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From the Editor

Three Retirement Policy Hacks

A worker's financial well-being starts with cash in a cookie jar to cover the inevitable minor catastrophe, continues with a rational long term savings and investment program and eventually transitions to a rest-of-life retirement spending plan. Alas, humans are wired towards immediate gratification and lack the skills, time and inclination to tackle the investment, economic and actuarial challenges imposed by these tasks. And why should they? A person does not need to be a computer whiz to check email or an engineer to drive a car. These every day devices are built to be used by ordinary folk. It should be the same for our financial lives. Here are three doable initiatives to improve retirement outcomes for Americans.

EMERGENCY SAVINGS IMPROVES CURRENT AND FUTURE WELLBEING

Having a rainy day savings account helps people avoid payday and other high interest loans and job loss (from lack of transportation or childcare) and improves long term health (by being able to pay for needed medical care and meds and reducing financial stress). Surprisingly, workers with emergency funds also find it easier to squirrel-away money for retirement and other long term needs. Yet, Federal Reserve analysis shows that roughly 40 percent of Americans could not come up with $400 to cover an emergency. As with retirement savings, a workplace payroll withholding program makes it easier and more likely that someone will accumulate a rainy day account. And, research by Aspen, AARP and others shows that many people would contribute to an emergency savings account if it was available at work. While federal tax law and the Employee Retirement Income Security Act of 1974 ("ERISA") do not (yet) have rules that address this need, a Roth 401(k) or IRA can be jurry-rigged to do the trick for many workers.

For example, an employer could direct that the first $500 or $1,000 of an employee's 401(k) contributions go to a Roth account (with an opt-out) and be invested in a stable value or similar low risk short term fund; once the threshold is reached, additional salary deferrals would go to the "regular" 401(k); and both the emergency and regular savings would be equally eligible for any employer match. It is crucial that the Roth account be labeled "for emergency savings" and the regular account "for retirement," because people find it much easier to manage their money when it is kept in different buckets. When the rain comes, the worker could withdraw from his or her Roth money that, after the emergency passes, could be restocked with additional contributions. True, the investment income component of the withdrawal would be both taxable and possibly hit with an early payment penalty (the Tax Code is not friendly towards emergency savings), but this friction is preferable to payday loans and the ills caused by an unmet financial need.

AUTO-IRAS WORK *BETTER* THAN ADVERTISED

When the first auto-IRA was launched by Oregon in 2017 – quickly followed by Illinois, California and now Connecticut and Maryland – there was understandable concern that it might entice some employers to abandon their 401(k)s in favor of these no-employer cost savings programs. Fortunately, it is the opposite: not only are employers with an existing 401(k) more likely to keep their plans, but employers in states with auto-IRA requirements are more likely to adopt a new 401(k) than in states without a mandate.

This favorable side-effect is shown from a recent study by the Pew Center for Retirement Research examining data through 2020. Most humans are hard-wired spenders but a workplace savings program, especially with auto enrollment, significantly increases savings. Auto-IRAs target companies that do not offer a savings vehicle, getting some 65 percent of covered workers to sock away a portion of each paycheck. Of course, a 401(k) with higher contribution limits and available employer contributions is typically better than an auto-IRA. However, for the nearly 50 percent of individuals without a workplace savings plan, a state auto-IRA requirement will start them on the path to savings.

MAKE IT EASY

Here is a lifetime investment and spending program for a retiree: start by investing 25 percent of savings in common stocks and 75 percent in inflation protected bonds with a duration matching the retiree's life expectancy, make conservative annual withdrawals based on performance and expected longevity, and adjust future investments and spending annually based on portfolio values, recalculated life expectancy and the current yield curve.[1] Got that! Dr. Mathieu Pellerin's analysis is spot on, but what are we mortals without an economist, investment pro and actuary on call supposed to do? You do not need to be an engineer to drive a car or physicist to ride a roller coaster. Whether it is SelFIES, tontine, Social Security buy-in, managed payouts or something else, the marketplace is crying out for a low-cost, simple lifetime investment and payment vehicle that actual retirees can (and want) to use ASAP. Sure an inflation-adjusted annuity could be that solution except people simply refuse to buy annuities thus – chicken and egg – making the individual annuity market small and costly, causing fewer retirees to annuitize. Employers, providers and financial firms alike need to embrace the challenge with the federal government supporting or, at least, not thwarting the initiatives.

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.

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NOTE

1. Investing for Retirement Income, Mathieu Pellerin (July 2021).