

ICI VIEWPOINTS

October 1, 2012

How to Build on the Success of 401(k)s

The trend toward 401(k) plans has strengthened Americans' prospects for secure retirement, as I discussed recently in [a speech before the Commonwealth Club of California](#). The 401(k) fits the needs of American companies and workers, today and tomorrow. It's flexible and evolves to meet those needs as our society and workforce change. And just as important, [Americans have confidence in the 401\(k\) system](#) and the role it plays in securing their financial futures.

What factors make 401(k)s and similar defined contribution (DC) plans so well suited for today's workforce? I singled out three elements: portability, ownership, and innovation. Regarding the latter, recent innovations have focused on increasing participation in retirement savings plans. Automatic enrollment helps get more workers into retirement plans. Employers also can use automatic escalation of workers' contribution rates to increase savings rates as workers focus more on retirement needs. And employers or workers can choose to invest 401(k) savings in target date funds, which provide diversification and keep 401(k) participants exposed to growth assets, even when individuals express less willingness to take financial risk.

Of course, as ICI has consistently maintained, the 401(k) system can and should be improved. How? Here are the three key elements that I set out in my speech.

- Preserve the tax incentives that encourage employers to sponsor retirement plans and that enable workers to save for retirement

As our leaders address America's fiscal challenges, they must not sacrifice the tax incentives that have successfully encouraged millions of Americans to accumulate savings toward retirement. On this, Americans are solidly in agreement: in our [2011 survey](#), 85 percent of all U.S. households said they didn't want the tax advantages of DC accounts to be eliminated, and 83 percent opposed any reduction in employee contribution limits.

- Improve and expand defined contribution savings plans for workers and retirees

We should build on the success of today's 401(k) plans by continuing the recent trend of innovation. Employers should be encouraged to use automatic enrollment if it's appropriate for their employee base. One unfortunate side effect of auto-enrollment is that many employers believe the government has endorsed 3 percent of pay as the "official" standard for 401(k) contributions. The fund industry supports encouraging employers to exercise greater flexibility and choose a higher contribution rate where appropriate.

We also can improve Americans' ability to make sound decisions about retirement savings

and investing. The fund industry was an early supporter of disclosure rules for 401(k) plan and investment option fees. Now, we'd like to go further—by promoting electronic delivery of plan information, interactive educational tools, and materials to help workers research and understand their savings options.

Further, as millions of Baby Boomers move into retirement, we can give them greater flexibility in how they manage income from their retirement savings. Currently, retirees face stiff tax penalties unless they start taking money out of their plans after age 70½. We think the age for these required minimum distributions should be raised to 75 to reflect advances in life expectancy and retirees' desire to be responsible stewards of their retirement assets.

- Increase access to retirement savings opportunities for small businesses and individuals

A particular area of concern in retirement saving is very small businesses. While such companies have a number of options for savings plans today, those options often are not well suited for workplaces where the majority of workers are focused on saving for goals other than retirement—such as education, a home, or an emergency fund.

One approach to help these companies would be to create a new, simpler retirement plan. Such a plan would allow the workers who are focused on retirement saving to put away between \$5,000 and \$10,000 a year—tax-deferred—without application of the rules and costs applicable to large plans (which act as a disincentive to small businesses adopting plans).

We also can take steps to promote savings through individual retirement accounts (IRAs). For a brief period in the 1980s, anyone with a job could make pretax contributions to an IRA. Today, anyone who wants to save through an IRA has to puzzle through a full-page chart published by the Internal Revenue Service to find out what he or she is eligible for. In an ideal world, IRAs would be universal again—but that could cost the government a lot of revenue. Instead, regulators should simplify the rules and promote the availability of IRAs for millions of workers and their spouses. Meanwhile, Congress should help older savers by indexing “catch-up” contributions for inflation.

Americans face many economic challenges today, including the task of providing for a secure retirement. Fortunately for us, our employment-based system offers us many strengths in facing the retirement savings challenge. Building on the foundation of Social Security, it provides workers with the means to save and invest, and the tools they need to meet their goals. Working together, America's employers, workers, plan providers, and government can continue to improve this flexible, innovative, and powerful system to the benefit of our nation.

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