit, but it is not refundable, so low-income savers with no tax liability do not benefit.

## Why America's IRA is the Way Forward

America's IRA is designed to tackle both the coverage and retirement income adequacy problems.

First, America's IRA would give low- and moderate-income workers a well-designed retirement savings vehicle that is the functional equivalent of an employer-based plan using existing IRA products and channels.

Second, America's IRA will include a new government matching structure to provide savings incentives. The matching structure is designed to reward those who consistently save at least three percent of their income a year with substantial income on top of Social Security in retirement.

## Benefits and Costs

- America's IRA gives the 62 million low- and moderate-income Americans who may never have an employer-based plan the ability to increase their retirement income significantly by saving just three percent of their income each year.
- The savings incentives in America's IRA—the dollar-for-dollar match and one-time grants—are estimated to cost roughly \$40 billion over ten years with a 10 percent participation rate. By comparison, the Saver's Credit, for which only a small percentage of low- and moderate-income workers qualify, delivers only about \$1 billion in savings incentives per year or \$10 billion over ten years.<sup>37</sup>
- Low- and moderate-income workers can save more

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than two times their salary, which, if converted into an annuity, could replace about an additional 20 percent of their pre-retirement income.

## Questions and Answers about America's IRA

### What is the purpose of America's IRA?

Many low- and moderate-income workers are at risk of financial insecurity in retirement because they are excluded from employer-based plans.<sup>38</sup> This risk will only increase in the future as Social Security provides less replacement income.<sup>39</sup>

### How is America's IRA different from the traditional IRA?

In many ways, it's not. It's the same IRA available to everyone. But it has some extra features designed to replicate the benefits (and avoid the deterrents) to saving found in work-based plans:

- Matching contributions from the federal government—a dollar-for-dollar match for those earning \$40,000 or less and a partial match for those earning between \$40,000 and \$50,000.
- A simple design—just two basic investment choices.
- Easy to administer—matching contributions are delivered through the income tax system directly to accounts.

### What are the primary benefits of America's IRA?

America's IRA was designed with successful savings outcomes in mind. Those who participate have the opportunity to achieve an additional layer of retirement income on top of Social Security.

- Low- and moderate-income workers can save more than two times their salary, which, if annuitized, corresponds to replacement income of about 20 percent.
- Added to Social Security benefits, America's IRA could enable low- and moderate-income workers to achieve approximately an 80 percent income replacement rate.

### Isn't America's IRA just a gimmick, a giveaway of tax dollars?

No. It just gives low- and moderate-income workers without an employer plan roughly the same financial incentives and savings support services enjoyed by workers with an employer plan. And it does so without creating a new government program.

### Isn't there a way to include these workers in employer-based plans instead?

Congress has been trying since 1942 to require employers to include more low- and moderate-income workers in their plans. Pension coverage rates, however, haven't budged for decades. Having a better employer-based pension system is, of course, an important social goal but it is not one likely to be realized soon. In the meantime, workers without a plan need a more effective savings solution than existing IRAs which have failed to generate much new net saving since they were created over thirty years ago.

### Will America's IRA jeopardize the employer-based pension system?

Unlikely. Employers with significant numbers of higher-income workers would not be tempted to terminate their current plans in favor of America's IRA for two reasons. First, workers can contribute far less to an IRA (\$4,000) than to a 401(k)-type plan (\$15,500) and, second, only low- and moderate-income workers are eligible for a matching contribution.

America's IRA will enhance the private pension system where it needs it the most. It will provide an efficient and effective savings vehicle for workers at small employers who have historically been reluctant to offer employer-based plans.

### Wouldn't improving the Saver's Credit fix the problem?

The Saver's Credit currently provides a government match for saving by some low- and moderate-income workers. The match is modest and not available unless a worker owes taxes, which many low- and moderate-income workers do not.

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Reforming the Saver's Credit to cover more workers and increase the match is a desirable improvement in the current system. It will not, however, replicate the synergies America's IRA is capable of creating between low- and moderate-income workers and the financial services industry.

#### **Why is a private sector delivery system appropriate for America's IRA?**

America's IRA harnesses the energy of the private sector to drive savings behavior in the same way 401(k) plans do. America's IRA is designed to grow savings accounts quickly beyond the small balance problem so that the private sector views low- and moderate-income consumers as a valuable market. This gives the private sector an incentive to extend the marketing, educational, and administrative and investment services it now provides to employer-based plans to individual low- and moderate-income savers. In turn, the industry will help persuade more low- and moderate-income workers to become savers.

Alternative proposals call for an intermediary between savers and the private sector. Some advocate expanding the Thrift Savings Plan for federal employees to include workers without an employer plan. Others would require employers to offer payroll deduction services to IRAs for such workers. The first approach requires building a new adminis-

trative system that will be costly to taxpayers. The second imposes a new employer mandate that fails to address the disconnect between low- and moderate-income savers and the financial services industry.

America's IRA is ultimately a more effective savings approach through its use of a familiar savings product, simpler investment options, existing private sector services, and expanded government funding for savings incentives to low- and moderate-income savers.

#### **How much might the matching contributions cost?**

We estimate that in today's labor force there are 62 million Americans who would be eligible for America's IRA.<sup>40</sup> If 10 percent decide to participate, the cost would be about \$40 billion for 10 years.<sup>41</sup>

#### **Why would a private-sector firm be interested in the America's IRA program?**

At a 15% take-up rate, America's IRA is estimated to generate \$155 billion in new assets under management in 10 years using existing financial products. As accounts grow, America's IRA should be as profitable for most firms as traditional IRAs. The "toaster" plus government match in the first year would help build the account size of America's IRA and increase its profitability.

## **America's IRA in the Real World**

Jason is also born in Jefferson, Iowa, on February 2, 2008. His parents open a Child Account for him, but never contribute. As a result, he has no money for college or to start a business. He works in a small hardware store, and his income is around \$20,000 in most years. His employer does not offer a pension plan at work.

When Jason turns 37, he decides that he needs to begin saving. Social Security is his parents' only income in retirement, and he realizes that won't be enough for him. So he opens an America's IRA and is able to save three percent of his income for four out of every five years. He also receives a dollar-for-dollar matching contribution from the government. At age 67, when he is eligible for full Social Security benefits, his account is worth about \$134,000 (about \$63,000 in today's dollars).<sup>42</sup>