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UNIVERSAL VOLUNTARY RETIREMENT ACCOUNTS: Expanding Employee Savings Opportunities

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INTRODUCTION

A generation ago, workers could count on being able to participate in a pension plan provided by their employer. In the mid-1970s, almost three-quarters of American workers had plans that guaranteed a certain percentage of their income, providing a secure savings plan to rely on for the future.[1] Upon retirement, workers could be sure that their hard work would pay off and that they would be able to pay for their needs and enjoy a decent quality of life. However, these types of retirement plans, known as "defined benefit" plans, have been on the decline in the decades since, making them increasingly scarce. In fact, by 2007, only about a third of employees had access to defined benefit plans.[2]

As defined benefit plans have declined, another type of retirement plan—"defined contribution" plans—has taken their place. The structure of defined contribution plans is significantly different from defined benefit plans; rather than guaranteeing a portion of the employee's income, these plans require workers to make their own contributions that are then invested in the market. Employers can choose to make contributions toward their employees' plans, but are not obligated to. As of 2003, only 45 percent of employees (at firms of more than 100 employees) participated in defined contribution plans with employer contributions.[3] Consequently, the burden of saving and investing is shifted mostly onto the employee, whose investments in their retirement funds are subject to economic fluctuations.

Whether a defined benefit or defined contribution plan, overall 67 percent of workers still have access to some kind of retirement planning opportunity through their workplace.[4] But this still leaves out a large segment of the workforce that has no access to employer-sponsored retirement plans at all. Many employers do not provide pension plans, leaving workers to plan and save for their retirement on their own. This not only jeopardizes the retirement security of individual workers, but also raises the question of how we, as a society, will care for the elderly who do not have enough resources to provide for their own needs. Currently, people aged 65 and older comprise about 14 percent of the Commonwealth's population; by 2030, they will comprise 21 percent. As this population grows, the issue of retirement savings and the financial security of retirees will become essential to the health of our citizens and the state as a whole.

The key to solving this issue will be expanding retirement savings opportunities to those who have been excluded. Establishing a statewide Universal Voluntary Retirement Accounts (UVRA) program—a state-sponsored retirement system that businesses can easily participate in at low cost—can be a

[1] US Department of Labor. Employee Benefits Security Administration. "Private Pension Plan Bulletin Historical Tables and Graphs." January 2009. http://www.dol.gov/ebsa/pdf/1975-2007historicaltables.pdf
[2] Ibid.
[3] For employees in firms of more than 100 employees. Employee Benefit Research Institution. Databook on Employee Benefits. Chapter 4: Participation in Employee Benefit Programs. http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2004.pdf
[4] US Department of Labor, Bureau of Labor Statistics. "Employee Benefits in the United States, March 2009." http://www.bls.gov/ncs/ebs/sp/ebnr0015.pdf

solution. In light of the current state of retirement savings among American workers, UVRA has the potential to expand access to many thousands of workers.

WHY IS RETIREMENT PLANNING IMPORTANT?

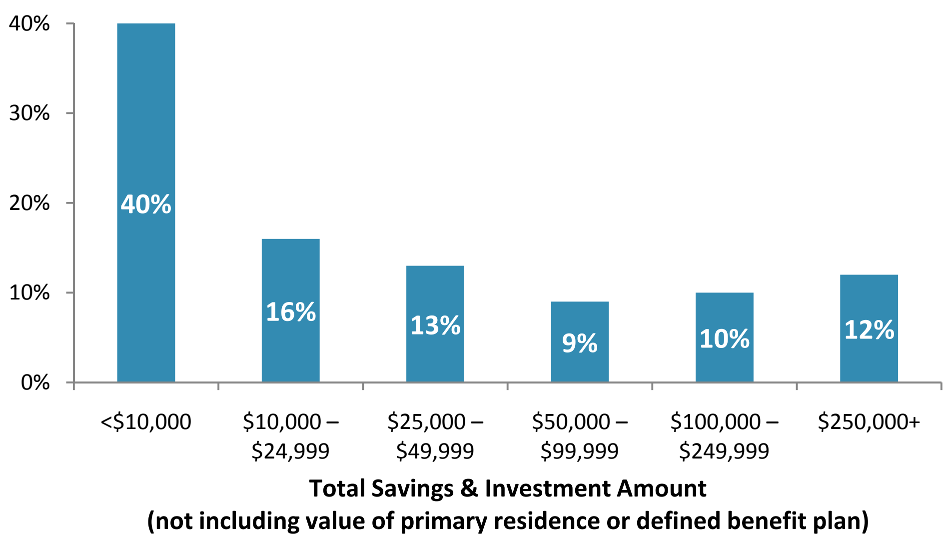
Retirement income is often described as a three-legged stool, each leg representing a different source of income to support workers when they reach retirement age: Social Security, personal savings, and retirement pensions. Each leg contributes to the overall financial security of individuals during retirement. As such, it is important that workers have the opportunity to save throughout their careers in order to pay for their basic needs and secure a decent quality of life upon retirement.

Personal savings are usually not sufficient to support even the basic needs of people as they age. A look at how much people save for retirement (Figure 1) shows that 40 percent of retirees have saved less than $10,000 for retirement, and over half of them have saved less than $25,000 (the first and second bars combined). This includes savings and investments (including defined contribution plans), but does not include the value of homes or defined benefit plans. Workers who do participate in an employer-sponsored defined contribution plan are three times as likely to report savings of at least $50,000, compared to workers who do not participate.[5]

One way to determine the value of retirement savings is to examine the cost of annuities, which are investments that individuals can purchase at retirement age that then provide regular payments for as long as the individual is alive. At $25,000, a person can purchase an annuity that will provide estimated monthly payments of $162 ($1,944 annually). At the highest end, however, an annuity purchased at $250,000 would provide monthly payment of approximately $1,617 ($19,404 annually).

Figure 1. Most Retirees Have Less than $10,000 in Retirement Savings

Percent of Retirees, 2009



Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc. 2002-2009 Retirement Confidence Survey.

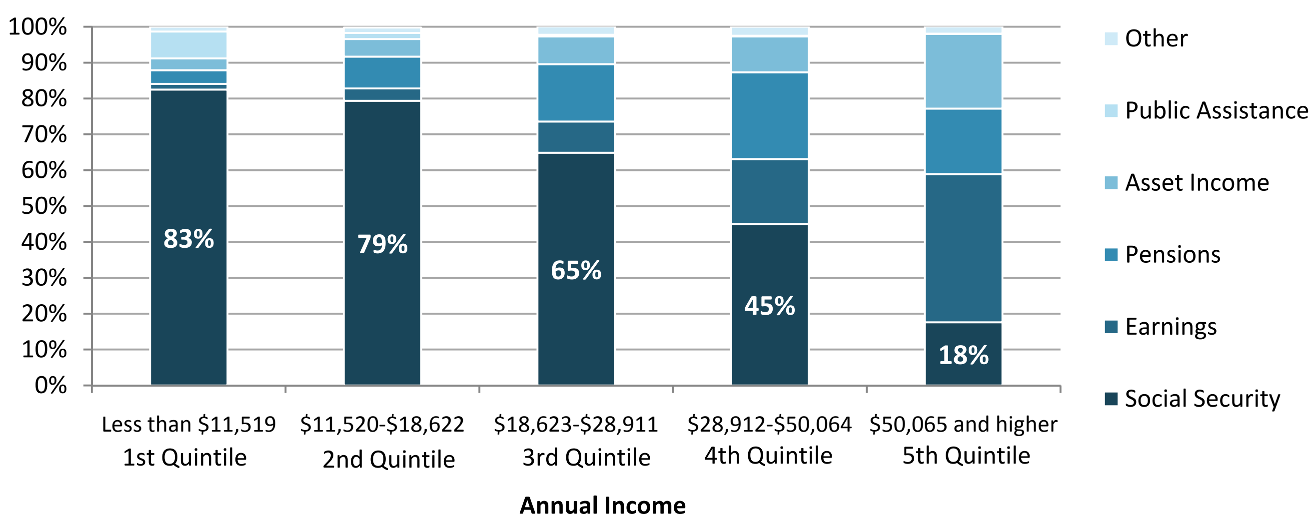
[5] Employee Benefit Research Institution. 2010 Retirement Confidence Survey. March 2010. http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-2010_No340_RCS.pdf

What do these figures mean? The Elder Economic Security Standard estimates the cost of living for elderly residents in Massachusetts, taking into account housing, food, travel, and health care. Depending on where the person lives, their health care needs, and housing costs, the standard ranges between $14,700 and $28,100 annually in Massachusetts.[6] When compared to the retirement savings described above, even the higher-cost annuity would barely be sufficient. Of course, most retirees do not rely on savings alone; however, even when combined with Social Security—two of the three legs supporting retirement income—many retirees would still struggle to make ends meet.

As a result of low savings, and because many workers are not offered the opportunity to participate in retirement plans offered through employers, more and more people are relying on Social Security as their primary retirement income source. Low-and moderate-income individuals, in particular, rely heavily on Social Security. For those in the lowest-income quintiles, Social Security comprises roughly 80 percent of retirement income (see Figure 2). Though Social Security is a stable source of income, it does not provide enough of an income to support a stable quality of life. For many individuals in the higher-income quintiles, pensions, earnings, and income from assets comprise a larger share of retirement income, providing a more diversified income source and greater financial stability. Some individuals in these quintiles are still working full- or part-time out of necessity and will move to lower quintiles when they stop working. As shown in the chart below, pensions comprise 24 percent of retirement income for individuals in the fourth quintile and 18 percent for individuals in the fifth quintile.[7]

Figure 2. Sources of Income, Age 65 and Older

Percent of Income by Source and Income Quintile



Source: US Social Security Administration, Office of Retirement and Disability Policy. "Income of the Populatin 55 or Older." 2006.
http://www.ssa.gov/policy/docs/statcomps/income_pop55/2006/index.html

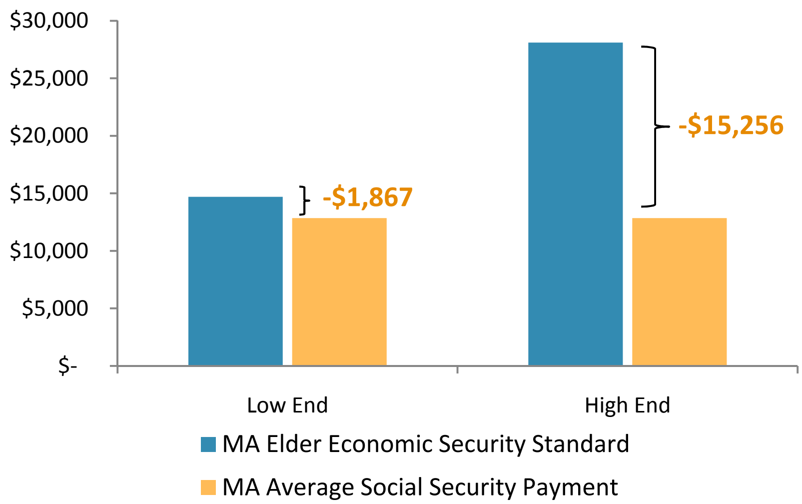
As of December of 2008, the average annual Social Security benefits in the state was approximately $12,844—between 13 percent and 54 percent lower than the amount needed for elderly residents to

[6] Elder Economic Security Initiative. "The Elder Economic Security Standard for Massachusetts." December 2006. http://www.wowonline.org/ourprograms/eesi/state-resources/documents/MAEESI2006.pdf

[7] US Social Security Administration, Office of Retirement and Disability Policy. "Income of the Population 55 or Older." 2006. http://www.ssa.gov/policy/docs/statcomps/income_pop55/2006/index.html

cover their basic needs and expenses, as shown in Figure 3.[8] Of course, this assumes that the retiree is relying solely on Social Security income. As Figure 2 illustrates, many of those in the lowest-income quintiles have some amount of savings (referred to as "asset income" in the chart). However, in addition to a more heavy reliance on Social Security, those with lower and moderate incomes do not have enough in personal savings to significantly increase their retirement income. On average, asset income is only 3.3 percent and 5 percent of the retirement income of the individuals in the first and second income quintiles, respectively, translating to an additional $346 to $931 annually—hardly enough to bolster retirement incomes and provide economic security.

Figure 3. Average Social Security Payment 13% to 54% Lower than Elder Economic Security Standard



Source: Social Security Administration: http://www.ssa.gov/boston/MA.htm

It is clear that retirement planning plays an important role in the financial security and quality of life for retired workers, while personal savings and Social Security alone are not enough. Being able to participate in retirement plans is a key component of building up an adequate savings. However, if the plans are not offered through employers, then as the research shows, many workers are excluded from the opportunity to adequately plan for their future.

RETIREMENT PLANS: ACCESS AND PARTICIPATION

Smaller and Low-Wage Employers Less Likely to Offer Plans

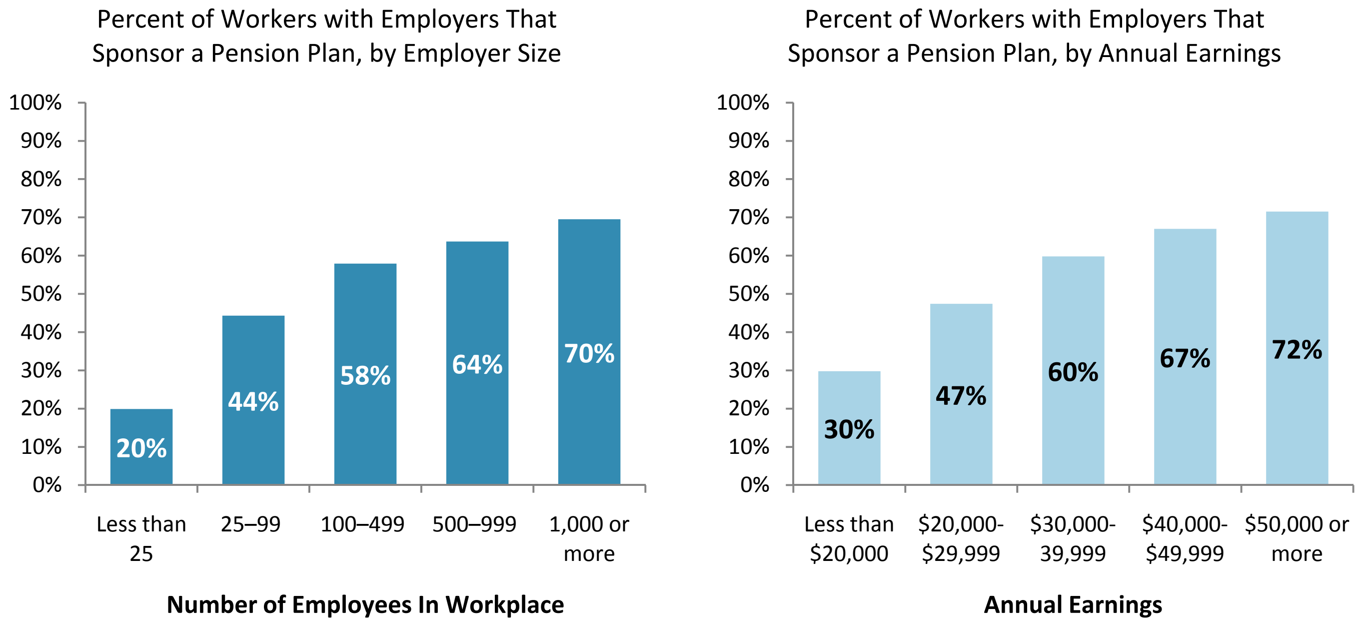
Today, only about 67 percent of workers have access to employer-sponsored retirement plans, yet of those who are offered plans, a high percentage of them choose to participate.[9] As discussed in the subsequent section, many employers feel they cannot dedicate the time and resources to understanding and implementing retirement plans and, consequently, avoid offering them to employees. For certain segments of the workforce, access to retirement plans is particularly limited. Smaller employers often do not offer retirement plans to their employees, most likely due to greater financial constraints and

[8] Social Security Administration. Boston Region. http://www.ssa.gov/boston/MA.htm

[9] US Department of Labor, Bureau of Labor Statistics. "Employee Benefits in the United States, March 2009." http://www.bls.gov/ncs/ebs/sp/ebnr0015.pdf

less staff capacity for administering retirement plans, as compared to larger employers. In fact, of those employers with fewer than 25 employees, only 20 percent offer retirement plans, as compared to nearly 70 percent of employers with more than 1,000 employees (see Figure 4). Likewise, lower-income workers are less likely to have access to employer-sponsored retirement plans than their higher-paid counterparts. Only a third of workers earning below $20,000 are offered pension plans at their workplace. [10]

Figure 4. Rate of Employer-Sponsored Retirement Pans (National)



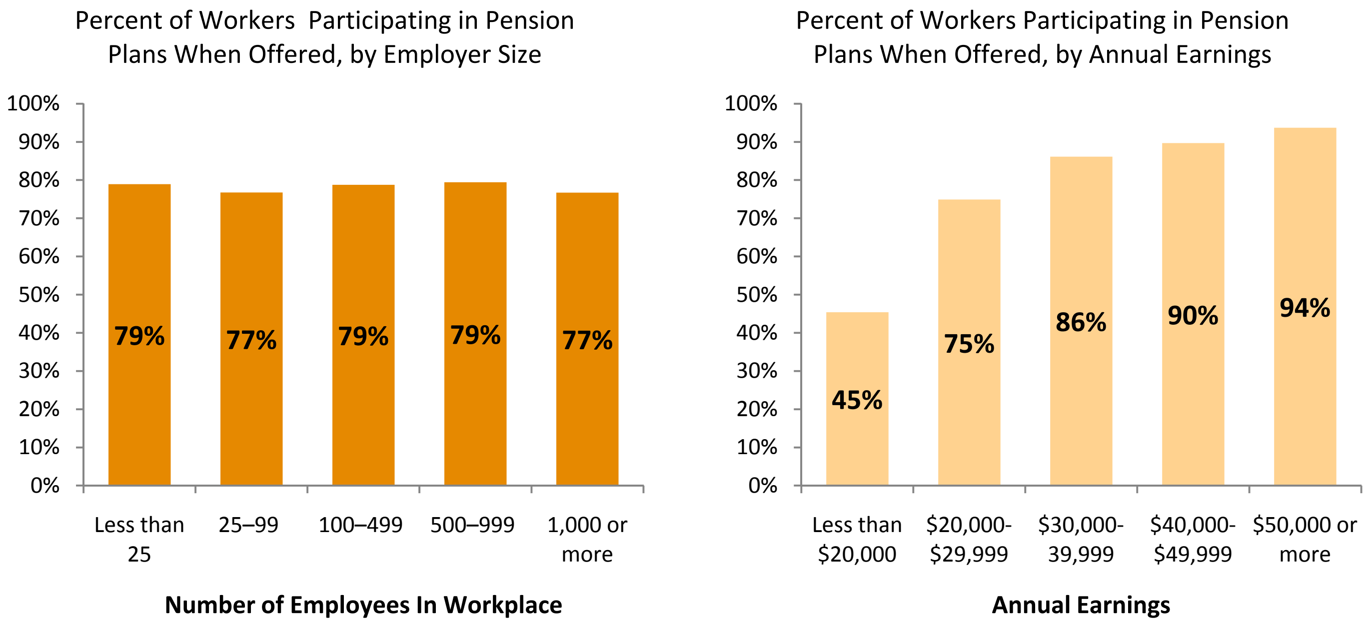
Source: Employee Benefit Research Institute. Issue Brief No. 322. "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007." October 2008.

When Plans Are Offered, Most Workers Elect To Participate

Although many workers at small employers and low-wage workers do not have a great degree of access to plans, research shows that when plans are offered, most workers elect to participate in them. As shown in Figure 5, even in smaller workplaces, when plans are offered, almost 80 percent of employees participate. In fact, among all employers that provide plans, the participation rate is virtually the same despite the size of the employer. Though the participation rate is more varied when examined by annual earnings, still almost 50 percent of workers at the lowest income level participate in pension plans when offered. For workers earning above $20,000 annually, the average participation rate across income levels is almost 90 percent. Not only does this point to the high level of participation across income levels, it also indicates that, if given the opportunity, workers at smaller employers are just as likely as workers at larger employers to participate in a retirement plan.

[10] Ibid.

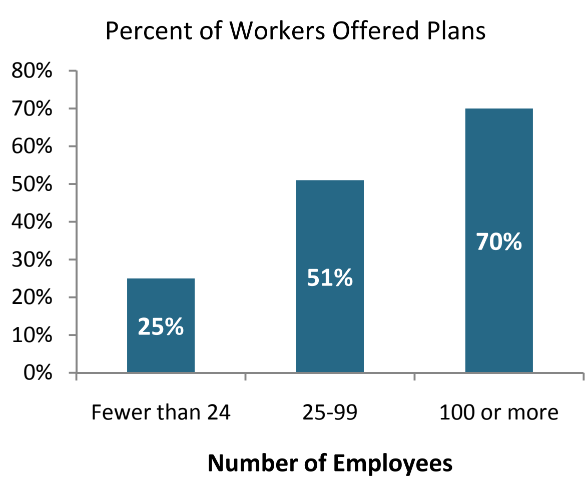
Figure 5. Take-Up Rates for Employer-Sponsored Retirement Pans (National)



Source: Employee Benefit Research Institute. Issue Brief No. 322. "Employment-Based Retirement Plan Participation: Geographic Differences and Trends. 2007." October 2008.

In Massachusetts, trends in retirement plan provision and take-up rates mirror the national pattern. Workers at smaller employers are less likely to be offered retirement plans, but take-up rates are consistent across employer size.[11] In regards to income, lower-wage earners are also less likely to have access to employer-sponsored retirement plans, but almost 90 percent of workers earning above $30,000 annually participate in plans if they are offered.[12] It is evident that despite firm size and income levels, a majority of workers elect to participate in a retirement plan if available.

Figure 6. Incidence of Employer Sponsored Retirement Plans & Take-Up Rates by Employer Size (Massachusetts)

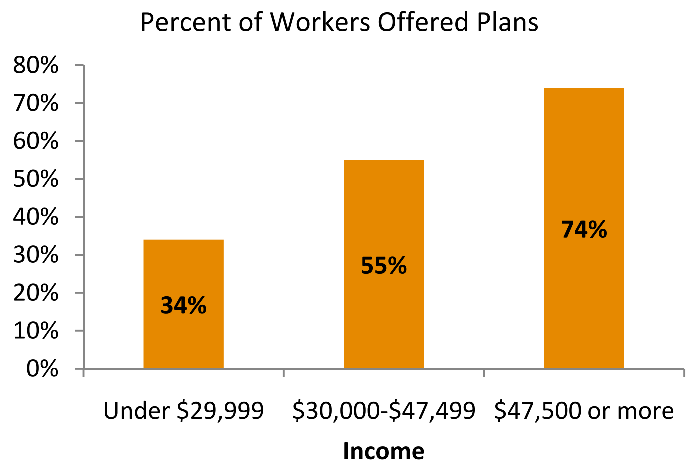


Take-Up Rates

Fewer than 24 Employees	83%
25 -99 Employees	84%
100 or more Employees	81%

[11] US Census Bureau. Current Population Survey. 2007-2009 March Supplement average. Because the sample size is small, the margins of error for the Massachusetts data on take-up rates presented in Figure 6 are very large. However, it does not appear to be inconsistent from the national pattern in take-up rates.
[12] Ibid.

Figure 7. Incidence of Employer Sponsored Retirement Plans & Take-Up Rates by Annual Income (Massachusetts)



Take-Up Rates

Under $29,999	57%
$30,000 and above	89%

BARRIERS TO PLAN PROVISION

Costs—both in the form of fees and the staff time needed for administrating and maintaining the plan— are cited by many employers as the primary reason why they do not offer retirement plans to their employees. The US Department of Labor (DOL) reports that in 2006, firms of 100 or more participants in retirement plans spent $2.4 billion, or $33 per participant, on administrative costs. DOL does not provide data on firms of less than 100 participants, but other research has shown that there is a "floor on administrative expenses for such plans below which a reduction in the size of the plan did not reduce expenses."[13] This means that for many small and low-wage employers, having a small number of retirement plan participants does not translate to lower costs. In fact, a survey of 300 small businesses without retirement plans, cost was named as the one of the top reasons why they did not provide plans.[14]

Lack of adequate information or familiarity with retirement plan options also impedes many small businesses from providing retirement plans. With such a wide variety of retirement plan options, the process of selecting a plan that best suits an individual business—and then dedicating the time and resources to maintaining it—can be an administrative hurdle. Despite this obstacle, there are plan types that are specifically designed for small businesses—Simplified Employer Pensions (SEP) plans and Savings Incentive Match Plan for Employees (SIMPLE).[15] The survey of small employers without plans also revealed, however, that many had never heard of these plans. Almost 50 percent had never heard of SEP plans and about one-third had never heard of SIMPLE plans.[16]

[13] Small Business Administration. "Small Business Retirement Plan Availability and Worker Participation." March 2010. http://www.sba.gov/advo/research/rs361tot.pdf

[14] Employee Benefit Research Institute. 2003 Small Employer Retirement Survey. "Fact Sheet: Small Employers Without Plans." http://www.ebri.org/surveys/sers/index.cfm?fa=sers2003

[15] SIMPLE plans are a type of Individual Retirement Account (IRA) geared toward small employers (those with 100 employees or less). They are simpler and less costly to administer than typical 401(k) retirement plans. SIMPLE plan have lower contribution limits than other employer-sponsored plans ($11,500, compared to $16,500) and require a minimum contribution from the employer. SEPs are IRAs geared toward employers with few to no employees. In SEP plans, the employees do not make contributions, and the tax-deductable contribution limits are much higher than typical 401(k) plans.

[16] Employee Benefit Research Institute. 2003 Small Employer Retirement Survey. "2003 SERS Summary of Findings." http://www.ebri.org/surveys/sers/index.cfm?fa=sers2003

The data indicates that, if given the option, most workers would choose to save for their retirement. In fact, though many workers accumulate only a small amount in their personal savings, two-thirds of workers report having saved money for retirement. Unfortunately, for many workers, personal savings and Social Security alone are not a stable and adequate source of retirement income. Employer-based retirement plans remain an effective means of encouraging long-term savings that can actually deliver a level of security during retirement. Developing new and innovative ways to expand retirement opportunities to all workers, and helping business owners overcome financial and administrative hurdles, is particularly important as the population continues to age. Establishing Universal Voluntary Retirement Accounts, described in the following section, is one cost-effective and efficient policy solution.

WHAT IS A UNIVERSAL RETIREMENT ACCOUNT?

A Universal Retirement Accounts system would be a state-operated retirement plan program, parallel to the state's existing defined contribution program, in which small employers could opt to participate. It would create a pathway for small businesses to provide retirement plans to their employees. In Massachusetts, 17 percent of the workforce is employed at firms with fewer than 20 employees. Removing barriers such as cost and complexity would provide a simple and low- to no-cost retirement option for small business owners, thus expanding access to retirement savings to thousands of people.

A UVRA program would allow small employers to opt into a larger retirement system that would be administered alongside the state's defined contribution retirement program, referred to as a "deferred compensation" plan.[17] Employees would enroll in the UVRA program through their employers, and employers could elect to make contributions toward their employees' plans. Employers would be relieved of many of the burdens of setting up retirement plans on their own. They would incur some administrative fees; however, because the program would be operated by the state at a large scale, the fees would be much lower than a typical retirement plan. Once an employer has enrolled in the UVRA, the state would design the package of investment options and handle the majority of administrative and legal tasks, including managing individual accounts and investments, as well as maintaining compliance with federal legislation. This way, the burden on employers would be greatly reduced, while the state would take on the bulk of the management and administration of the plans.

An effective UVRA system would help fulfill three broad goals, or principles: coverage, adequacy, and security. In terms of coverage, the UVRA system should provide access broadly, to the largest number of people possible. By casting a wide net, UVRA would make a change in the lives of those who have been excluded from the opportunity to save for retirement. Once access is expanded, however, the system should be adequate, or actually provide workers with a viable means of setting aside money to meet their basic needs and secure a reasonable quality of life for their retirement. Though broader changes would be necessary to have a more meaningful impact and for the retirement system to really achieve adequacy, a UVRA program would be a step toward an adequate retirement system for workers.

Finally, UVRAs should provide a set of secure options for investing retirement funds. In private retirement plans, an individual's contributions to a retirement account are invested in the market. It is typically understood that these investments will grow and yield positive returns over the long term; nevertheless, retirement investments are subject to the ups and downs of the economy and the risk is

[17] A deferred compensation plan is one in which an employee's income that is earned in one year is paid out at a later date.

assumed entirely by the individual. The current economic recession, which caused an average 30 percent drop in retirement assets, provides a prime example of the potential risks inherent in private retirement plans, such as 401(k) plans.[18] While a UVRA system would not eliminate risk, it should be designed to provide stable options—including both high-risk-high-return as well as more secure low-risk-low-return options— and to help workers and employers make educated decisions about their future. Reducing the complexity of the investment options would allow people to better understand both the risks and benefits of their retirement plan.

HOW WOULD UVRAs WORK?

Using the Commonwealth's existing deferred compensation program for state employees, the state would be able to create a low- to no-cost, straightforward retirement plan option that small businesses could easily opt into. Because the state already administers and maintains a large public sector pension system of its own, it would be able leverage its size and scale to obtain lower costs from providers. Ideally, the program could be designed to use federal funds to cover start-up costs, thus incurring no cost to the state. If, however, federal funding is not used, the state would incur an initial start-up cost, which would be recouped over time through the plan's fees and individual contributions.

A successful UVRA program would include several design elements, including: automatic enrollment, default investment, payroll deductions, pre-tax contributions, and portability. Each of these is described in detail below.

Automatic Enrollment: Rather than requiring employees to opt into a UVRA plan, employees would automatically be enrolled and would be required to opt out if they choose not to participate. A worker is more likely to join and participate in a retirement plan—and therefore, begin making investments toward their retirement—if they are automatically enrolled. In fact, automatic enrollment increases worker participation in retirement plans to up to 95 percent of eligible workers.[19]

Default investment: UVRAs should be designed such that employees who do not select their own investment options are automatically set up with a few pre-selected investment options. Often, choosing a set of investment options can be a complicated and overwhelming process for employees. Furthermore, without adequate understanding of the various options, employees can end up choosing investment options that, over the long-term, are not the most optimal combination of choices. Default investments make setting up plans less complicated and more streamlined for both employers and employees.

Payroll Deductions: Contributions to UVRA retirement plans should be automatically deducted from workers' paychecks. Electronically transferring funds from each paycheck to the retirement account lessens the perceived immediate impact for employees. Compared to employees taking money out of their paychecks to deposit into their retirement accounts, automatically deducting the retirement contribution before the employee receives his or her paycheck reduces the feeling of loss for the employee. Furthermore, many employers already have automated systems in place to electronically transfer money from paychecks for taxes and other fees, so utilizing this system for transfers to retirement accounts would efficient and cost-effective for employers.

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[18] VadDerhei, Jack. Employment Benefit Research Institute. "The Impact of the Recent Financial Crisis on 401(k) Account Balances." February 2009. http://www.ebri.org/pdf/briefspdf/EBRI_IB_2-2009_Crisis-Impct.pdf
[19] Retirement Security Project. "Automatic IRAs: Extending Retirement Saving Opportunities to 78 Million More American Workers." August 2009.

Pre-Tax Contributions: By making it much easier for employers and employees to establish and contribute to 401K and IRA tax-deferred retirement accounts, UVRA plans would allow employees to take advantage of existing federal tax benefits. For the employee, reducing the amount of income that is taxed lowers their overall tax bill in the year the income is earned. In addition, by contributing to their retirement account, low- and middle-income taxpayers can receive the Saver's Tax Credit of up to $1,000 (or $2,000 for couples).[20] Finally, the money that would have been paid in taxes is instead invested in the retirement account to yield benefits in the long run. This not only reduces the immediate impact but also generates more savings for the future.[21]

Portability: The final component of UVAs is to enable workers to keep their retirement accounts if they change employers. It is estimated that the average worker holds about 11 jobs during his or her working life.[22] It is essential to ensure continuity in workers' retirement savings contributions as they move from job to job.

In the 2008 book, Nudge, authors Richard H. Thaler and Cass R. Sunstein discuss the role that some of these design elements play in encouraging employees to make choices that lead to greater savings. They contend that providing individuals with a set of default options can influence outcomes by effectively "nudging" people toward smarter and healthier choices:

> "While automatic enrollment or 'quick' enrollment makes the process of joining a retirement plan less daunting, expanding the number of funds available to participants can have the opposite effect. One study finds that the more options in the plan, the lower the participation rates. This finding should not be surprising. With more options, the process becomes more confusing and difficult, and some people will refuse to choose at all."[23]

Thus, providing employees with a plan that incorporates the design elements above can result in greater participation by both the employees and their employers.

CONCLUSION

Retirement security will only become more pressing as the Commonwealth's population continues to age. Employer-sponsored retirement plans are a key component of ensuring that workers are able to achieve financial security during their retirement. Without this, people will continue to rely heavily on inadequate and unstable resources, such as Social Security and personal savings—which is not enough to cover even basic needs.

Despite the benefits of providing retirement options at the workplace, most small businesses do not offer such plans. Administrative costs and the often convoluted nature of retirement plans prohibit these employers from devoting the financial resources and time needed to establish and maintain plans.

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[20] Tax Policy Center. Tax Topics. "Expand saver's credit and automatic enrollment in IRAs and 401(k)s." http://www.taxpolicycenter.org/taxtopics/Copy-of-2010_budget_saverscredit.cfm

[21] To the extent that there may be some employees who would be best off with Roth IRAs that require taxes to be paid on earnings before they are contributed to the account and allow tax-free withdrawals from the account, those plans could be included in the UVRA program as well.

[22] US Bureau of Labor Statistics. "Number of Jobs Held, Labor Market Activity, and Earnings Growth Among the Youngest Baby Boomers: Results From a Longitudinal Survey." June 2008. http://www.bls.gov/news.release/pdf/nlsoy.pdf

[23] Richard H. Thaler and Cass R. Sunstein. Nudge.Caravan Books: 2008. Page 110.

Many states have begun to study the impact and potential of establishing UVRA programs.[24] UVRAs provide a viable and cost-effective option for businesses that do not provide retirement plans for their employees—particularly small business, which employ thousands of workers but face the highest barriers in providing plans.

[24] For a full list of states with Universal Retirement Account proposals, see http://www.eoionline.org/retirement_security/uvra_state_updates.htm.