InvestmentNews
The Leading Information Source for Financial Advisers

Workers and employers would be forced to save 3% of pay under new retirement proposal

Private equity exec Tony James and economist Teresa Ghilarducci advocate for a national retirement system starkly different from our current one

By Greg Iacurci | *March 2, 2016 - 3:51 pm EST*

A new proposal to solve the country's retirement savings crisis would force workers and their employers to contribute at least 3% of the employee's salary each year toward an account that would be converted into an annuity at the time of retirement.

The proposal, hatched by economist Teresa Ghilarducci and Tony James, the president of private-equity behemoth Blackstone Group, is designed to replace current 401(k) plans, which have been ineffective in providing a secure retirement for millions of Americans.

Ms. Ghilarducci and Mr. James are advocates of a national retirement system called the Retirement Savings Plan. Under that plan, both full-time and part-time workers would have individual, portable savings accounts. Accumulated savings would be annuitized at retirement and provide a lifelong income stream to retirees in addition to Social Security benefits.

The proposal “is a fundamental departure from the way we've done retirement business up to this point,” according to Christian Weller, a senior fellow at the Center for American Progress and professor of public policy at the University of Massachusetts Boston.

“I think the current system is woeful, not just ineffective,” Mr. James told *InvestmentNews*.

The proposal comes amid a broad push by policymakers to boost retirement coverage in the U.S. and a continued retreat from traditional defined benefit pension plans in favor of defined contribution plans.

Legislation introduced by Sen. Jeff Merkley (D-Oregon) in January, called the American Savings Act, seeks to establish universal savings accounts for all working Americans under an automatic-enrollment scheme. Also at the federal level, President Barack Obama created the MyRA program, which established voluntary, starter retirement savings accounts for employees without access to a workplace retirement plan.

States such as Illinois, Oregon, Connecticut and California have passed legislation that would mandate most employers to offer an automatic IRA — or, auto-IRA — for their employees, with several other states considering similar measures. Under a directive from the Obama administration the Department of Labor proposed rules last year making it easier for states to develop these retirement plans.

UNUSUAL SUSPECTS

Ms. Ghilarducci and Mr. James may seem an odd pairing to push reform of the country's retirement-savings mechanics, but there are motivations for teaming up. Ms. Ghilarducci, an economics professor at the New School for Social Research and director of the Schwartz Center for Economic Policy Analysis, has been an ardent critic of the 401(k) system for years, and Mr. James' firm would likely benefit from such a proposal.

“Blackstone is interested in getting into the individual retirement market more and more, so there's certainly a self-interest,” Mr. Weller said. “But you have to remember the financial services industry generally doesn't like mandates. So I'd say this is definitely [a case of] unusual suspects partnering.”

Mr. James, though, also seems genuinely interested in fixing a system he feels is broken. Young workers especially face several obstacles for a comfortable retirement, namely massive loads of student debt, stagnant entry-level wages and a retirement savings burden falling squarely on individuals in the absence of pensions, Mr. James said. At 65 years old, he also said he'd be "long gone" by the time Blackstone would profit from such a plan.

“Not only is it a human crisis, I think, but it's fixable. And it's fixable with very little pain and suffering on the part of any constituency if we start now,” Mr. James said. The joint proposal is a way to start a national dialogue, he added.

Ms. Ghilarducci couldn't immediatley be reached for comment.

THE NITTY-GRITTY

Workers would be required to contribute a minimum 1.5% of their income into their retirement accounts, and employers 1.5% for each employee. That money would go to a pooled trust managed by an entity of their choosing, which would handle manager selection, asset allocation and administration, Mr. James said, comparing it to Australia's superannuation system.

Mandated employee contributions would be offset by a “revenue-neutral federal tax credit” of $600 for every worker, “making it virtually costless” for lower-income families to contribute, the proposal says. The credits would be funded by phasing out the ability of individuals to defer taxes on their 401(k) contributions. The contribution cost for most employers would be offset by their no longer having to administer or contribute to other retirement plans.

Individuals would purchase an annuity at retirement, but the monthly payments would be made by the Social Security Administration, leveraging existing infrastructure. The base amount on which the annuity payout is based would be guaranteed — contributions plus 2% annual compounding — in the event a portfolio delivered lower returns.

“We need a game-changer in our retirement savings world if we want to address the crisis,” Mr. Weller said, adding that this is a “30,000-foot vision” meant to promote intermediate steps in pursuit of this goal.

Although there's been very little action at the federal level for change, there's been high activity at the state level, said Mr. Weller. As states develop their plans, they may choose to copy bits from proposals such as Ms. Ghilarducci and Mr. James' — universal coverage, new tax incentives and annuitization, for example — and that can ultimately drive federal action to create a nationwide system, he added.