

How much will retirement-reform proposals reduce retirement deficits?

The Employee Benefit Research Institute (EBRI) Retirement Security Projection Model® (RSPM®) estimates that the aggregate national retirement deficit or Retirement Savings Shortfall (RSS)¹ is \$4.13 trillion for US households headed by those between the ages of 35 and 64. A number of tax reform proposals seek to reduce this deficit. These include:

- A federal auto-IRA (Individual Retirement Account) approach, such as that proposed in the 2015 version of the Obama administration's budget.
- Expansion of the existing defined contribution (DC) system, as proposed under the Automatic Retirement Plan Act of 2017 (ARPA).

In addition to discussing the tax proposals referenced above, in this Fast Facts, EBRI Research Director Jack VanDerhei analyzes a version of a universal defined-contribution system that assumes all employers not currently offering defined benefit and/or defined contribution plans start sponsoring a defined contribution plan immediately.

In EBRI's May 2018 *Issue Brief*, "EBRI Retirement Security Projection Model (RSPM) – Analyzing Policy and Design Proposals," VanDerhei explored how much both of these proposals might actually trim the retirement deficit using our RSPM model. He also used RSPM to analyze the potential deficit reductions that could be obtained by theoretically expanding the existing system to all workers.

Auto IRA: As proposed, a federal² auto-IRA approach would require most employers above a minimum size threshold who are not providing a defined benefit or defined contribution plan to automatically enroll workers into an IRA at 3 percent of pay (workers would have the opportunity to modify the rate or opt-out of the deferral). Analysis of this proposal assumes that there are no employer contributions and that no current defined-contribution-plan sponsors decide to discontinue their current plan and shift to the auto IRA. Moreover, the analysis assumes employers with auto IRAs do not transition to a defined contribution plan, and that the proposal applies to all employers regardless of size.³

In a best-case scenario—in which optouts are zero—findings show that the aggregate retirement deficits are simulated to decrease by \$268 billion or 6.5 percent (Figure 1).

Expanding Access to the Existing DC System: In contrast, under ARPA, all employees who have attained age 21 (except those working for the smallest employers) would be required to be covered by a DC plan, including new, part-time workers. The plans would be required to incorporate the following provisions, provided that certain existing plans would be grandfathered:

- Automatic enrollment at 6 percent.
- Automatic enrollment triennially at 6 percent.
- Automatic escalation at 1 percent per year up to 10 percent, i.e., 6 percent to 7 percent to 8 percent to 9 percent to 10 percent.

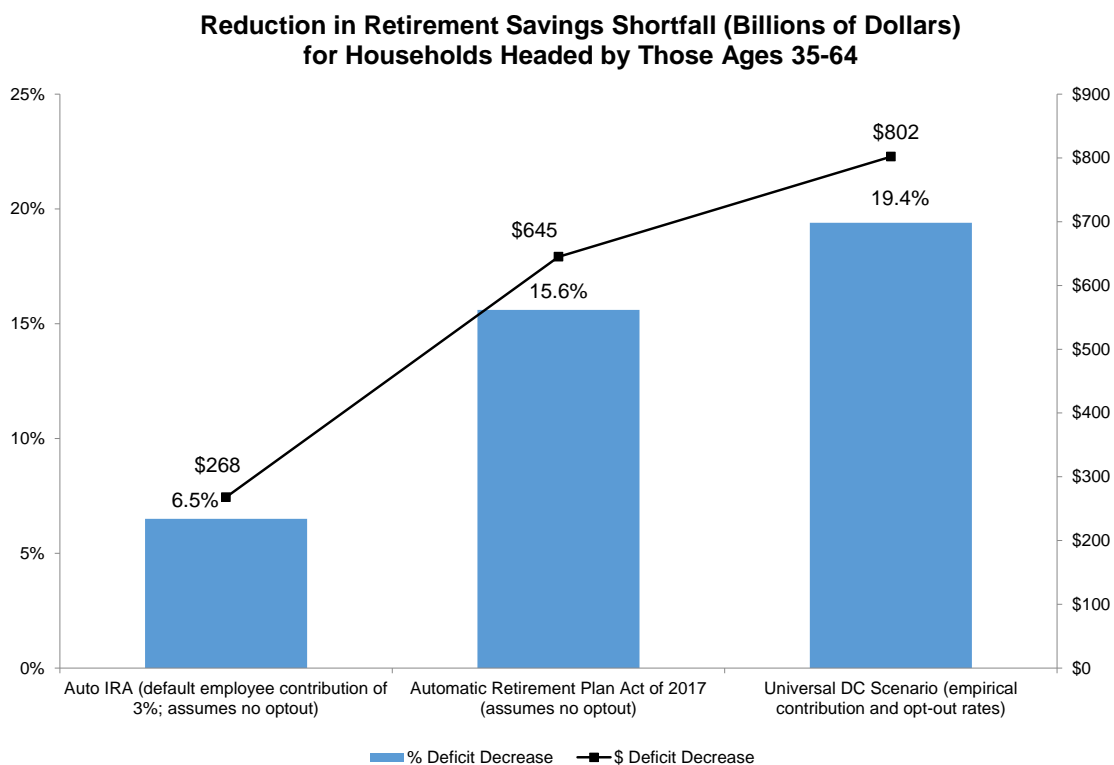
Given the higher automatic enrollment rates (6 percent vs. 3 percent) compared with the auto-IRA proposal, as well as the automatic escalation up to 10 percent of compensation, one would expect that the ARPA scenario would reduce the retirement deficit significantly more than the automatic IRA proposal for any given level of optout.⁴ And indeed, if we assume no optout, ARPA would reduce the deficit by \$645 billion or 15.6 percent (Figure 1).

Universal Defined-contribution System: Figure 1 also includes a universal defined-contribution scenario that assumes all employers not currently offering defined benefit and/or defined contribution plans start sponsoring a defined contribution plan immediately. Rather than simplistically presuming a single stylized defined contribution plan for employers regardless of size, this analysis assumes employers will choose a type of plan and a set of generosity parameters similar to employers in their size range. Unlike the auto-IRA and ARPA analyses, the universal defined-contribution scenario is based on observed contribution rates and demonstrated opt-out behavior when simulating employee and employer behavior.

Not surprisingly, this scenario -- which, unlike the others examined includes employer contributions -- produces an even greater reduction in the retirement deficit (even though the analysis of the other two proposals assumed no employee optouts): \$802 billion, or 19.4 percent of the aggregate \$4.13 trillion deficit from the baseline.

Conclusion

As policymakers consider various proposals to reduce the retirement deficit, it is important to recognize that these defined-contribution policy initiatives could have limited impact for those already on the verge of retirement. Such initiatives would have correspondingly much greater impact on younger age cohorts. It is also important for policy makers to consider what impact legislation might have on the behavior of employers in the DC system.



Note: Assumes long term care costs are present.
Source: EBRI Retirement Security Projection Model, © versions 2258, 2270, 2749.

The EBRI report, “EBRI Retirement Security Projection Model®(RSPM) – Analyzing Policy and Design Proposals,” is published as the June 5, 2018, *EBRI Issue Brief*, and is available online [here](#).

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¹ The Retirement Savings Shortfalls are present values at age 65, and represent the additional amount that individuals will have to save by age 65 to eliminate their expected deficits in retirement (which, depending on the simulated lifepath, could be a relatively short period or could last decades). For more information see Jack VanDerhei, Retirement Savings Shortfalls: Evidence from EBRI’s Retirement Security Projection Model®, EBRI Issue Brief (Employee Benefit Research Institute, February 2015)

² This type of arrangement was included in the 2015 version of the Obama administration’s budget, proposing that employers with more than 10 employees that do not currently offer an employment-based retirement plan would be required to automatically enroll their workers in an IRA. A similar program had been introduced by Sen. Sheldon Whitehouse (D-RI), and Rep. Richard Neal (D-MA) in their proposed Automatic IRA Act earlier that year (H.R. 506 in the House, S. 245 in the Senate).

³ However, Figure 9 in Jack VanDerhei, “Auto-IRAs: How Much Would They Increase the Probability of ‘Successful’ Retirements and Decrease Retirement Deficits? Preliminary Evidence from EBRI’s Retirement Security Projection Model®”, EBRI Notes (Employee Benefit Research Institute, June 2015), demonstrates the impact of increasing conditional probability of participation in a defined contribution plan to one if already in an auto-IRA.

⁴ A caveat needs to be included in any type of comparison between these two proposals given that, everything else equal, the opt-out rate is likely to be larger at a 6 percent initial deferral than one at 3 percent.