

A Solari Report - Recent Proposals for Annuitization of 401(k) and IRA Accounts

By David Liechty

Introduction

Over the past few years, various proposals for annuitization of 401(k) and IRA accounts upon retirement and automatic enrollment in 401(k) programs have been made. On September 14-15, 2010, the Departments of Labor and the Treasury held a joint hearing on [Lifetime Income Options for Participants and Beneficiaries in Retirement Plans](#). The hearings focused specifically on annuitization of retirement funds and the feasibility for introducing these annuities into 401(k) and IRA plans.

Switch to Annuities/Lifetime Income

The possibility of 401(k) annuitization appears to have caught the public eye primarily in response to the November 04, 2008 testimony of Teresa Ghilarducci before House



Democrats and a November 20, 2007 paper she wrote entitled "[Guaranteed Retirement Accounts: Toward retirement income security](#)," published by the Economic Policy Institute's Agenda for Shared Prosperity. A report in the [Carolina Journal Online](#) characterized her testimony and the hearings as "proposals to confiscate workers' personal retirement accounts—including 401(k)s and IRAs—and convert them to accounts managed by the Social Security Administration." While somewhat polemic in its language, and perhaps not entirely accurate, the

Carolina Journal did cover the most salient points of this proposal. Ghilarducci advocates creation of Guaranteed Retirement Accounts (GRAs), which would be mandatory, and which would be funded through payroll deductions in the same way Social Security currently is. These funds would be matched and placed into a pooled account which the Federal Government would invest and manage, guaranteeing a 3% rate of return. Upon retirement, these funds would be annuitized, and that portion of the funds contributed by the individual, minus any benefits received, could be passed on to heirs. Ghilarducci further advocates shifting current employer tax incentives from 401(k)s to these GRAs, and to the extent that tax privileges are, indeed, shifted, there would almost certainly be a shift of funds held in 401(k)s to the GRAs, though there would technically be no "confiscation" of 401(k) assets.

As interesting as Ghilarducci's proposal is, it pales in comparison to the influence and reach of the writings and proposals of individuals associated with the Heritage Foundation and the Brookings Institution's Hamilton and Retirement Security Projects.

In April of 2006, the Brookings Institution's Hamilton Project published "[Improving Opportunities and Incentives for Saving by Middle- and Low-Income Households](#)", in which it advocated mandatory and automatic enrollment in retirement plans for employees

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of all businesses (“with possible exceptions for the smallest”), universal matching by the Federal Government for all contributions, and “other changes to the retirement system to promote lifetime annuities.” In particular, the paper “recommend[s] that the government set as a default that the matching contributions in each person’s account be annuitized,” which “would set the precedent ... that annuities are a sensible use of retirement resources.” These annuities would ideally be provided by the Federal government and processed by the Social Security Administration.

Chief among the individuals associated with the Brookings Institution and its retirement policy proposals is [J. Mark Iwry](#), who is currently serving as Obama’s [deputy assistant Treasury secretary for retirement and health policy](#). Iwry co-sponsored the September 14-15 Joint Hearing on Lifetime Income Options, and the writings with which he is associated suggest the ultimate agenda of the hearings.



In June of 2008, Iwry co-authored, and the Hamilton Project published, “[Increasing Annuitization of 401\(k\) Plans with Automatic Trial Income](#)”, in which Iwry and his colleagues advocated that “a substantial portion of assets in 401(k) ... plans be automatically directed (defaulted) into a two-year trial income product[, i.e., an annuity,] ... unless [retirees]

affirmatively choose not to participate.” The reasoning for these automatic trial annuities is not clear, and seems simply to be that retirees might run out of money if they manage their own savings themselves.

In July of 2009, the Retirement Security Project of the Brookings Institute published “[Automatic Annuitization: New Behavioral Strategies for Expanding Lifetime Income](#)”, in which Iwry and his colleagues continued their proposal for automatic, mandatory trial annuities, and added a proposal for automatic enrollment, mid-career, in a separate annuity fund within existing 401(k) accounts, to which the employer’s matching contribution would be directed.

The push for automatic annuities appears mainly to be rationalized through the demise of the historic private pension plan system in which companies provided fixed income benefits to their employees upon retirement. As 401(k) programs were introduced, businesses opted for these less-burdensome and tax-incentivized plans, abandoning the traditional pension plans. The need for fixed-income payments is also briefly rationalized in an articulated concern over the future of Social Security benefits, something which does not really lend support to yet another Federal government-sponsored annuity plan. Finally, the arguments for automatic annuitization are generally based on the uncertain financial landscape and a general need for guaranteed income on the part of retirees. As important as these factors are to consider, however, the necessary logical conclusion that all retirement accounts must be turned into annuities simply does not follow.

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The actual testimony at the Joint Hearings on September 14-15 was varied on the subject of mandatory annuitization. The [Vanguard Center for Retirement Research](#) indicated that annuities are not a popular investment choice for retirees, especially given the annuity-like Social Security and Medicare programs already provided, and most individuals want to have the flexibility and liquidity of a lump-sum payment managed under their own direction, rather than a fixed-income annuity. However, several large entities, including [TIAA-CREF](#) came out in favor of at least partial retirement annuities, and in support of proposed Federal regulation requiring annuity information on retirement documents.

Making 401(k)s Mandatory

A second aspect of current 401(k) and IRA proposals at issue is the possibility that all business entities will be required to provide 401(k) plans and that all employees will be required to enroll in these plans.

As indicated above, the Brookings Institution published a paper in April of 2006 in which it advocated making 401(k) plans mandatory for all employees and all businesses (“with possible exceptions for the smallest”).



Iwry and his colleague [David C. John](#) of the Heritage Foundation testified in the summer of 2008 before both the U.S. House and Senate in support of this automatic IRA proposal. (“[Making Saving for Retirement Easier through Automatic IRAs](#)”—J. Mark Iwry, David C. John, June 26, 2008, House Committee on Ways and Means, Subcommittee on Select Revenue Measures (“House Testimony”);

“[Protecting and Strengthening Retirement Savings: Strategies to Reduce Leakage in 401\(k\)s and Expand Saving Through Automatic IRAs](#)”—J. Mark Iwry, David C. John, July 16, 2008, Senate Special Committee on Aging (“Senate Testimony”).) Iwry and John indicate that “half of our workforce” work “for employers (usually small businesses) that do not offer a retirement plan,” and therefore have no way to save “at work” (House Testimony). This, combined with lowered expectations for Social Security, will create a major national problem that can be alleviated through the “automatic IRA” plan.

Iwry and John continue their support for the automatic, mandatory IRA program in their July, 2009 paper entitled “[Pursuing Universal Retirement Security Through Automatic IRAs](#)” and in the September 9, 2010 Brookings Institution paper “[Expanding Automatic Enrollment and Making Saver’s Credit a Match Will Help to Improve Retirement Security](#)” this theme is carried forward, with the added discussion of Federal government matching of funds for these IRA accounts.

To indicate the influence of these papers, various iterations of the Automatic IRA Act have been proposed over the past few years, including the most recent Automatic IRA Act of

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2010 ([S.3760](#) and [H.R. 6099](#); see also [‘Automatic’ IRAs to Fill Retirement Gap](#), and [‘Bingaman Introduces Bill to Spur Retirement Savings’](#)). These acts are based on the Brookings Institution proposals set forward by Iwry and his colleagues.

Why This Is Serious



According to the Investment Company Institute’s [“The U.S. Retirement Market, First Quarter 2010”](#) (and see also Investment Company Institute’s [Retirement Snapshot, First Quarter 2010](#)), as of the end of the first quarter 2010, U.S. investors held \$4.2 trillion in employer defined contribution plans, including \$2.9 trillion in 401(k)s, and an estimated \$4.3 trillion in IRA accounts.

The shortfall on Medicare and Social Security, according to the [U.S. Debt Clock](#) website is approximately \$76 trillion and \$14 trillion, respectively, at the time of writing. The total unfunded liability per citizen in the U.S. is approximately \$356,676.00.

To make up this shortfall, it will be necessary to obtain the money from some place, and the \$7.2 trillion in 401(k)s and IRAs appears a good place to start.