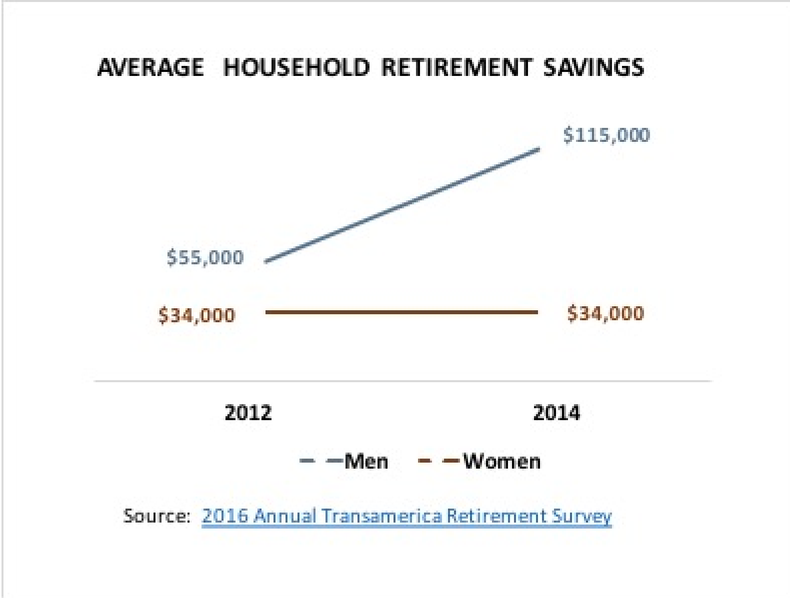
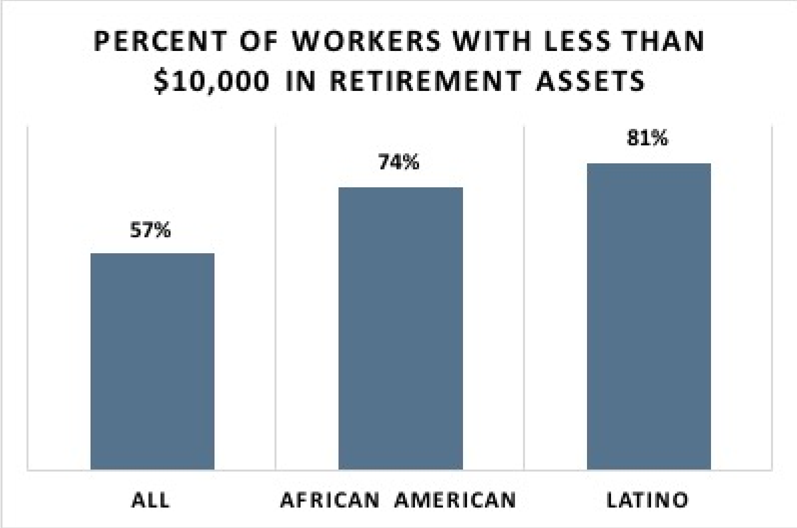
Missed Opportunity to Support Retirement Equity

On May 17, 2017, President Trump followed the Senate's lead, signing a resolution rescinding an Obama administration regulation allowing states and cities to automatically enroll private sector workers without an employer-provided retirement plan in Individual Retirement Accounts (auto-IRAs). These accounts use payroll deductions to create savings that grow tax-free until retirement – with contributions made using payroll deductions. And the administration's move puts current and proposed state and local programs in jeopardy.

Research suggests that government-run auto-IRA programs could help address significant racial and gender disparities in retirement assets (which, themselves, are due in part to differences in access to employer-provided retirement savings plans), which see married women and all men better positioned, financially, for retirement than single women and people of color. According to the US Department of Labor, of the 63 million wage and salaried women (age 21 to 64) working in the United States, just 44 percent participated in a retirement plan in 2015. The 2016 Retirement Confidence Survey by the Employee Benefits Research Institute and Greenwald and Associates shows the roughly 55 million single women in the U.S. are in a far more precarious position than married women – and all men – when it comes to retirement savings.

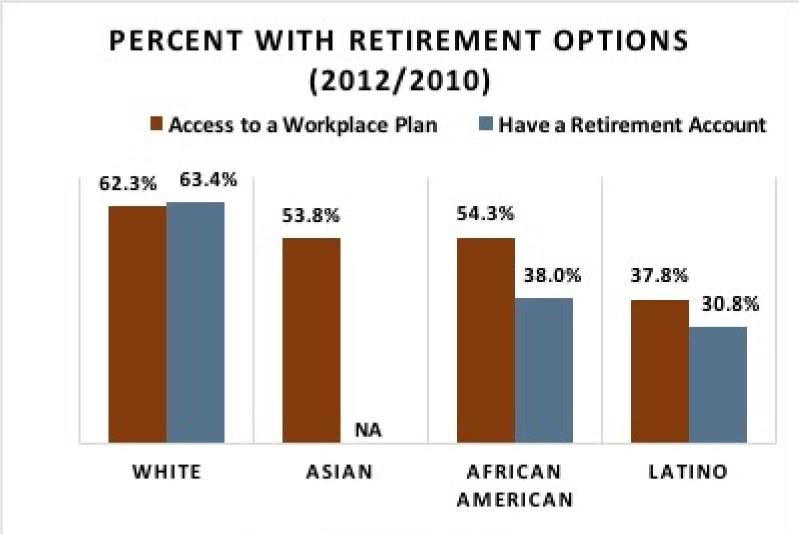


There are some fairly straightforward explanations for these gaps. First, according to the US Department of Labor, women are more likely to work in part-time jobs that don't qualify for retirement plans. And working women are more likely than men to interrupt their careers to take care of family members. Therefore, they work fewer years and contribute less toward their retirement, resulting in lower lifetime savings. According to the 2016 Annual Transamerica Retirement Survey, women's retirement savings have remained flat over the past four years, while retirement savings for men have grown significantly over the same time frame (Figure 1). Finally, on average, a woman retiring at age 65 can expect to live another 20 years, 2 years longer than a man who retires at 65. That is, women's longer life expectancy means they have smaller savings that must be spread across more years.



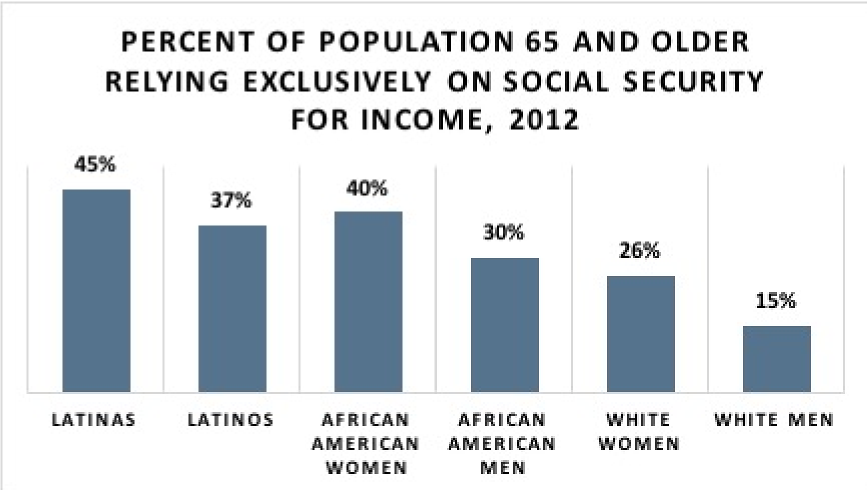
Disparities at the Intersection of Race and Gender

Several studies have documented racial disparities in wealth and retirement savings, as shown in Figure 2. The gender pay gap is even larger for many women of color; and African American women and Latinas are more likely to live in poverty and more likely to care for children without financial support from a spouse, limiting their ability to save for retirement. Thus women of color face a double disadvantage.



Source: Global Policy Solutions

Segregation in low-wage work also effects access to retirement vehicles. African American women and Latinas are more likely to work in the service industry (20% white women, 28% black, 33% Latina) in jobs that, according to Global Policy Solutions, are “generally lower paying, seasonal, part-time and hourly… [and] often offer less in the way of workplace benefits and support." Indeed, 68% of all workers have retirement plan benefits, compared to just 45% in the service sector. African American and Latino workers are much less likely than White workers to have a retirement account, in large part due to differences in access to a workplace retirement plan (Figure 3). As a result of all these factors, women of color are more likely than white women and all men to rely exclusively on Social Security during retirement (Figure 4).



States Turn to Auto-Enroll Solution

To help alleviate the retirement wealth gap for women, particularly women of color, five states (Illinois, Maryland, Oregon, Connecticut, and California) are in the process of launching a program, and, according to the Pension Rights Center, another 25 states are considering state-run Auto-IRAs. Without further legal clarity following the Senate and the President's moves to remove explicit federal permission, the permissibility of auto-enroll undertaken by public entities is in question. The states may even be open to lawsuits. As Bloomberg summarizes: "Without the federal government's blessing, it's harder to surmise how courts might rule on state auto-IRA programs …the Obama administration eased some doubts by issuing the new regulations, bolstering the plans' legal authority." Even if states and cities prevail in court, Bloomberg continues, the lack of federal-level explicit approval will almost certainly discourage others from undertaking Auto-IRA programs.

The Obama-era regulation would have put workers contributing automatically to a retirement account run by the government on par with their private-sector counterparts whose plans have been covered by similar regulations since 2006 (with the passage of the Pension Protection Act, PPA, under President George W. Bush). While the PPA addressed several areas of retirement savings concerns, two of its provisions granted employers the authority to automatically enroll employees in a defined contribution plan (e.g., 401(k) plan) and provided protections for investment options for these funds so long as they met the Qualified Default Investment Alternatives condition (including the now-popular lifecycle funds that automatically balance investment risk based on an individual's target retirement year).

The Powerful Effect of Defaults

These two provisions of the 2006 PPA came in response to groundbreaking economics research showing the powerful effect of defaults—the outcome when no choice is made—on employee savings behavior. Madrian and Shea (2001) showed that changing the default provision guiding retirement plan participation from "opt-in" to "opt-out" increased participation by 50 percent among new hires. Individuals hired under opt-out rules were also more likely to persist at the default contribution rate (which was 3%) and the investment election (money market fund) as compared to those hired under the opt-in regime. Therefore, pairing automatic enrollment regulation with safe harbors for asset allocation (given that allocations with minimal risk, like money market funds, are unlikely to provide sufficient wealth for retirement) was seen as an important step in efforts to reduce later-life poverty.

Why is automatic enrollment so powerful? Retirement savings decisions are particularly vulnerable to inertia and procrastination. For most workers, retirement is something in the far-off future and has little bearing on financial decisions in the present. Interestingly, though, that long-horizon makes participating and saving early *critically* important for retirement readiness. Along with their penchant for procrastination, Americans systematically underestimate the power of compound growth (Goda et al. 2015). Consider the following scenario from a study by McKenzie and Liersch (2011):

> *Imagine that both Alan and Bill just started working and are going to retire in 40 years. Alan deposits $100 every month into his retirement account. Bill waits 20 years to start saving, but then deposits $300 every month into his retirement account. Both accounts earn 5% interest every year, compounded annually. Who has more money at retirement?*

For this scenario, Alan would have more savings than Bill at retirement, yet ***only 36%*** *of respondents thought Alan would have more.*

Automatic enrollment likely mitigates the effect of procrastination and misunderstanding of compound growth, two widespread tendencies among Americans. However, automatic enrollment also has a cost. As mentioned, in the study by Madrian and Shea (2001), workers who participated via automatic enrollment tended to persist at the default contribution rate and asset allocation. But if that default contribution rate is too low, the worker may not save enough for retirement.

An alternative route explored by researchers is financial education; while there is some evidence that financial education affects decisions (Song 2015, Goda et al. 2014), though, it is more expensive to administer than changing default rules.

Regardless, preventing states and cities from capitalizing on the power of automatic enrollment tends to place those workers who are not covered by employer-provided plans (disproportionately women and people of color) at a disadvantage compared to their peers with an employer plan. Opponents of auto-enrollment take issue with government involvement in this area and herald individual choice over mandated savings. Yet research shows that policymakers *should* focus on asset accumulation, particularly for never-married mothers, who are predominantly from communities of color and face compound barriers to building wealth. Unfortunately, recent actions by Congress and the Trump administration create additional burdens and uncertainty for state and local governments that are defying Washington and moving ahead with their programs designed to increase economic security in retirement for more American workers – to the disproportionate benefit of women.

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– Photo by Terry Chapman