

# WebMemo



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## Automatic IRA Builds Retirement Security

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President Obama's FY 2011 budget contains at least one common-sense idea that could help to increase Americans' retirement security: the Automatic IRA.<sup>1</sup> This simple, easy-to-understand way for workers to save some of their own money each payday is important, because almost 78 million American workers—about half of all workers—are employed by companies that do not offer any sort of pension plan or 401(k)-type retirement saving plan.

For anyone other than a career minimum-wage worker, Social Security benefits are too low to provide a comfortable retirement and must be supplemented by either a traditional pension plan or the worker's own retirement savings. This situation will be made even worse by Social Security's coming financial problems<sup>2</sup> that will make it difficult to pay full promised benefits to everyone. Without an expanded retirement saving system that makes it easier for all workers to save for their own retirement from the day they first enter the workforce until the day they retire, future retirees could face retirement poverty. Alternately, they could demand yet another new government program to rescue them.

**Automatic Features Help to Increase Retirement Savings.** The Automatic IRA is designed to help fix this problem. It uses automatic enrollment techniques that have already helped to boost saving in 401(k) plans. Under this method, employees need do nothing if they want to participate. Unless they specify otherwise, they will be automatically enrolled in the Automatic IRA, they will contribute a set proportion of their income, and their money

will go into a specific fund. However, the worker still retains full control and can choose to save more or less, send his or her money to a different investment fund, or even refuse to participate at all.

Automatic enrollment especially helps those groups who are most likely to undersave: women, minorities, younger workers, and low- to moderate-income workers. Experience shows that these groups move from very low participation rates to levels equal to all workers. Overall, 401(k) participation rates under automatic enrollment average in the mid-80 percent level. And the mechanism is very popular: Polls show that employees strongly support automatic enrollment.<sup>3</sup>

Under the expected structure, workers will have a choice of three investment options ranging from a very low-cost savings account for new savers to a target date-type fund that automatically changes investments as the worker ages, with a third option available upon request. The savings account could be a government bond that automatically rolls money into a privately managed account once it reaches a certain amount.

While many focus on the value of the Automatic IRA to a new saver, it would be equally valuable to older workers who change jobs from a company

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[www.heritage.org/Research/Economy/wm2798.cfm](http://www.heritage.org/Research/Economy/wm2798.cfm)

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that offers a 401(k) plan into a smaller company that has only the Automatic IRA. Under the proposal, that worker could combine his or her old accounts into an Automatic IRA that allows the worker to continue saving. Data show that most workers change jobs as many as 10 times during a career, and without the ability to continue saving through payroll deduction, many workers will have gaps in their saving history that could endanger their ultimate security.

#### **The Automatic IRA Is Simple for Employers.**

The Automatic IRA does not impose a burden upon employers. They need do little more than they do now with the income and payroll taxes they deduct from an employee's paycheck and send to the IRS. In this case, employers will deduct some of the employees' own money and send it to the private sector funds manager that administers the employer's Automatic IRA. The employer selects that manager from an online list, and if the employer does not wish to choose a provider, that

company will be assigned at random to a funds manager that is willing to accept all comers. The program applies only to employers with more than 10 employees that do not offer their employees any form of retirement savings plan or pension.

Because an IRA is personal savings, employers would not be required—or even allowed—to match these savings. Employers would also have no liability for determining if employees are eligible for the program or face the complexity of complying with a 401(k)-type plan's regulatory environment.

The Automatic IRA has wide bipartisan support from the left and right and was endorsed in 2008 by both the McCain and Obama campaigns. It is a simple, cross-ideological, and practical solution to a serious problem.

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1. See J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security Through Automatic IRAs," Brookings Institution, July 2009, at [http://www.brookings.edu/papers/2009/07\\_automatic\\_ira\\_iwry.aspx](http://www.brookings.edu/papers/2009/07_automatic_ira_iwry.aspx) (February 5, 2010).
2. David C. John, "Social Security's Deficits Reinforce the Need to Reform Spending," Heritage Foundation WebMemo No. 2727, December 10, 2009, at <http://www.heritage.org/Research/SocialSecurity/wm2727.cfm>.
3. Retirement Made Simpler, "Fact Sheet: 2009 Survey of Employee Sentiments on Saving for Retirement," at [http://www.retirementmadesimpler.org/Library/RMS\\_Styles\\_Fact\\_Sheet\\_FINAL\\_092309.pdf](http://www.retirementmadesimpler.org/Library/RMS_Styles_Fact_Sheet_FINAL_092309.pdf) (February 4, 2010).