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Savings and Retirement Reboot

At the start of 2020, almost half of American families would have had trouble scratching together $400 to cover an unexpected expense, and 78 percent were living paycheck to paycheck. Then COVID-19 struck—decimating wages, employment, savings, and retirement security.

As the economy restarts, there's a strategic opportunity—and a critical need—to reboot savings in America by helping folks accumulate short-term emergency funds and prepare for long-term retirement in a unified and simple program.

According to the Aspen Institute Financial Security Program and other researchers, short-term savings and retirement preparedness are linked. Folks having trouble paying to fix a leaky roof tend not to save for the long term. And those with money in the company 401(k) or an individual retirement account (IRA), but no rainy day funds, typically raid their retirement accounts when hit with a financial emergency. This pre-COVID retirement leakage has likely (statistics are not yet available) turned into a torrent as people try to make ends meet during the crisis. Indeed, using retirement assets to meet current living expenses was made easier under the Coronavirus Aid, Relief, and Economic Security (CARES) Act by increasing plan loan limits and liberalizing the hardship withdrawal rules.

Looking to the future, what is needed is a coordinated four-prong savings regime to (re)build rainy day and retirement savings. First, every wage earner—employee, gig worker, or self-employed—should have access to a savings program. That means expanding access to company 401(k)s and other retirement plans, open multiple-employer plans, state-sponsored auto-IRAs, or—perhaps—a national savings vehicle. Roughly half of all private-sector workers currently are not covered by any sort of program and, without the ease and simplicity of a readily available savings plan, do not save. Thus, Congress and regulators need to do more (and in many cases stop getting in the way) to foster these programs.

Second, every program should automatically enroll workers at a reasonable level (say 6 percent of pay, with annual auto-increases) with easy opt-out procedures. Auto-enrollment and auto-escalation are the closest things to a free lunch in savings; inertia and choice framing makes it much more likely that people will do the right thing to help themselves. Automatic savings is proven effective across demographic and income groups, including many of those who "couldn't afford to save."

Third, the programs should be designed to allow people to squirrel away money for a rainy day, say up to $1,000, and then allocate contributions for retirement. One problem is that existing tax law does not provide a ready accumulation vehicle. While Roth 401(k)s, IRAs, and other after-tax accounts can be jury-rigged to serve as rainy day funds, tax and Employee Retirement Income Security Act rules make them clunky and inefficient. Congress needs to update the Roth rules so they function smoothly. For example, limited (say up to $1,000) rainy day withdrawals should be penalty-free and readily available, without proving hardship. Also, emergency savings through a 401(k) should be counted when employers test plans for discrimination. Employers should be allowed, if they choose, to match workers' rainy day savings by adding to that account or to retirement savings.

Fourth, people should not need psychic powers and a team of actuaries, financial planners, investment managers, and tax wizards to figure out how much to save, how to invest, and how much to spend. As Mark Carney, former governor of the Bank of England, elegantly observed, "[a]fter decades of risks being downloaded onto individuals, the bill has arrived, and people do not know how to pay it." Retirement programs should make it possible for workers to prepare for and retire in relative comfort without being, or needing, an expert. This requires a total rethink of our approach to retirement. Investments that are tailored to an individual's retirement spending needs (not account balances), annuities, or (gasp) pension-like plans, should all be considered. This pandemic has emphasized the gaping holes in our approach to many things, including rainy-day savings and retirement security. Let's not waste this painful lesson.

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

David E. Morse
Editor-in-Chief
K&L Gates LLP
New York, NY