AARP Public Policy Institute

New Ways to Promote Retirement Saving

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* Smith was a research assistant with the Brookings Institution when the paper was written. He is currently with the Council of Economic Advisors.

Research Report

AARP®

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AARP's Public Policy Institute informs and stimulates public debate on the issues we face as we age. Through research, analysis and dialogue with the nation's leading experts, PPI promotes development of sound, creative policies to address our common need for economic security, health care, and quality of life.

The views expressed herein are for information, debate, and discussion, and do not necessarily represent official policies of AARP.

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Executive Summary

Many American households do not save for retirement. Those that do save often contribute too little, invest poorly, or withdraw funds early. These patterns leave households, particularly low- and middle-income households, vulnerable to insufficient savings to finance adequate living standards during old age and retirement. Looking ahead, the retirement of the baby boomers, the aging of the population, and rising health care costs will place increasing pressure on Social Security and Medicare, making achieving a secure retirement even more challenging for many. As Congress considers budget reform, proposals to strengthen the private retirement system should be given serious consideration.

This Research Report proposes retirement saving reforms designed to help boost saving among low- and middle-income households. We group our proposals under five themes: (1) making saving easier, (2) making saving more rewarding, (3) strengthening the market infrastructure for saving, (4) providing private information to savers, and (5) improving public education for saving.

Build New Platforms to Make Saving Easier

Individuals face a deluge of complicated savings options. To make matters worse, the savings vehicles available to workers are hard to consolidate or store in one location.

Proposal 1: Expand Saving with Corporate Platforms

We propose to use the employer-sponsored retirement saving mechanism for other short- and long-term saving purposes, such as a home purchase, college expenses, health care costs, and more. This would facilitate both retirement and nonretirement saving, make saving simpler and easier, and improve the financial security of families and individuals at all stages of life. It would add value for employers and employees, particularly if the mechanism uses automatic enrollment for both retirement and nonretirement savings.

Proposal 2: Establish R-Bond Accounts for New Savers

Fees and complexity can discourage first-time retirement savers with small-balance accounts. We propose a simple government bond account (or “R-Bond”) without administrative fees to help first-time savers build a nest egg that can eventually be rolled over into a privately managed account. This will help individuals with small balances who want to save but do not in order to avoid high fees or complex arrangements.

Reform the Tax System to Make Saving More Rewarding

The idea that savings decisions can be influenced by plan design, such as defaults like automatic enrollment, does not mean economic incentives are irrelevant. Many people do not enroll in or contribute enough because there is no strong or immediate financial incentive to do so.

Proposal 3: Convert Individual Income Tax Deductions for Retirement Saving to Matching Contributions

We propose replacing the existing individual income tax deductions with a flat-rate refundable credit that serves as a matching contribution into a retirement savings account. This would enhance retirement saving incentives for most households, is likely to raise overall national saving, and could reduce the federal budget deficit.

Proposal 4: Reform the Saver's Credit

To make it simpler and more rewarding, we propose reforming the Saver's Credit to create a flat, refundable credit that phases out with income. Furthermore, the credit should act like a matching contribution. That is, it should be deposited directly into savers' accounts rather than delivered in the form of a lower tax liability or a tax refund. This will strengthen saving incentives and outcomes for low-income households.

Strengthen the Infrastructure for Saving

Proposal 5: Federal Backup Insurance for Annuity Products

To protect against the threat of annuity market failure, we propose federal backup insurance for life annuities and similar products. This backup protection could take several forms, including (1) Federal Deposit Insurance Corporation-type insurance that replaces state guaranty fund coverage for annuity-type products only, (2) supplemental insurance above the amount offered by state guaranty funds coupled with a federal line of credit to state guaranty funds, again to protect annuity-type products only, or simply (3) a federal line of credit available to state guaranty funds.

Proposal 6: Expand the Employer Tax Credit

Employers play a critical role in advancing retirement security, but many smaller ones do not offer their employees retirement services because doing so is costly. We propose an increase in the employer tax credit for new retirement plans and a further incentive to add employees to an existing plan. This will help employers, particularly small ones, manage the cost of setting up accounts, managing payroll deductions, and providing important information to their employees.

Make Private Information Easier to Access

There are several ways to use private information to make saving simpler, easier, and more secure. This is true for both employees and employers.

Proposal 7: Use Tax Information to Consolidate Retirement Accounts

Today, millions of Americans have more than one retirement savings account. Account owners can consolidate most types of accounts, but many do not. Some consciously decide to maintain multiple accounts, but many do not know the consolidation procedure, lack the needed information, or simply fail to take the necessary steps. We propose to use tax information to help employees find and consolidate multiple retirement accounts. This will cut down on lost or neglected accounts and preserve the wealth of individuals who changed employers many times, while maintaining individual freedom and choice.

Proposal 8: Combine Social Security and 401(k) Statements

To make better decisions about retirement, people must have better information. We propose that retirement savings account providers give combined estimates of account owners' Social Security benefits, using information provided by the Social Security Administration, and the annuitized value of retirement savings balances on statements they provide to their customers. Doing so will give future retirees a more complete picture of their retirement outlook and help them make important choices about current saving and spending levels.

Proposal 9: Create a Central Website to Connect Employers and Retirement Savings Plan Providers

Employers who wish to start a retirement savings plan for their employees must find a plan administrator. Service providers aggressively market to larger employers, but many employers must seek an administrator themselves, often without the information necessary to compare the fees and levels of service offered by different providers. We propose the creation of central websites where employers can "shop" for retirement savings plan service providers. This will make finding and selecting providers of retirement savings accounts simpler and more efficient, particularly for small employers.

Improve Public Education for Saving

Numerous studies have documented that a significant proportion of Americans have limited financial knowledge, that financial illiteracy leads people to make financial mistakes, and that planning can help people make better choices.

Proposal 10: Create a Public Information Campaign to Raise Financial Literacy

One way to address gaps in the public's financial knowledge is through a mass media public information campaign designed to raise financial literacy. The campaign would be coupled with, and direct people to, a website to exploit the massive growth in online financial activity and information. Ideally, it would promote a simple but comprehensive message—for example, the need to create a financial plan—with targeted sub-messages for specific groups.

Proposal 11: Create and Disseminate a Comprehensive Graphic for Financial Planning

Another way to address this issue is to develop financial guidelines simple enough to be explained in graphic form and disseminate the guidelines to nonexpert households to help bolster financial acumen and security. A "financial food pyramid" or similar graphic would offer simple rules of thumb for difficult saving and spending decisions. It could be separate from or part of a larger public information campaign.

Conquering the saving problem in the United States will require a wide variety of tools, instruments, and policies. These five themes and eleven proposals represent a host of ways to approach the problem. While no one proposal is likely to be a "silver bullet," the combination of policies proposed demonstrates both the depth and the breadth of the problem, on the one hand, and the potential for creative solutions, on the other.

INTRODUCTION

Many American households do not save for retirement, and many of those that do contribute too little, invest poorly, or withdraw funds early. These patterns leave households, particularly low- and middle-income households, vulnerable to insufficient savings to finance adequate living standards during old age and retirement. Today, a weak economy threatens to reduce the vitality of the retirement system—for example, by driving workers to stop participating in their 401(k) plans or individual retirement accounts (IRAs), to contribute less for retirement saving, to invest more conservatively, or to withdraw funds early.

At the same time, the nation's medium- and long-term fiscal outlook is unsustainable. The retirement of the baby boomers, the aging of the population, and rising health care costs will place increasing pressure on Social Security and Medicare.[3] Without reform, the Social Security trust funds will be depleted by 2033[4] and will be able to pay only about three-quarters of the benefits retirees have been promised. This will further weaken the retirement prospects of low- and middle-income households and make them more vulnerable to poverty in old age. As Congress considers budget reform, proposals to strengthen the private retirement system would be appropriate and constructive.

Low retirement saving is not due to lack of eligibility for tax-favored retirement accounts. About half of workers are either enrolled in defined benefit (DB) plans or eligible for 401(k) accounts through their employers, and almost all households can contribute to IRAs. A principal explanation for low retirement saving is the lack of take-up—too many people fail to take advantage of the available tax-preferred retirement savings opportunities. Inadequate take-up, in turn, stems from two key factors: Enrollment often requires people to act affirmatively, and some have little immediate financial incentive to enroll or contribute very much.

One reason people do not enroll in a 401(k) or IRA is that enrollment requires them to take specific action. Furthermore, the plans sometimes present a confusing array of choices regarding investment allocations and other features, increasing the nonmonetary cost of enrollment. Many people, as a result, procrastinate to avoid any decision, even though they recognize that they should save more. Thus, inertia tends to keep workers out of 401(k) plans and IRAs, since participation usually requires them to make an affirmative choice. The provision of automatic enrollment in 401(k) plans has helped to remedy this problem, as have features of the Pension Protection Act of 2006. Automatic enrollment in 401(k) plans has increased dramatically over the past decade, particularly

[3] Alan J. Auerbach and William G. Gale, "Tempting Fate: The Federal Budget Outlook." *Tax Notes* 132, no. 4 (2011): 375–88.

[4] Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds (Washington, DC: Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, 2012).

in large plans.[5] The extension of automatic enrollment to IRAs would help expand participation further.[6]

Against this backdrop, we propose retirement saving reforms that could help boost saving among low- and middle-income households, building on the achievements and ideas behind automatic enrollment in 401(k)s and IRAs. We group our proposals under five themes:

- Make saving easier
- Make saving more rewarding
- Strengthen the market infrastructure for saving
- Make private information easier to access
- Improve public education for saving

The logic behind making saving easier is that saving for retirement or nonretirement purposes can be difficult and complex. Individuals face a deluge of complicated options, and—to make matters worse—the savings vehicles available to workers are hard to consolidate or store in one location. In other cases, administrative fees are too high to make saving practical for individuals with small balances.

We explore two ideas to make saving easier and more comprehensive, particularly for young or first-time savers. The first is a proposal to use the employer-sponsored retirement saving mechanism for other saving purposes. In the end, this will facilitate both retirement and nonretirement saving, make saving simpler and easier, and improve the financial security of families and individuals at all stages of life. It will add value for both employers and employees. The second is a proposal to establish simple, no-fee government bond accounts for first-time savers. These accounts, which could be used for both retirement and nonretirement purposes, would help savers build a nest egg to be rolled over into a privately managed account at a later date and would help individuals with small balances who want to save to avoid high fees or complex arrangements. Together, the two proposals will expand saving by making it easier.

Turning to making saving rewarding, we note that the idea that savings decisions are influenced by behavioral factors, such as defaults, does not mean economic incentives are irrelevant. Indeed, recent evidence suggests that the rate at which the government matches retirement savings contributions can significantly affect contributions. Thus, a second reason many people do not enroll in or contribute enough to an IRA or a 401(k) plan—and the focus of the next two proposals—is that they have a weak or nonexistent immediate financial incentive to do so. Not only do the existing tax rules provide less immediate benefit to low- and middle-income households, they are also relatively ineffective at inducing new saving.

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[5] John Beshears, James Choi, David Laibson, and Brigitte Madrian, "The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States," in *Lessons from Pension Reform in the Americas*, ed. Stephen J. Kay and Tapen Sinha (New York, NY: Oxford University Press, 2008).

[6] Mark J. Iwry and David C. John, *Pursuing Universal Retirement Security Through Automatic IRAs* (Washington, DC: Retirement Security Project, The Brookings Institution, 2009).

Our next two proposals aim to address these concerns. One would convert the retirement saving deduction in the individual income tax into a flat, refundable government matching contribution that would be deposited directly into the saver's account. This would enhance retirement saving incentives for most households and could reduce the deficit at the same time. The second would convert the Saver's Credit to a flat, refundable matching contribution deposited directly into the saver's account. We also analyze interactions between the two proposals.

A third theme of our analysis is that policymakers can take steps to improve the operation of the retirement saving system. On this front, we discuss two market enhancements. The first is a proposal, with several variations, to provide federal backup insurance for annuity products. This will protect against any future threat to the annuity market and, in doing so, instill confidence in the safety of annuities. Second, we discuss a proposal to expand the employer tax credit for new retirement savings plans. This will help employers, particularly small ones, manage the costs of setting up accounts, managing payroll deductions, and providing important information to their employees.

Fourth, there are several ways to use private information to make saving simpler, easier, and more secure. This is true for both employees and employers. We present three proposals to make information more accessible and useful. Some of these efforts will require careful collaboration between the public and private sectors. The first is a proposal to use tax information to consolidate retirement accounts. This will cut down on lost or neglected accounts and preserve the wealth of individuals who changed employers many times, all while maintaining individual freedom and choice. The second is a proposal to combine Social Security and 401(k), IRA, or similar retirement account statements. Doing so will give workers a complete picture of their retirement outlook and help them make important choices about current saving and spending levels. Finally, we propose a central website to connect employers and retirement plan providers. This will help employers, particularly small ones, find providers and compare fees. All three proposals promote the responsible use of private information to improve retirement saving.

Fifth, we present two major proposals to address the shortfall of financial education among future retirees, particularly among low- and middle-income people. Numerous studies have documented that a significant proportion of Americans have limited financial knowledge, that financial illiteracy leads people to make financial mistakes, and that planning can help people make better choices. To address these issues, we make two proposals. First, the government could launch a mass public information campaign to raise financial literacy. Ideally, this would promote a simple but comprehensive message—for example, on the benefits of creating a financial plan—with targeted sub-messages for specific groups. We also discuss the idea of a "financial food pyramid" or similar graphic to illustrate simple rules of thumb for difficult saving and spending decisions. It could be separate from or part of a larger public information campaign.

Conquering the saving problem in the United States will require a wide variety of tools, instruments, and policies. These five themes and eleven proposals represent a variety of new ways to approach the problem. While no one proposal is likely to be a "silver bullet," the combination of policies proposed demonstrates both the depth and the breadth of the problem, on one hand, and the potential for creative solutions on the other.

BUILD NEW PLATFORMS TO MAKE SAVING EASIER

Proposal 1: Expand Saving with Corporate Platforms

A recent development in the United Kingdom has the potential to improve both retirement and other types of savings for Americans, give employees better control over their overall finances, increase the value of employer-offered benefits to employees, and improve financial literacy simply by expanding the employer's retirement savings platform. Already being studied in both Australia and the United States, the improvement has wide application and can be adapted to benefit employers, employees of all income and age groups, and financial services providers.

In the United States, employer-sponsored payroll deduction savings platforms are usually limited to retirement saving. To save for other purposes, employees must look elsewhere. This causes several problems. First, the financial products available to consumers can be confusing or intimidating. The sheer number and variety of accounts and low financial literacy add to this confusion to create high barriers to saving for many people. Second, employees who seek financial products for nonretirement saving may incur new and unpredictable administrative costs that could be minimized if they were able to find these savings products through an employer-sponsored savings plan. Even in cases where administrative costs are fairly low, employees may hesitate to open these accounts for fear that they will encounter hidden fees at a later date. Together, the barriers and the potential cost mean that many individuals fail to have adequate savings for both emergencies and for major purchases. While auto-enrollment for retirement saving has greatly increased participation in plans that offer it, the default for nonretirement saving is no saving whatsoever.

These problems have two important implications. The first is straightforward: inadequate general savings. Households find themselves without the financial resources to own a home, invest in education, take on business risk, or otherwise protect against uncertainty. Second, when even a minor disaster hits, households without adequate general savings turn to their retirement savings for help. The result is widespread leakage from retirement accounts and insufficient funds for old age. To combat these pressures, we propose to expand automatic payroll deduction platforms to include opportunities to save for nonretirement purposes.

Proposal

Known in the UK under the term "corporate platforms" to indicate that it expands options available on the employer's benefit platform, this innovation allows employees to use the employer-sponsored retirement savings mechanism to save and invest for other purposes. When it is fully implemented, employees will be able to manage almost all of their investments and savings from one online location, thus giving them a consolidated view of their entire financial status. If carried to its full potential, the expanded saving platform also allows employees to shop for savings products—vehicles to save for housing, education, vacations, and more—among options that are available on the platform instead of having to seek them out from individual suppliers, a search that often takes up work hours. The ability to choose products from such a platform would give employees a level of confidence that the product is reputable and cost-effective. The platform could also serve as a single source for individualized advice and/or financial literacy training.

The platform would have even greater value to employees if it used automatic enrollment for both retirement and nonretirement savings. As with the existing automatic enrollment into retirement savings plans, employees would have complete control over all aspects of the relationship. They would be able to save more or less than the automatically specified amount, divide the total among various accounts, or not participate at all. By offering different types of savings and investment opportunities according to the age of the employee, automatic enrollment could encourage them to save for purposes such as a first home, sending children to college, or additional health services.

In practice, contributions would be split between retirement and nonretirement accounts. Assuming they just use the automatic default deduction, younger employees would see a greater proportion of their contributions go to nonretirement purposes, but as they aged, a larger proportion would go to retirement accounts. The goal is to ensure that employees contribute enough to reach their savings goals *and* save enough for a secure retirement. Since they have complete control over their participation, employees who are saving for a first home or a similar purpose would have the option of increasing their nonretirement contributions while holding their retirement contributions constant.[7] However, contribution allocations between types of accounts could also be adjusted automatically if investment gains put one or more account balances significantly above their targets.[8]

The retirement saving would remain tax-preferred and Employee Retirement Income Security Act of 1974 (ERISA)-regulated. Nonretirement accounts would not benefit from special tax treatment and would be regulated as financial products by the appropriate federal or state entity.[9] Retirement savings amounts would continue to go to the employer's 401(k) default investment fund just as they do now. In fact, adding other types of savings opportunities to the platform would not have any effect on the structure and treatment of those balances. However, while employers are protected by ERISA from legal challenges to their default retirement investment choice if they choose ones specified by regulations, there would be no such protections for employers' nonretirement default savings choice. For that reason, although employees could voluntarily choose to place their money into any number of accounts, automatic nonretirement contributions would probably go to a stable value-type fund or bank or credit union savings account until the employee chooses otherwise.

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[7] Much of this discussion assumes individuals will save for nonretirement purposes *in addition to* what they already save for retirement. One of the goals is to encourage such additional savings, and educational campaigns for the additional savings vehicles should stress the need to increase total savings. However, it is possible that promotion of nonretirement saving could lessen total retirement saving.

[8] Contributions would be best expressed in terms of percentage of earnings to enable them to automatically keep pace with increases in income. Similarly, investment targets would be best expressed in terms of percentage of the overall portfolio unless the individual is setting aside an explicit amount for a specific purpose.

[9] Since retirement savings products are regulated by ERISA and other laws, at a minimum, a safe harbor will be needed to ensure that nonretirement savings can be invested in a broad range of products without accidentally bringing them under ERISA.

The enhancement has special significance in the UK, where in late 2012 larger employers that do not offer any other type of pension or retirement savings plan must begin to automatically enroll their employees into basic retirement savings accounts. These accounts will include both employee and employer contributions as well as a government tax refund. Contributions will be invested in a target-date fund, and upon retirement, employees will be able to receive a lump sum, an annuity, or a mixture of the two.[10]

This new requirement is causing a great deal of discussion about the future role of employer-provided benefits as well as reconsideration of the fees and services included in a traditional employer-offered DB or defined contribution (DC) package. The platform enhancements allow employers to differentiate their employee benefit package from the basic required account structure. It also gives younger employees a benefit of more immediate value than they would have from a retirement savings account that they will not access for many years.

Presentations from a variety of service providers at an October 2011 summit hosted by *Pensions Insight*, a UK trade journal, showed that the platform can be easily customized to meet the needs of a specific workforce. Using a single computer interface, employees can select from a wide variety of savings and investment options that are appropriate for their income level and stage of life. Thus, an upper-income manager who manages his or her own finances could see more sophisticated products, while an entry-level worker sees more basic savings products. Adding live presentations by financial professionals that explain what is available on the computer platform can increase the system's value and its use.

Discussion

The platform will have special value for moderate- and lower-income employees. While higher-salaried employees may appreciate the opportunity to build their investments, the real value of the platform will be to enable moderate- and lower-income workers to find savings opportunities that they might otherwise miss because they do not know where to go, are uncertain about what is a fair price to pay, or for a variety of other reasons. Because employees tend to believe that services on the corporate platform are implicitly endorsed by the employer, they usually have greater faith that the services are from legitimate providers at a fair price.

For employees, the platforms have additional value in that they allow for near-term withdrawal. Of course, employees should refrain from withdrawing their retirement savings early, but near-term saving goals may in fact encourage greater saving across the board. Retirement saving, by definition, involves sacrificing today for consumption years in the future. Saving for a car, a house, or a child, on the other hand, represents something more immediate and tangible.

Employees at all levels can also use the site to receive guidance on individual products or just basic financial literacy training. Individuals can choose what is of most immediate value to them, from short videos on a specific topic by experts or fellow employees to longer connected courses designed to meet the needs of specific age or

[10] For details, see http://www.nestpensions.org.uk.

income groups. Use is increased when employees receive emails or text messages geared to birthdays or other life events, or generated after they visit a specific part of the website.

Understanding the value of peer evaluations to motivate others, some financial services providers in the UK include a place where employees can post feedback about specific products or savings choices. These postings help to guide decisions and build the reputation of the platform as a source of unbiased information. The site can also include links to outside advisors who can answer questions, guide employees to another site for more information, or perform other services either online or over the telephone.

Different age groups can be contacted and guided through different technologies. At the UK platform summit, David Harris of Tor Financial Consulting showed that younger employees preferred different communication methods than either older employees or the usual way that employers provide information. However, the platform is able to use a wide variety of methods, and is equally effective no matter which is used.

Although the UK's platform is intended as an enhancement to employer-provided benefits, it can also be used for a wide variety of policy goals, as the basic structure can be easily adapted to meet almost any nation's tax and savings system. In the United States alone, policy experts have proposed separate dedicated savings accounts for nonretirement purposes ranging from unemployment benefits and retraining, home purchases, health care, and long-term health care coverage, to repaying student loans or building college balances for children or grandchildren. However, if all of these accounts were established and funded, the individual might have little left for everyday consumption.

Rather than a host of specific savings programs, employees may be better served by more flexible accounts useable for a variety of purposes. The platform concept would allow them to choose which purposes they need to save for and how much to save for each. Combined with targeted guidance or education, this structure could expose individuals to possibilities that they might not have considered before.

The structure is ideally suited to employment situations, including small business employment. Increasing coverage among employees of small businesses is critical, and platforms can be customized to meet the needs and goals of small businesses. The structure could also be used by the self-employed or by consultants at sites aimed specifically at them and sponsored by trade associations, unions, or even government agencies. While their circumstances may preclude payroll deductions, the same products could be offered through direct debits of bank accounts.

The flexibility of the platform allows it to be used by employees with all levels of financial sophistication, but new participants would benefit from a variation on automatic enrollment that places certain amounts in addition to the retirement savings amount into a general savings account or similar vehicle. The added automatic savings amounts deducted need not be large, and in places where the law allows, could vary according to the age of employee, with a larger proportion of the overall deduction going to nonretirement purpose for younger employees and a larger proportion going to retirement for older ones.

The platform will benefit employers and providers as well. For employers, offering the platform provides real and continuing benefit to their employees. It could be customized to help retain valuable personnel. The platform could also help manage costs. Many “platform additions” would cost employers nothing. Are employers interested? Colonial Life[11] polled human resource managers and benefit administrators in the United States and found that almost half (49 percent) expect to add voluntary benefits to their plans within next year. LIMRA[12] reports that 57 percent of U.S. employers already offer various types of voluntary benefits. In an environment where employers increasingly move to replace existing employer-paid benefits, the new platform would give them an effective and affordable way to help their employees. According to several UK sources close to the industry, six large UK insurance companies already use the platform, and about 35 major employers have agreed to start offering the enhanced platform to their employees. Providers will also benefit. The platform allows them to sell additional financial products to a known customer base, and they can retain clients even after retirement. Thus, we believe employees, employers, and providers all stand to gain from this proposal.

Although the platform has a variety of uses, its primary purpose is still to build retirement security. Before retirement, the platform helps employees understand how to save, what they have, and how much more they need for a comfortable lifestyle. In addition to meeting specific goals, general nonretirement savings provide funds that can be used in the event of an emergency, thus helping to reduce leakage from retirement accounts in countries that allow early access to that money. At retirement, the platform helps individuals see what other assets are available to them and what loans or other liabilities they must factor in. In the UK, it is also being used to encourage individuals to use annuities and add them to their investments.

The UK experience can help guide U.S. policymakers in their efforts to increase the use of similar products. Because American pension and retirement savings products are regulated by ERISA and similar laws, various laws and regulations will need to be revised to ensure that the platform can offer non-ERISA-regulated products without bringing them under ERISA. In addition, existing laws and regulations will need to be examined to ensure that financial education available on or through the platform is not limited by ERISA.

The enhanced information and flexibility of the corporate platform should help individuals better understand their finances and meet their goals. Connecting retirement and nonretirement saving plans will increase the visibility of each. This will promote regular use of the platform and a fuller understanding of what is necessary for a comfortable retirement.

Proposal 2: Establish R-Bond Accounts for New Savers

Fees and complexity can discourage first-time retirement savers with small accounts. Ideally, these individuals would have access to simple accounts with few or no

[11] Colonial Life, “Employers expect to add voluntary benefits to their plans” (Columbia, SC: Colonial Life, 2011), http://www.coloniallife.com/Newsroom/~/media/acrobat/newsroom/news%20releases/news-release-20110803.ashx.

[12] LIMRA, “LIMRA Study Measures Opportunity in Voluntary Market” (Windsor, CT: LIMRA, 2011), http://www.limra.com/newscenter/newsarchive/archivedetails.aspx?prid=197.

administrative fees that they can use to start saving for their retirement. Private-sector account options exist, but many private-sector providers either do not want to handle small start-up accounts or charge administrative fees that would significantly eat into the savings balances, resulting in little or no growth.

We see the need for simple, no-fee government bond accounts to help first-time retirement savers. The bond accounts could be used to facilitate certain types of nonretirement saving, too, which is of critical importance to low- and middle-income households that have limited access to banks, credit unions, or other financial intermediaries. The accounts could also help reduce or eliminate "orphaned" retirement savings accounts by acting as a repository for these account balances until owners are found. Currently, abandoned accounts are sent to holding funds that impose comparatively hefty annual fees that can sometimes consume the balance of small accounts. Simple, no-fee government bond accounts could help address this problem while providing much-needed retirement and nonretirement saving opportunities for new and low- and middle-income savers.

Proposal

We propose a simple government bond account (or "R-Bond") without administrative fees to help first-time savers build a nest egg that can eventually be rolled over into a privately managed account. The R-Bond would be an account, not a specific bond. It would pay interest at a rate similar to the five-year Treasury (T-Bond), with rates set every six months. There would be no maturity date, and amounts could be added to the R-Bond account at any time. When an R-Bond account grows to a preset limit, the balance would roll over into a private-sector account unless the owner specifies otherwise.

The accounts need not be limited to retirement saving. This mechanism could be used for other types of saving, too, or as a temporary repository for "orphaned" or otherwise inactive retirement savings accounts belonging to former employees. The R-Bond accounts would use owners' Social Security numbers (SSNs) for identification, making them easy for both the owner and the Treasury Department to carry over from one employer to another until the limit is reached.

The role of the employers in privately managed 401(k)-type or IRA retirement savings accounts would depend on the retirement plan provider. The employer could set up the account and send contributions directly to the Treasury Department, leaving the employee to decide the timing of any transfer of funds to the manager of that employer's retirement savings plan.

Alternatively, the provider could set up the R-Bond account, receive contributions from the employer, and forward them to the Treasury.[13] Then, when the account has reached the maximum size, the provider could arrange to have the account rolled back to it (assuming that the account owner agrees to the transfer), where the funds would be invested in other types of investment options appropriate to the account owner's age and

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[13] Treasury would pay all costs associated with administering the R-Bond. As the R-Bond structure will build off existing savings bond programs, these costs are anticipated to be minimal.

wishes. Use of the R-Bond by private plan managers would be optional. The manager could decide to use some other form of stable value or low-cost accumulator account.

Discussion

We expect R-Bond accounts to have several benefits for new and low-income savers. The simple structure and low to nonexistent fees would help them build retirement balances that are both more interesting to private providers and likely to be large enough so that fees would not consume the principal. These accounts could also help low- and middle-income workers save for nonretirement purposes. Finally, R-Bond accounts could help reduce the costs and loss related to orphaned retirement accounts. The R-Bond account could act as a holding account for these lost retirement accounts until their owners can be identified and the balances can be consolidated with other savings. Using the orphaned account owner's SSN as an identifier would simplify this process.

Reform the Tax System to Make Saving More Rewarding

Proposal 3: Convert Individual Income Tax Deductions for Retirement Saving to Matching Contributions

Evidence suggests that the rate at which the government matches retirement savings contributions can significantly affect contributions. In a recent study, households were randomly offered different matching rates for IRA contributions at the time they were preparing their taxes. Households made significantly higher contributions when offered a higher match rate.[14]

Thus, a second reason (besides inertia, discussed in the introduction) that many people do not enroll in or contribute enough to an IRA or a 401(k) plan—and the focus of the next two proposals—is that they have a weak or nonexistent immediate financial incentive to do so. This is true for the vast majority of middle- and low-income households; about three-quarters of tax units face statutory marginal tax rates of 15 percent or less. For most of these plans, contributions are deductible from income in the year they are made, accrue tax-free until they are withdrawn, and are taxed as ordinary income at withdrawal. (The exception is Roth plans, where contributions are not deductible when made and not taxable when withdrawn. The immediate tax benefits, as a result, are nonexistent.)

For a regular or traditional IRA or 401(k), the immediate value of excluding contributions from taxation depends on the taxpayer's income tax bracket. For example, consider two taxpayers, each of whom contributes $6,000 to a 401(k) and thus reduces taxable income by $6,000. One taxpayer has high income and faces a marginal tax rate of 35 percent; by contributing to the 401(k), she reduces taxes owed by $2,100 (35 percent of the $6,000 contribution). The other has relatively low income and is in the 10 percent tax bracket, so that the 401(k) contribution only reduces taxes by $600. The current

[14] Esther, Duflo, William G. Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," *Quarterly Journal of Economics* 121, no. 4 (2006): 1311–46; Emmanuel Saez, "Details Matter: The Impact of Presentation and Information on the Take-up of Financial Incentives for Retirement Saving," *American Economic Journal: Economic Policy* 1, no. 1 (2009): 204–28.

system thus provides the smallest immediate benefit to taxpayers who face a zero or low marginal income tax rate, and who are typically low or middle income. These taxpayers are also typically most in need of increasing savings to meet basic retirement needs.

Not only do the existing tax rules provide less immediate benefit to low- and middle-income households, they are also relatively ineffective at inducing new saving. Contributions by high-income households to tax-subsidized retirement accounts are more likely to represent funds that are reshuffled from existing savings to take advantage of the tax benefit rather than a net new addition to saving.[15] In other words, the current tax incentives to increase saving have relatively low bang for the buck because they merely subsidize shifting saving for high-income households rather than raising the total amount of saving in the economy.

This discussion suggests that the current system is flawed. By providing incentives for contributions through tax provisions that are linked to the marginal tax rates that people face, current incentives deliver their largest immediate benefits to individuals in the highest tax brackets. These individuals are precisely the ones who can respond to such tax incentives by reshuffling their existing assets into these accounts rather than by increasing their overall level of saving. As a result, the tens of billions of dollars in tax expenditures associated each year with 401(k) and IRA contributions could be targeted more effectively to increase overall saving.

Proposal

We propose a new incentive structure for contributions to retirement savings accounts. The plan would replace the existing individual income tax deductions with a flat-rate refundable credit that serves as a matching contribution into a retirement savings account. The plan would thus change the treatment of retirement saving in three ways. First, unlike the current system, workers' contributions to employer-based 401(k) accounts would no longer be excluded from income subject to taxation, and contributions to IRAs would no longer be tax-deductible. Second, all qualified employee contributions would be eligible for a flat-rate refundable tax credit, given to the employee. Third, the credit would be deposited directly into the retirement saving account, as opposed to the current deduction, which simply results in a lower tax payment. (Note that some parts of the proposal are separable. For example, the matching contribution could be returned to the taxpayer via a lower tax bill or refund.)

Everything else would stay as is. Contribution limits would not change. Earnings in 401(k) plans and IRAs would continue to accrue tax-free, and withdrawals from the accounts would continue to be taxed as ordinary income. The Saver's Credit would remain in its current form. Catch-up provisions, for workers aged 50 and older, would continue to apply, as would penalties for early withdrawal. Roth plans and DB plans would be unchanged.

[15] Daniel Benjamin, "Does 401(k) Eligibility Increase Saving? Evidence from Propensity Score Subclassification," *Journal of Public Economics* 87, no. 5–6 (2003): 1259–90; Eric M. Engen and William G. Gale, *The Effects of 401(k) Plans on Household Wealth: Differences Across Earnings Groups*, NBER Working Paper 8032 (Cambridge, MA: National Bureau of Economic Research, 2000).

Discussion

There is a formal economic equivalence between the incentives created by a deduction at a given rate and those created by a tax credit of a different rate. For example, a 30 percent matching credit is the equivalent of an income tax deduction for someone with a 23 percent tax rate. For every $100 contributed to a retirement account by an individual with a 23 percent tax rate, the individual receives a tax deduction worth $23. Thus, for each dollar contributed, the individual's after-tax cost is 77 cents. Under a 30 percent credit, the individual would receive a matching contribution of 30 percent, deposited into the account. If the individual made a contribution of $77, the government would provide a matching contribution of $23 (30 percent of $77), so—as with a 23 percent income tax deduction—the individual would have one dollar in his or her account at a cost of 77 cents. For similar reasons, an 18 percent matching credit is the equivalent of an income tax deduction for someone in the 15 percent income tax bracket. See table 1 for more examples and the mathematical formula relating income tax rate to the credit rate at which an income tax deduction and credit will be equal.

Table 1
Tax Credits and Income Tax Deductions at Tax Rate *t*

Income tax rate	10%	15%	25%	28%	33%	35%	t
Credit rate at which income tax deduction equals credit	11%	18%	33%	39%	49%	54%	$t / (1-t)$

We analyze two different versions of the proposal: one with a 27.76 percent matching contribution (which is revenue-neutral under current law), the other with an 18 percent matching rate (which holds harmless those in the 15 percent income tax bracket).

According to estimates from the Tax Policy Center, the 27.76 percent credit would be revenue-neutral over the next 10 years relative to current law. The 18 percent credit would raise revenue by about $250 billion. (Adding employer contributions to the new tax treatment would make the 18 percent proposal raise an *additional* $200 billion over 10 years relative to current law. It would permit a revenue-neutral credit of 30 percent.)

Tables 2 and 3 show the distribution of winners and losers under the two versions of the proposal. Under the revenue-neutral change shown in table 2, about 23 percent of tax filers would receive a reduction in tax liabilities, whereas 7 percent would see an increase. Tax increases would be concentrated in the top decile of the income distribution, while the bottom 90 percent of the distribution would receive, on net, a tax reduction.

Under the 18 percent credit reported in table 3, about 12 percent of taxpayers would receive a tax cut, while 18 percent would see an increase. The bottom 20 percent of the income distribution would receive a small tax cut, the second and third quintiles would experience no change in after-tax income, and the top 40 percent, on net, would face higher tax liabilities.

The analysis underlying both of the tables and the revenue numbers holds retirement saving contributions constant. If retirement saving participation and contributions were to

Table 2
Replace Employee Retirement Saving Contribution Deduction with a Revenue-Neutral Government Matching Refundable Credit

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]				Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]	
	With Tax Cut		With Tax Increase						
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase				Change (% Points)	Under the Proposal
Lowest Quintile	6.5	-173	*	**	0.1	11.5	-11	-0.1	1.5
Second Quintile	18.5	-199	1.7	56	0.2	31.3	-36	-0.1	7.1
Middle Quintile	29.2	-284	4.2	91	0.2	60.9	-79	-0.2	13.8
Fourth Quintile	45.4	-234	4.5	158	0.2	63.0	-99	-0.1	18.8
Top Quintile	27.9	-164	35.7	466	-0.1	-66.7	120	0.0	25.6
All	23.1	-224	7.0	367	0.1	100.0	-26	0.0	20.4
Addendum									
80-90	43.9	-143	20.1	187	0.0	7.0	-25	0.0	22.5
90–95	18.8	-172	49.7	443	-0.1	-25.4	188	0.1	24.9
95–99	4.9	-379	55.1	668	-0.1	-38.8	349	0.1	25.9
Top 1 Percent	3.9	-1,344	47.4	824	0.0	-9.5	338	0.0	28.0
Top 0.1 Percent	3.1	-1,531	42.8	1,249	0.0	-1.4	488	0.0	30.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Number of AMT taxpayers (millions). Baseline: 31.2 Proposal: 32.4.

* Less than 0.05.

** Insufficient data.

(1) Calendar year. Baseline is current law; proposal is replacing retirement saving deduction with a revenue-neutral government matching, refundable credit. Only contributions in traditional IRA accounts and employees' contributions in traditional DC accounts are qualified for the matching credit. Employers' contributions in traditional DC accounts are not qualified for the matching credit.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

Table 3

Replace Employee Retirement Saving Contribution Deduction with an 18 Percent Government Matching Refundable Credit

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]				Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]	
	With Tax Cut		With Tax Increase						
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase				Change (% Points)	Under the Proposal
Lowest Quintile	6.5	-109	*	**	0.1	-1.8	-7	-0.1	1.5
Second Quintile	14.4	-113	5.9	96	0.0	-2.3	-11	0.0	7.2
Middle Quintile	21.3	-126	12.2	181	0.0	-0.9	-5	0.0	14.0
Fourth Quintile	17.3	-132	32.9	290	-0.1	11.7	73	0.1	19.0
Top Quintile	1.6	-421	62.1	1,085	-0.3	93.4	667	0.2	25.8
All	12.2	-127	18.0	653	-0.2	100.0	102	0.2	20.6
Addendum									
80-90	2.3	-319	61.7	568	-0.3	24.2	343	0.3	22.8
90–95	0.7	-454	67.9	1,158	-0.5	26.8	783	0.4	25.2
95–99	0.8	-554	59.2	2,002	-0.5	33.1	1,181	0.3	26.2
Top 1 Percent	1.8	-1,465	49.7	2,679	-0.1	9.2	1,305	0.1	28.0
Top 0.1 Percent	2.2	-760	43.7	3,221	0.0	1.0	1,392	0.0	30.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Number of AMT taxpayers (millions). Baseline: 31.2. Proposal: 32.4.

* Less than 0.05.

** Insufficient data.

(1) Calendar year. Baseline is current law; proposal is replacing retirement saving deduction with an 18 percent government matching, refundable credit. Only contributions in traditional IRA accounts and employees' contributions in traditional DC accounts are qualified for the matching credit. Employers' contributions in traditional DC accounts are not qualified for the matching credit.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

rise among lower- and middle-income households—as would be expected given the improved incentives they would receive—the revenue would decline and the progressivity would increase.

The proposal also appears likely to raise national saving. In the revenue-neutral version of the proposal, there is no decline in government saving, and almost all low- and middle-income households have better incentives to contribute than under the current system. As noted above, evidence suggests that contributions to retirement accounts by such households are more likely to represent net increases in private saving than are contributions by high-wealth households, which can more easily shift funds from other assets. In the revenue-raising version of the proposal, government saving rises. Private saving would still likely rise, though perhaps by not as much as in the revenue-neutral version because incentives to contribute would have improved less.

While a deduction and credit are similar in economic terms, as discussed above, the proposal also differs from current law in that the matching contribution would be deposited directly into the retirement savings account, whereas the current system "delivers" the deduction in the form of a lower tax liability. Depositing the match directly into the account should make it more likely to be saved than the tax deduction under current law; this would be apart from any improvement in the formal incentive to save for most households. Although we have no direct evidence on this point in the context of retirement savings, some evidence suggests that direct matches are more effective than equivalent tax rebates at inducing people to contribute to charities.[16] (However, it should also be noted that the provision of a flat-rate refundable credit could be separated from the provision that the credit is deposited directly into the account, as opposed to provided as a credit on the income tax form. This would allay concerns that such a deposit may prove difficult because of administrative or other reasons.)

This proposal comes with several points of caution. By making the regular or traditional 401(k) and IRA more attractive for low- and middle-income households, the proposal would effectively reduce the relative attractiveness of Roth vehicles for those households. Similarly, by making traditional vehicles less attractive for higher-income households, the proposal would make Roth options more attractive than under current law. In fact, the proposal may lead high-income persons to switch away from traditional 401(k)s and IRAs entirely. To the extent that these tax units represent employers, their own personal incentives may also influence their willingness to provide 401(k)s to their employees. An advantage of the revenue-neutral credit is that fewer high-income households will lose out, and so any such effect on participation would be smaller.

By matching employee contributions to 401(k) plans, the proposal could affect firms' willingness to match contributions themselves. However, firms offer matches for many reasons, including (and perhaps most important) maintaining a competitive compensation

[16] Catherine C. Eckel and Philip J. Grossman, "Rebates and Matching: Does How We Subsidize Charitable Contributions Matter?" *Journal of Public Economics* 87 (2003): 681–701.

package. Firms respond to many pressures, and those that eliminate their own matching programs in response to a government match may lose valuable personnel.[17]

Another reason the proposal may discourage employer matches to 401(k)s has to do with nondiscrimination requirements: To meet nondiscrimination rules, pension plans must ensure sufficient participation and contribution levels by low-income employees; the match is an incentive to encourage such participation. To the extent that the proposal raises 401(k) participation by low-income employees, it could erode the use of matching contributions by employers (since these matches would be less needed to satisfy the nondiscrimination standards). But again, many potential motivations exist for employer matching. The match—like the 401(k) itself—may be seen as part of a competitive pay package, and it may be offered as a way of furthering tax-free compensation for the highly paid employees most likely to participate in 401(k) plans; such a motivation would still exist under the proposal.

Finally, although the proposal would raise the benefits of retirement saving for most households, it might be described in a technically correct, but economically misleading way as creating "double taxation" because contributions to retirement accounts would no longer be tax-deductible and withdrawals from these accounts would continue to be taxed as ordinary income. Of course, the tax treatment under the proposal, which includes a government matching credit, is more generous for the majority of households than the current system. Tax units that receive less benefit under the proposal are likely to be high-income households. Recall that the current system of deductions for retirement saving favors high-income households most because the value of the deduction is linked to marginal tax rates. Also note that making the tax treatment less generous for these households will not necessarily reduce their overall level of saving, as tax-preferred contributions made by high-income households are more likely to be funds that are reshuffled to take advantage of the tax benefit than net increases in saving.[18]

Proposal 4: Reform the Saver's Credit

Increased retirement saving among low-income households should be a priority for both policymakers and the private sector. Low-income workers will be most vulnerable in old age, but they are the least likely to save for retirement. To encourage saving, financial incentives must be stronger and more visible.

Under current law, the Saver's Credit exists to boost the return to retirement saving for low-income households. It provides up to $2,000 in tax credits (for married couples filing jointly) for contributions to tax-preferred retirement accounts. The credit is available to low- and middle-income households, with income limits of $28,750 for single filers and $57,500 for married couples filing jointly in 2012. The credit, however,

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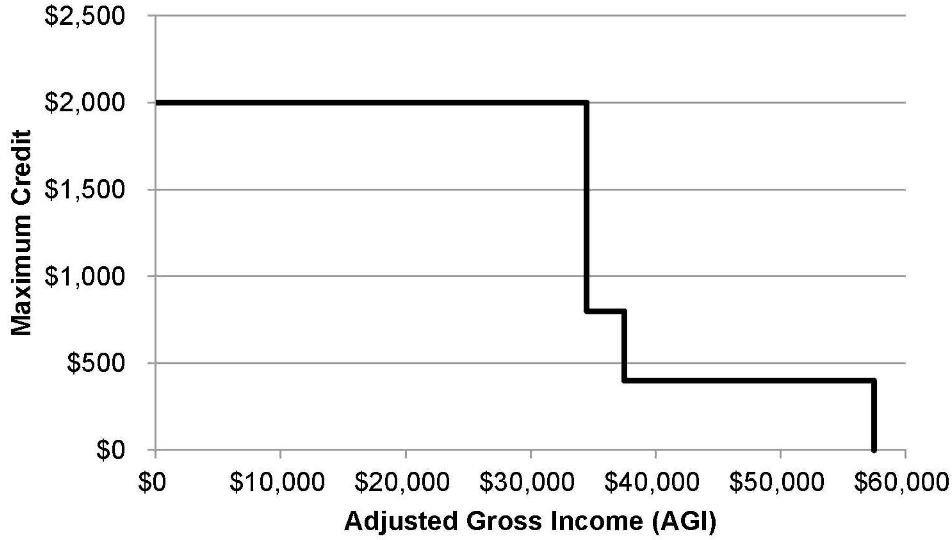
[17] A highly publicized survey commissioned by EBRI (VanDerhei 2012) is often misapplied to this issue. The survey actually addresses a different point—namely, how firms would respond to changes in the tax treatment of employee *and employer* contributions. Also, it is by no means clear that survey respondents have the authority to make changes in the firms' pension plans or how they arrived at their conclusions about how their respective firms would respond in a competitive climate.

[18] Benjamin, "Does 401(k) Eligibility Increase Saving?"; Engen and Gale, "The Effects of 401(k) Plans on Household Wealth."

Figure 1
Maximum Saver's Credit Obtainable Married Couples Filing Jointly in 2012



is not refundable, and the credit rate falls abruptly with income. In 2012, a 50 percent credit was available to married couples filing jointly with adjusted gross income (AGI) at or below $34,500, a 20 percent credit for those with AGI above $34,500 but not over $37,500, and a 10 percent credit for those with AGI above $37,500 but not over $57,500. To visualize this structure, see figure 1, which shows the maximum credit obtainable for married couples filing jointly in 2012.

The current structure Saver's Credit is problematic for several reasons. First, the credit is confusing and poorly understood. As a result, take-up is low among eligible households. Second, the credit is not refundable, which dramatically limits eligibility. After all, many of the households that would otherwise be eligible have no federal tax liability. Finally, the current structure creates problematic "notches." For example, consider a married couple filing jointly with gross income of $35,501. If they contribute $1,000 to a traditional IRA, their AGI becomes $34,501, and they are eligible for a 20 percent (or $200) credit. If, however, the couple contributes $1,001 to a traditional IRA, their AGI falls to $34,500, making them eligible for a 50 percent (or $500) credit. That is, the couple can make money by contributing one dollar more. Ramnath[19] finds that these notches cause bunching of AGI just below the level at which the credit rate changes, and taxpayers with AGI just below the notch are more likely to contribute to front-loaded plans (which reduce AGI) than others are. This makes little policy sense. With these deficiencies—the complexity of the Saver's Credit, its nonrefundability, and notches in the rate structure—in mind, we see an opportunity for reform.

[19] Shanthi Ramnath, *Responding to the Saver's Credit: Evidence from the Universe of Tax Returns* (Washington, DC: Office of Tax Analysis, U.S. Department of the Treasury, 2011).

Proposal

To make the credit simpler and more rewarding, we propose reforming its structure to create a flat, refundable credit that phases out with income. Furthermore, the credit should act like a matching contribution. That is, it should be deposited directly into savers' accounts rather than delivered in the form of a lower tax liability or a tax refund. The refundable credit rate would stay the same for all eligible income levels, but the maximum contribution to which it applies would phase out as income increases. This maximum eligible contribution would start as under current law ($2,000 per person), but would phase out once income reaches the current income cap less $10,000 for married couples filing jointly (current cap less $5,000 for single filers). We analyze the effects of two credit levels: a 50 percent matching credit and a 6.64 percent matching credit, which would be revenue-neutral over the next 10 years relative to current law.

Discussion

Replacing the Saver's Credit with a 6.64 percent refundable matching credit would be revenue-neutral over the next 10 years relative to current law. The reason this revenue-neutral rate is so low (and lower than any of the rates under the current Saver's Credit) is that the credit is not refundable under current law. Making it refundable will be expensive. Replacing the Saver's Credit with a 50 percent refundable matching credit would cost $112 billion over the next 10 years relative to current law.

The distributional effects of a revenue-neutral credit and a 50 percent credit are shown in tables 4 and 5, respectively. The revenue-neutral credit would reduce tax liabilities for about 8 percent of filers and increase them for 2.9 percent. Tax cuts and tax increases both would be concentrated among second- and middle-quintile earners. There would be essentially no change in average federal tax rate. A 50 percent matching credit would cut taxes for about 10 percent of filers. Fewer than 1 percent of filers would see an increase in their tax liability. The bottom 60 percent would benefit most, and the top 20 percent would see no change in their average federal tax rate.

To obtain a sense of how this might affect take-up and contributions, we turn to a large, randomized field experiment on the effects of explicit matches in retirement saving. The experiment took place in 60 H&R Block offices in the St. Louis metro area in 2005. Clients, who met one-on-one with H&R Block representatives, were offered a match rate of zero, 20, or 50 percent (assigned randomly) for IRA contributions up to $1,000. Of those offered no match, 2.9 percent participated in an "express IRA" (X-IRA). But of those offered a 20 percent and 50 percent match, 7.7 percent and 14 percent participated, respectively. Average contributions for those offered a 20 percent and 50 percent match were around $1,100, compared with $765 for those offered no match. For detailed methodology and results, see Duflo et al.[20]

In contrast, the Saver's Credit offers stronger incentives than the matches from the experiment, so one could reasonably expect it to have stronger effects on take-up and contributions. (Note that a Saver's Credit rate of 50 percent is economically equivalent to a match of 100 percent, a credit rate of 20 percent is equivalent to a match of 25 percent,

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[20] Esther Duflo, William G. Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," *Quarterly Journal of Economics* 121, no. 4 (2006): 1311–46.

Table 4

Replace Current Law Saver's Credit with a Phased-out Revenue-Neutral Saver Credit for Traditional IRA and Employee Retirement Saving Contribution

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]: With Tax Cut: Pct of Tax Units	With Tax Cut: Avg Tax Cut	With Tax Increase: Pct of Tax Units	With Tax Increase: Avg Tax Increase	Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]: Change (% Points)	Average Federal Tax Rate[6]: Under the Proposal
Lowest Quintile	7.0	-58	0.8	255	0.0	11.8	-2	0.0	1.6
Second Quintile	14.5	-89	6.1	156	0.0	16.3	-3	0.0	7.3
Middle Quintile	12.6	-159	5.7	150	0.0	49.6	-12	0.0	14.1
Fourth Quintile	1.9	-297	1.0	179	0.0	13.2	-4	0.0	18.9
Top Quintile	0.6	-391	0.1	236	0.0	6.9	-2	0.0	25.5
All	8.0	-116	2.9	162	0.0	100.0	-5	0.0	20.5
Addendum									
80-90	0.8	-358	0.1	196	0.0	3.8	-2	0.0	22.5
90–95	0.6	-445	0.1	231	0.0	1.9	-2	0.0	24.7
95–99	0.4	-489	0.1	341	0.0	0.9	-1	0.0	25.8
Top 1 Percent	0.6	-332	0.1	811	0.0	0.3	-2	0.0	28.0
Top 0.1 Percent	0.2	-872	0.1	987	0.0	0.0	-1	0.0	30.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Number of AMT taxpayers (millions). Baseline: 31.2. Proposal: 31.2.

* Less than 0.05.

* Insufficient data.

(1) Calendar year. Baseline is current law; proposal would repeal Saver's Credit and introduce up to 6.64 percent matching refundable credit for contributions in traditional IRA accounts and employees' contributions in traditional DC accounts among tax units whose AGIs are below a specified threshold. The AGI thresholds for the full 50 percent credit are $40,000 for married filing jointly, $30,000 for head of household, and $20,000 for single tax units. The Saver's Credit will be phased out completely when AGI reaches $50,000 for married filing jointly, $37,500 for head of household, and $25,000 for single tax units. The dollar amounts are in 2006 dollars and would be indexed by CPI. Employers' contributions in traditional DC accounts are not qualified for these matching credits. http://www.taxpolicycenter.org/T11-0270,

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

Table 5

Replace Current Law Saver's Credit with a Phased-out 50 Percent Saver Credit for Traditional IRA and Employee Retirement Saving Contribution

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]				Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]	
	With Tax Cut		With Tax Increase						
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase				Change (% Points)	Under the Proposal
Lowest Quintile	7.4	-422	0.0	0	0.3	9.5	-31	-0.3	1.3
Second Quintile	19.0	-625	0.8	63	0.5	30.4	-118	-0.5	6.8
Middle Quintile	17.7	-1,120	0.3	85	0.5	45.3	-198	-0.4	13.7
Fourth Quintile	2.7	-2,040	0.2	167	0.1	10.1	-54	-0.1	18.9
Top Quintile	0.7	-3,080	*	**	0.0	3.7	-23	0.0	25.5
All	10.3	-844	0.3	82	0.2	100.0	-87	-0.1	20.3
Addendum									
80-90	0.9	-2,573	*	**	0.0	1.9	-23	0.0	22.5
90–95	0.7	-4,040	*	**	0.0	1.1	-28	0.0	24.7
95–99	0.4	-4,079	0.0	0	0.0	0.5	-16	0.0	25.8
Top 1 Percent	0.7	-2,729	0.0	0	0.0	0.2	-18	0.0	28.0
Top 0.1 Percent	0.3	-7,195	0.0	0	0.0	0.0	-20	0.0	30.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Number of AMT taxpayers (millions). Baseline: 31.2. Proposal: 31.2.

* Less than 0.05.

** Insufficient data.

(1) Calendar year. Baseline is current law; proposal would repeal Saver's Credit and introduce up to 50 percent matching refundable credit for contributions in traditional IRA accounts and employees' contributions in traditional DC accounts among tax units whose AGIs are below a specified threshold. The AGI thresholds for the full 50 percent credit are $40,000 for married filing jointly, $30,000 for head of household, and $20,000 for single tax units. The Saver's Credit will be phased out completely when AGI reaches $50,000 for married filing jointly, $37,500 for head of household, and $25,000 for single tax units. The dollar amounts are in 2006 dollars and would be indexed by CPI. Employer's contributions in traditional DC accounts are not qualified for these matching credits. http://www.taxpolicycenter.org/T11-0270.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

and so on.) To study the Saver's Credit, Duflo et al.[21] use national H&R Block data for the 2005 tax season, including all returns with X-IRA contributions (about 180,000 returns in total) and a 9 percent random sample of other returns (which amounted to about 1,400,000 returns). The authors find that an increase in the Saver's Credit rate from 20 percent to 50 percent (which is equivalent to changing the "match" from 25 percent to 100 percent) raises participation by only 1.33 percentage points and, on average, contributions conditional on take-up by only $81. Compare that to the H&R Block experiment, where increasing the match from 20 percent to 50 percent raised participation by 6 percentage points and contributions conditional on take-up (and inclusive of the match, to be consistent with the Saver's Credit) by $311.

What can explain the difference? One possibility is that taxpayers simply lack information. Among Saver's Credit participants, only 3 percent contributed exactly the credit-maximizing amount. In the experiment, 50 percent contributed the match-maximizing amount. These people, of course, were sitting face-to-face with tax professionals and receiving advice. Ordinary taxpayers desperately need this advice. Among those who could have made money by contributing more and getting the higher Saver's Credit rate (50 percent credit, which equals a 100 percent match), only 6 percent did. Some with AGI just above the 50 percent credit notch even put money in a Roth IRA rather than a traditional vehicle, meaning they failed to reduce their AGI enough to trigger the higher credit rate. These observations point to a need for more financial education, which we discuss later.

A second possibility is that the match-versus-credit presentation affects the efficacy of the Saver's Credit. In the experiment, direct matches increased participation and contributions, and the sizes of those increases were greater than for the Saver's Credit. A match is simple and understandable, even for those with little financial education. If the Saver's Credit's presentation as a credit stymies its effectiveness, then our proposal could increase its potential to raise saving among low-income households. Not only does the proposal boost the financial incentive to save for some households and get rid of kinks in the rate structure, it replaces the credit with a simple, understandable match.

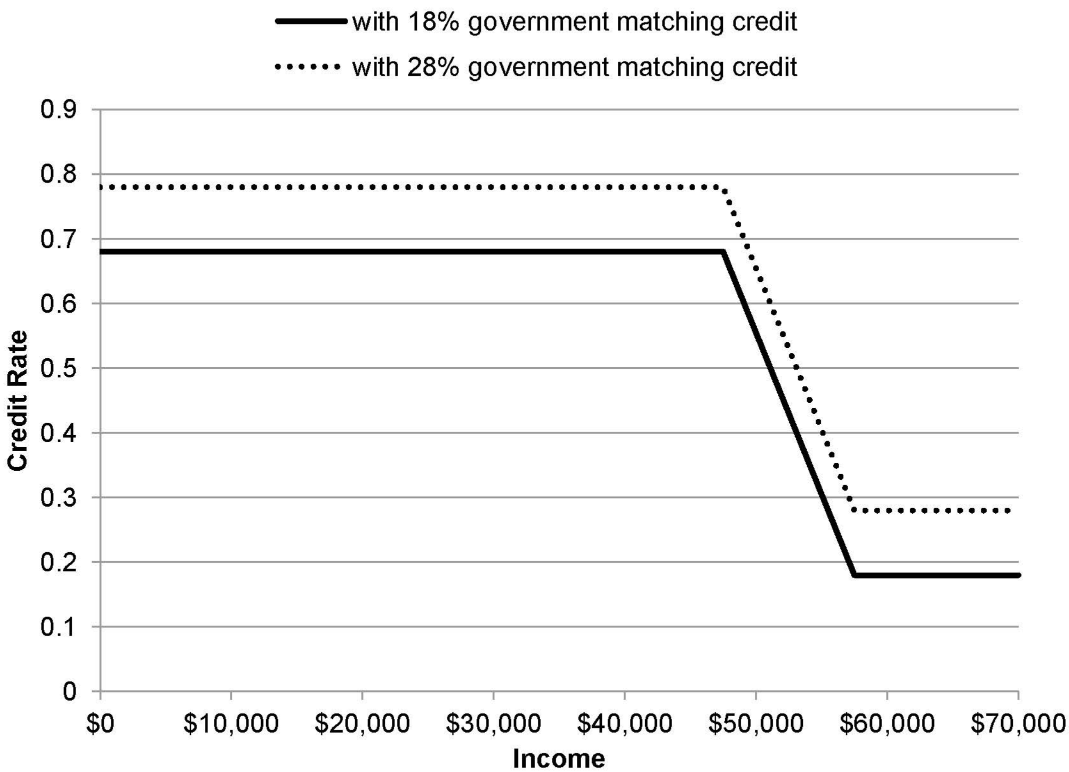
Combining the Two Proposals

We can also combine this reform with the proposal to convert deductions to credits—that is, make the Saver's Credit flat and refundable with a simple phaseout and, on top of that, convert deductions for employee contributions to retirement savings accounts to refundable matching credits. We could, for example, offer a 50 percent refundable Saver's Credit and either an 18 percent or 27.76 percent refundable match. These are the proposals we analyze next. To see how the rate structure would work under a combined proposal for married couples filing jointly, see figure 2.

Combining the Saver's Credit reform and the conversion of income tax deductions to refundable matching credits results in different revenue and distributional estimates. A 27.76 percent refundable matching credit for employee contributions to retirement savings accounts paired with a 50 percent refundable Saver's Credit for low-income households would reduce revenue by about $100 billion over 10 years relative to current

[21] Ibid.

Figure 2
Effective Match Rate on a $1,000 Contribution: Combined Proposal
Married Couples Filing Jointly in 2012



law. An 18 percent refundable matching credit paired with a 50 percent refundable Saver's Credit would raise $160 billion in revenue over the same time frame. The distributional estimates of these two proposals can be found in tables 6 and 7. The first cuts taxes for 26 percent of filers and raises taxes for 5.5 percent. Tax increases are concentrated in the top decile of earners, and the bottom 80 percent receive, on net, a tax reduction. The second proposal cuts taxes for 16 percent of filers but also raises taxes for 16 percent of filers. Tax increases are concentrated in the top 20 percent of earners, and the bottom 60 percent receive, on a net, a tax reduction.

We expect the combined proposal to produce the benefits of each. It will create stronger incentives to save for most households, particularly low- and middle-income households, produce a simpler and more progressive tax system, and raise private and national saving. However, many of the same caveats from the deductions-to-credits proposal apply to the combined proposal. For example, the relative attractiveness of Roth vehicles may increase for some higher-income households.

Table 6

Repeal Traditional IRA and Employee Retirement Saving Contribution Deduction and Saver's Credit and Introduce 27.76 Percent Matching Refundable Credit and, in Addition, Phased-out 50 Percent Saver 's Credit for Traditional IRA and Employee Retirement Saving Contribution

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]				Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]	
	With Tax Cut		With Tax Increase						
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase				Change (% Points)	Under the Proposal
Lowest Quintile	7.7	-545	0.0	0	0.4	10.8	-42	-0.4	1.2
Second Quintile	21.8	-660	0.1	78	0.6	31.6	-144	-0.6	6.7
Middle Quintile	34.4	-716	0.4	180	0.6	47.9	-246	-0.5	13.6
Fourth Quintile	48.0	-295	2.6	135	0.2	22.1	-138	-0.2	18.8
Top Quintile	28.7	-233	35.1	460	-0.1	-13.2	95	0.0	25.5
All	25.8	-488	5.5	429	0.2	100.0	-102	-0.2	20.3
Addendum									
80-90	45.2	-191	19.0	183	0.1	3.7	-52	0.0	22.5
90–95	19.1	-312	49.5	442	-0.1	-5.4	159	0.1	24.8
95–99	5.2	-541	55.0	657	-0.1	-9.3	333	0.1	25.9
Top 1 Percent	4.2	-1,440	47.3	756	0.0	-2.1	297	0.0	28.0
Top 0.1 Percent	3.4	-1,814	42.6	1,227	0.0	-0.3	462	0.0	30.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Number of AMT taxpayers (millions). Baseline: 31.2. Proposal: 32.4.

* Less than 0.05.

** Insufficient data.

(1) Calendar year. Baseline is current law; proposal would repeal retirement saving deduction for traditional IRA and employees' DC contributions and Saver's Credit and introduce 27.76 percent government matching, refundable credit for contributions in traditional IRA accounts and employees' contributions in traditional DC accounts and, in addition, up to 50 percent matching refundable credit for these contributions among tax units whose AGIs are below a specified threshold. The AGI thresholds for the full 50 percent credit are $40,000 for married filing jointly, $30,000 for head of household, and $20,000 for single tax units. The Saver's Credit will be phased out completely when AGI reaches $50,000 for married filing jointly, $37,500 for head of household, and $25,000 for single tax units. The dollar amounts are in 2006 dollars and would be indexed by CPI. Employers' contributions in traditional DC accounts are not qualified for these matching credits. http://www.taxpolicycenter.org/T11-0270.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

Table 7

Repeal Traditional IRA and Employee Retirement Saving Contribution Deduction and Saver's Credit and Introduce 18 Percent Matching Refundable Credit and, in Addition, Phased-out 50 Percent Saver's Credit for Traditional IRA and Employee Retirement Saving Contribution

Current Law Baseline Distribution of Federal Tax Change by Cash Income Percentile, 2012[1]

Cash Income Percentile[2,3]	Tax Units with Tax Increase or Cut[4]				Percent Change in After-Tax Income[5]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[6]	
	With Tax Cut		With Tax Increase						
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase				Change (% Points)	Under the Proposal
Lowest Quintile	7.6	-491	*	**	0.4	-38.6	-38	-0.4	1.2
Second Quintile	20.6	-580	1.3	90	0.5	-103.5	-119	-0.5	6.8
Middle Quintile	28.5	-636	6.4	155	0.4	-132.9	-172	-0.4	13.7
Fourth Quintile	18.6	-275	32.1	265	-0.1	21.7	34	0.0	19.0
Top Quintile	2.0	-1,288	61.9	1,076	-0.3	356.4	641	0.2	25.7
All	15.7	-545	15.7	711	-0.1	100.0	26	0.0	20.5
Addendum									
80-90	2.8	-950	61.4	559	-0.3	88.7	316	0.2	22.8
90–95	1.0	-3,019	67.8	1,157	-0.5	102.5	755	0.4	25.1
95–99	0.9	-1,471	59.2	1,988	-0.5	129.6	1,165	0.3	26.1
Top 1 Percent	2.0	-1,720	49.6	2,615	-0.1	35.6	1,264	0.1	28.0
Top 0.1 Percent	2.5	-1,244	43.5	3,207	0.0	3.9	1,366	0.0	30.4

Number of AMT taxpayers (millions). Baseline: 31.2. Proposal: 32.4.

* Less than 0.05.

** Insufficient data.

(1) Calendar year. Baseline is current law; proposal would repeal retirement saving deduction for traditional IRA and employees' DC contributions and traditional DC accounts are not qualified for these matching credits. http://www.taxpolicycenter.org/T11-0270.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2011 dollars) 20%, $16,812; 40%, $33,542; 60%, $59,486; 80%, $103,465; 90%, $163,173; 95%, $210,998; 99%, $532,613; 99.9%, $2,178,886.

(4) Includes both filing and nonfiling units but excludes those that are dependents of other tax units.

(5) After-tax income is cash income less individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

Strengthen the Infrastructure for Saving

Proposal 5: Federal Backup Insurance for Annuity Products

As more and more Americans reach retirement with only the assets in a DC plan to add to their Social Security benefits, an increasing proportion of retirees will depend on private-sector life annuities for their income. This is a trend that should be encouraged, as it is extremely difficult for individuals to use phased withdrawals from a lump sum without exposing themselves and their families to a substantial risk that they will run out of money late in life.

However, as the use of life annuities increases, the failure or even near-failure of a major annuity provider could shake confidence in the safety of annuities enough to discourage their use. Currently, annuities (and other types of insurance products) are regulated by states and protected up to a set level by the state guaranty fund system.[22] When a loss is sustained, most state guaranty funds raise money by assessing companies that do business in the state, usually in proportion to their market share in that state for the specific product. These funds guarantee the present value of individual annuity contracts with limits ranging from $100,000 (23 states) to $500,000 (2 states). Individual consumers are also subject to an overall payout cap for all policies from one company that ranges from $300,000 to $500,000.

Associations that represent the state guaranty funds have run “stress tests” on the funds to see whether they would be able to meet their full obligations in the event of the failure of one or more major providers. The test results were reassuring, but the ability of state guaranty funds to meet such a challenge has not been tested in practice. Stress tests, while valuable, can never fully anticipate a major financial crisis, especially when the financial effects may be exacerbated by the near panic of consumers.

Annuity providers weathered the 2008 financial crisis, but that does not guarantee they would all survive some subsequent crisis that is at least as serious. In the event of such a financial crisis, one or more major providers could fail or be on the brink of failure. This situation, along with the ensuing publicity, could produce a major reaction among retirees who depend on annuity payments.

Even if state guaranty funds can meet their full legal obligations, there may still be a crisis of confidence because their limits on life annuity contracts may prove to be too low. Although the existing limits appear adequate in the current market, where the use of annuities is very limited, as more and more people depend on them for a significant proportion of their retirement income, those limits may prove to be far too low. Companies covered by state guaranty funds also suffer because of a ban on publicizing that protection, unlike bank and credit unions, where Federal Deposit Insurance Corporation (FDIC) and National Credit Union Share Insurance Fund coverage is widely publicized.

[22] State guaranty funds are privately organized entities that all insurance companies offering certain lines of business are required to join as a condition of doing business in the state. Despite their name, almost all state guaranty funds do not actually have assets. Instead, they are funded after losses have occurred by an assessment on the remaining companies that offer that line of business in the state.

Currently, the McCarran-Fergusson Act of 1945 enables states to regulate annuities and other traditional insurance products. There is no federal regulation of these products, although federal agencies have attempted to regulate some specialized types of annuities that come close to securities products.

Proposal

To protect against the threat of annuity market failure, we propose federal backup insurance for life annuities and similar products. Such protection, thoughtfully developed well before any potential crisis, would be far preferable to a solution developed after a crisis. Backup protection could take several forms, including (1) FDIC-type insurance that replaces state guaranty fund coverage for annuity-type products only, (2) supplemental insurance above the amount offered by state guaranty funds coupled with a federal line of credit to state guaranty funds, again to protect annuity-type products only, or simply (3) a federal line of credit available to state guaranty funds. In all cases, the added federal security would apply only to life annuities and similar products. All other types of insurance products would remain under the existing state guaranty funds.

An FDIC-type insurance would replace the coverage of annuity-like products by state guaranty funds with a federal program that covers all annuity contracts up to a uniform national level. This national coverage level would eliminate the confusion that might result if a major annuity provider failed and protection of contract owners varied significantly depending on which state had the responsibility to cover the contract.

This new program could either be part of a new agency, be part of the Treasury Department, or be handled by another existing federal entity. It would not be like the Pension Benefit Guaranty Corporation, which takes over assets of failed pension funds and makes the payments itself up to a set maximum monthly benefit. Instead, the annuity program would use private-sector providers and pay the difference between the purchase price of an annuity contract of the same amount for the remaining lifetime of the annuitant and the amount of that purchase price that can be financed from the remaining assets of the failed insurance company. Funds to cover losses would come from a regular small assessment on insured annuity contracts, with access to a backup federal line of credit if those assets proved to be insufficient. Providers would be subject to both asset quality standards and regular examinations, but all other insurance lines would remain under the control of state regulators and be protected by state guaranty funds.[23]

The second possible structure, supplementary insurance and a federal line of credit, would provide all consumers with a uniform national coverage level in addition to that provided by state guaranty funds. Under this option, all annuity contracts, regardless of where they are issued, would be insured to the same level, which would be higher than that of almost all state guaranty funds. While the supplementary amount would vary from state to state unless they decide to harmonize, states would be responsible for the same level of

[23] The statute creating the backup insurance plan would enable the appropriate federal agency to set and review asset quality standards and to require insurance up to a set level if necessary. Since this federal backup would only apply to certain types of annuity contracts, and not to any other insurance lines of business, this is not a repeal of McCarran-Fergusson, but a necessary supplement to one specific insurance product. The program could also be structured so that participation by insurance companies is voluntary, although nonparticipating companies would be required to provide notice that their products do not come under the federal guarantee.

coverage that is currently in place for their state guaranty funds. The supplementary insurance would be paid for with risk-based premiums based on assets underlying the contracts and special features, such as specific guarantees that might increase the potential for loss, assessed on companies that offer annuity contracts in the state.

In addition, the federal entity would provide a line of credit to state guaranty funds to ensure that they have enough assets available in the event of a major annuity market disruption. That federal entity would probably be part of the Treasury Department, but it could also reside in another agency. Companies issuing annuity contracts would be subject to asset quality standards and required capital levels, which could be checked during examinations by the state regulator. Individual state guaranty funds would also be subject to certain federal standards. States would remain the primary insurance regulators, and all other lines of insurance would still be covered by state guaranty funds only.

A third, even less invasive idea for improved annuity protection would be a simple federal line of credit available to state guaranty funds. This would be a safety net for the funds, ensuring that they have adequate resources in the event of a major market disruption. The line of credit would cover annuity contracts only and have no effect on the maximum amount of coverage each state guaranty fund offers. States would remain in total control of insurance regulation, but the guaranty funds would have to meet federal standards to qualify for the line of credit.

Under all three versions of the proposal, there would be no limitations on publicizing coverage, as there currently are for the state guaranty funds. Secret insurance does no one any good.

Discussion

Federal insurance for annuities would protect retirees who depend on private-sector annuities for their income. Not only would the insurance cover annuity contracts up to a certain maximum in the event of a major market disruption, it would also instill confidence in the safety of annuity products, and therefore help to limit the effect of such a disruption To prevent states from responding to the supplemental insurance contained in the second version of this proposal by reducing their own coverage, lawmakers should explicitly prohibit such a move. In addition, to ensure that the federal insurance for annuity contracts does not provide an incentive for providers to engage in excessively risky behavior, the regular examinations would be structured to explicitly seek out such practices and enable the regulator to take steps to eliminate them.

Finally, some have charged that raising the limit on coverage would help to protect wealthier households but do little to help low- and middle-income annuity owners, who are unlikely to own annuity contracts above current coverage limits. As workers of all income levels save for retirement for their entire careers, they will amass sufficient savings to purchase larger annuity contracts than they do today. Basing coverage on today's experience would be a serious error. Depending on the age of the covered individual, some of the existing state guaranty fund coverage limits may fall well below the size of annuity contracts used by even moderate-income retirees.

Which of the three versions of the proposal is actually implemented is up to legislators, but all three should be seriously considered after a thorough and rigorous study of the state guaranty funds. Although some industry and state regulatory spokespersons may dismiss the entire idea, they should remember that not so long ago, respected professionals declared many DB pension plans in both the private and public sectors to be completely safe.

Proposal 6: Expand the Employer Tax Credit

Employers have a critical role to play in advancing retirement security. For most workers, their place of employment is the first point of contact for all things retirement. This role has little to do with what type of retirement plan or pension the employer offers. Even as DB plans become scarcer, employers will remain central to assisting their employees to build retirement security. From deducting payroll taxes for Social Security to sponsoring 401(k)-type retirement savings plans to simply providing information about retirement saving options, employers can help their employees understand the importance of early saving.

Unfortunately, many smaller employers still do not offer their employees these vital services, in part because the cost of some retirement plans can place additional pressure on an employer's already tight finances. Currently, employers that sponsor a new 401(k) plan receive a $500 per year tax credit for three years. Proposals for an Automatic IRA[24] (Auto IRA) include a similar credit of $250 per year for two years. We think that these incentives can—and should—be increased.

Proposal

We propose an increase in the tax credit for new plans and a further incentive that recognizes the costs of adding an employee to an existing payroll deduction retirement savings plan. Lawmakers should expand the tax credit for new 401(k) plans to $1,500 per year for three years. This is similar to the increase to $1,000 per year proposed by President Obama. For new Auto IRA plans, we propose a tax credit of $1,000 per year for two years. Furthermore, lawmakers should add a new permanent tax credit of $25 per year for two years for each new employee enrolled in any type of payroll deduction 401(k)-type plan. This would apply to both new hires and current employees who are newly enrolled.

Discussion

Expanding the employer tax credit will encourage employers both to start a new 401(k)-type plan or Auto IRA and to expand participation in existing plans. The higher new plan credit will help allay employers' cost concerns, and the new participant credit will offset the cost of adding an employee to the plan and setting up the payroll deduction. This improved tax deduction would also respond to complaints that the Auto IRA could be costly to smaller employers.

Make Private Information Easier to Access

Proposal 7: Use Tax Information to Consolidate Retirement Accounts

Today, millions of Americans have more than one retirement savings account. While some have additional accounts because of a conscious decision, most accounts come from past jobs where the account owners failed to roll the money into accounts sponsored by their current employers. Many of these accounts are "orphaned" because the account

[24] Auto IRA proposals extend automatic features available to 401(k)-eligible workers to individual retirement accounts. For more on the Auto IRA, see Iwry and John (2009).

administrator does not have current information about the owner's address, and many of these accounts are consumed by administrative fees, leaving nothing for the saver's retirement.[25]

This is not an inevitable side effect of the existing retirement savings system. Account owners can consolidate most types of retirement savings accounts, but many do not. Few know the procedure, and many lack the needed information, such as the current address or contact information of a former employer. Moreover, employers may go out of business, and former employees may not know who administers their accounts or how to recover them. These "orphaned" accounts hurt both employees and employers. Some employers send the accounts to custodians that try to trace the account owner, but custodians often impose annual fees that can consume the entire balance. Even when employers retain accounts and employees can find them, owners may pay more in fees than if their accounts were consolidated. We propose a simple reform to make saving easier and minimize the losses associated with lost or duplicate accounts. At the same time, we recognize that some account holders want to have more than one account, and our proposal would allow them to continue to do so.

Proposal

When an individual files a 1040 or other tax form with a current address, the Internal Revenue Service (IRS) should use a computerized check to see whether the individual's SSN is associated with more than one tax-preferred retirement savings account. Information from past employers is already available to the IRS. Rolling 401(k) balances into an IRA after an employee leaves triggers an annual IRA Form 5498 that lists fair market value plus any contributions or withdrawals. For money that remains in 401(k) accounts, the details of former employees are found on Form 8955 SSA in the year they leave the employer. Both forms include information on the account owners that could be used to provide the information needed for such a cross-check. Individuals indentified as having more than one tax-favored account would receive a letter detailing the number of accounts they own, the value of consolidating accounts, and the process they could use to consolidate. The letter would also include a method that would allow the account owner to access account numbers, names and addresses of custodians, and a copy of the form to use for consolidation. Taxpayers who wish to retain several accounts could notify the IRS, perhaps online or using a simple form, that they do not wish either to consolidate accounts or to be reminded in the future.

Discussion

This measure would help to reduce the number of "orphaned" accounts and the cost they pose to employees and employers. It will simplify tax-preferred retirement saving by creating an efficient and reliable way to consolidate accounts. The proposal could even go one step further. A taxpayer who does not respond to the initial notification could be notified about the multiple accounts again, but this time told that the accounts will be consolidated unless the taxpayer directs otherwise. If the taxpayer does not respond to this second notification, the IRS would send forms to providers directing them to transfer

[25] Again, some have multiple retirement accounts because of a conscious decision. Account owners may choose to not roll over their account to a new employer because they prefer terms or investment options under their current employer.

balances to the currently active account. The taxpayer would still be able to specify if certain accounts should not be consolidated. This would add to the efficiency and reliability of the reform by making the process nearly automatic, while still preserving taxpayer choice and control.

Proposal 8: Combine Social Security and 401(k) Statements

To make better decisions about how much to save for retirement and to have realistic expectations as they approach retirement, individuals must have better information. All too often, retirement savers are blinded by the aggregate amount of their savings and fail to understand how that figure translates into a monthly income stream. In addition, employees need to have an idea about what level of Social Security benefits they will receive and combine them with their retirement account in order to have an idea of their full retirement resources. Fortunately, simple steps can go a long way to providing this information.

Currently, 401(k) and IRA statements inform accounts owners of their balances at regular intervals. In the near future, the Department of Labor will require 401(k) statements to include the annuitized value of those balances at least once annually. Until recently, the Social Security Administration (SSA) issued annual Social Security statements that showed participants an estimate of their benefit levels, but the agency has suspended that practice, citing its cost. Combining the information on retirement savings with that formerly provided by SSA would help individuals prepare for retirement.

Proposal

We propose that retirement savings account providers give combined estimates of account owners' Social Security benefits, using information provided by SSA, and the annuitized value of retirement savings balances annually on either an annual statement in the case of IRAs or on the 401(k) quarterly statement issued closest to the account owner's birthday. Distribution of the information would be paid for by the 401(k) administrator, just as quarterly statements are now, but SSA could pay the cost of providing the additional benefit information. To address privacy concerns, initially individuals could opt into receiving SSA data on their 401(k) statement using a paper or online form. Eventually, however, it could be provided using an opt-out system.

Discussion

Some 401(k) providers already simulate Social Security benefits and provide this information to account owners, but these providers lack the income and work history data to make a truly accurate projection. We propose collaboration between SSA and 401(k) plan administrators that would add information formerly included in the annual Social Security statements to one 401(k) quarterly report each year. This statement would also include a measure of the annuitized value of existing 401(k) balances as well as projections using certain scenarios.

Two sets of concerns about using Social Security information would need to be addressed: concerns about privacy and concerns about accuracy. Previous discussions of this proposal have failed because of privacy concerns, as many individuals do not want employers to have access to their Social Security information. Account holders' privacy is a concern for 401(k) providers too, and providers go to great lengths to protect the confidential data in the quarterly statements. To assuage concerns about the data from SSA, Social Security data could be provided to 401(k) administrators and included on an annual 401(k) statement only if the administrators meet certain SSA-developed privacy standards. Individuals would have control over this decision through the ability to opt in to the service or to opt out, if the service were automatic. This should preserve individual choice and satisfy persons especially concerned about privacy.

To ensure accuracy and consistency, annuitized balances in the 401(k) and SSA projections would need to be produced using compatible methodologies that allow the projected monthly income estimates to be combined for a complete picture of estimated retirement income. These statements would be more useful if they included projected Social Security benefits plus both (1) current balances annuitized with payouts beginning at age 65 and (2) projections of future balances if the account owner continues to save at the current level or changes the percentage of salary saved.

We believe this reform will give people important information about how to plan their futures. They desperately need this information, and providing it should be fairly simple and cost-effective.

Proposal 9: Create a Central Website to Connect Employers and Retirement Savings Plan Providers

Employers who wish to start a retirement savings plan for their employees must find a plan administrator. Employers who already have a provider may wish to compare its services and charges with those of other providers.

While service providers tend to market aggressively to larger employers, many employers must seek an administrator themselves. There is an active market for providing these services to smaller employers, but the employers often lack the information necessary to compare the fees and levels of service different providers offer. Although pending Department of Labor regulations will require more disclosure of fees charged to employers, there is no mechanism to allow employers to compare one provider's fees with another's.

The enactment of the Auto IRA or a similar proposal that requires employers to offer some type of retirement savings account to their employees will make this situation even more serious. As small businesses seek to comply with these requirements, they will need to identify potential providers and compare their products and services. We want to make this process as simple and easy as possible for employers.

Proposal

We propose the creation of central websites where employers can "shop" for providers of retirement savings plan services. We expect that several websites would be established, one for each different type of retirement savings plan or account. In addition, employers would get added value from a website that assisted them to objectively compare the different types of retirement savings vehicles and decide which is best for them.

These websites would supplement existing marketing channels, not replace them. Employers would enter basic information about their industry, location, number of employees, payroll, and other characteristics, and the website would return all providers interested in serving them as well as a uniform presentation of services and fees so the employer can easily compare them. For instance, the website for the Auto IRA, which is expected to be limited to three types of accounts that would be common to all providers and a simplified level of services, would focus on fees, while that for 401(k) plans would include information on investment options and other services as well as fees. Information on fees could be presented using a thermometer graphic showing for each service or investment the amount charged by the highest- and lowest-cost providers at the top and bottom, with the fee charged by a specific provider indicated by an arrow showing where on the continuum it falls. A similar graphic could show the total cost of the services being offered.

Once an employer selects a provider, the site would make it possible to connect with the provider and open the relationship on the spot. Another optional feature might be a link that would randomly assign an employer who is having trouble deciding to a provider that has agreed to accept business from such employers.

Discussion

Listing on the websites would be controlled by a site sponsor, but based on objective criteria. The business model would be similar to a travel website, such as kayak.com, that simply agglomerates and presents seller information. The sponsor need not be a government agency. It could be a private entity, an association, or some sort of public-private partnership. Whoever the sponsor(s) are, they should aim to make as many low-cost options as possible available to employers. Again, the website is intended to supplement, not replace, direct sales. We expect that many plan administrators would both participate in the website and continue to sell directly. And of course, a provider could choose not to be listed on the website and continue to use its existing marketing methods.

This proposal should make finding and selecting retirement savings account providers simpler and more efficient. In particular, it should ease the burden on small employers, who may soon be urged or required to offer retirement savings accounts to their employees.

IMPROVE PUBLIC EDUCATION FOR SAVING

Proposal 10: Create a Public Information Campaign to Raise Financial Literacy

Numerous studies have documented that a significant proportion of Americans have limited financial knowledge.[26] A recent study found that households correctly answered, on average, just three out of five questions on basic financial topics.[27] Women, African

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[26] See, e.g., B. Douglas Bernheim, "Do Households Appreciate Their Financial Vulnerabilities? An Analysis of Actions, Perceptions, and Public Policy," *Tax Policy and Economic Growth in the 1990s* (Washington, DC: American Council for Capital Formation, 1995); B. Douglas Bernheim, "Financial Illiteracy, Education, and Retirement Saving," in *Living with Defined Contribution Pensions*, ed. Olivia S. Mitchell and Sylvester J. Schieber (Philadelphia, PA: University of Pennsylvania Press, 1998); Marianne A. Hilgert and Jeanne M. Hogarth, "Household Financial Management: The Connection between Knowledge and Behavior," *Federal Reserve Bulletin* (July 2003), http://www.federalreserve.gov/pubs/bulletin/2003/0703lead.pdf.

[27] The study asked financial questions identical to those posed in Annamaria Lusardi and Olivia S. Mitchell, *Financial Literacy and Planning: Implications for Retirement Wellbeing*, Pension Research Council Working Paper 1 (Philadelphia, PA: Pension Research Council, 2006) .Lusardi and Mitchell (2006), discussed in this section, plus one question on the relationship between bond prices and bond yields, and another question about accumulated mortgage interest. Respondents on average answered 2.99 questions correctly, answered 0.73 questions incorrectly, and refused to answer 1.21 questions

Americans, Hispanics, less-educated individuals, and both the young (those in their 20s) and the old (retirees and near retirees) are consistently less likely to answer questions about basic financial topics correctly than members of other demographic groups.[28]

We define financial literacy as the ability to make informed judgments and effective decisions regarding the use and management of money and wealth, including not only knowledge of personal finance but also the ability and discipline to implement intended or desired saving behavior.[29]

Although the connection between financial illiteracy and financial mistakes may appear obvious, it is worth highlighting some of the abundant evidence relating the two. A variety of studies employing differing measures and definitions of financial literacy have found that households or individuals who are less financially literate are also less likely to own a checking account, maintain an emergency fund, own a retirement plan, or hold stocks.[30] Such individuals are more likely to take payday loans, pay only the minimum balance on a credit card, take on high-cost mortgages, have higher debt levels, and be delinquent on debt.[31] Bucks and Pence[32] show that homeowners with low incomes and less education often do not understand the terms of their mortgages, especially

[28] Sumit Agarwal, John C. Driscoll, Xavier Gabaix, and David Laibson, "The Age of Reason: Financial Decisions over the Life-Cycle with Implications for Regulation," *Brookings Papers on Economic Activity* (Fall 2009); Lusardi and Mitchell, *Financial Literacy and Planning*; Annamaria Lusardi and Olivia S. Mitchell, "Planning and Financial Literacy: How do Women Fare?" *American Economic Review: Papers and Proceedings* 98, no. 2 (2008): 413–7; Annamaria Lusardi and Olivia S. Mitchell, "Financial Literacy, Retirement Planning, and Retirement Wellbeing: Lessons and Research Gaps," prepared for the RSP Conference on Financial Literacy, Washington, DC, 2009; Annamaria Lusardi and Olivia S. Mitchell, *How Ordinary Consumers Make Complex Economic Decisions: Financial Literacy and Retirement Readiness*, NBER Working Paper 15350 (Cambridge, MA: National Bureau of Economic Research, 2009); Annamaria Lusardi, Olivia S. Mitchell, and Vilsa Curto, *Financial Literacy Among the Young: Evidence and Implications for Consumer Policy*, NBER Working Paper 15352 (Cambridge, MA: National Bureau of Economic Research, 2010).

[29] Our intent is to provide a concrete and broad definition of a term we use throughout the paper. We offer this definition of financial literacy as a plausible working definition, not as a means of redefining or somehow narrowing the topic. Other commonly used definitions of financial literacy focus on similar themes and would likely generate comparable conclusions.

[30] Dimitris Christelis, Tullio Jappelli, and Mario Padula, *Cognitive Abilities and Portfolio Choice*, Economics Working Paper No. 19/WP/2008 (Venice, Italy: University of Venice, 2008); Hilgert and Hogarth, "Household Financial Management"; Maarten Van Rooij, Annamaria Lusardi, and Rob Alessie, *Financial Literacy and Stock Market Participation*, NBER Working Paper 13565 (Cambridge, MA: National Bureau of Economic Research, 2007).

[31] Kristopher Gerardi, Lorenz Goette, and Stephan Meier, *Financial Literacy and Subprime Mortgage Delinquency: Evidence from a Survey Matched to Administrative Data*, Federal Reserve Bank of Atlanta Working Paper Series No. 2010-10 (Atlanta, GA: Federal Reserve Bank of Atlanta, 2010); Annamaria Lusardi and Peter Tufano, *Debt Literacy, Financial Experience and Overindebtedness*, NBER Working Paper No. 14808 (Cambridge, MA: National Bureau of Economic Research, March 2009), http://www.nber.org/papers/w14808; Danna Moore, *Survey of Financial Literacy in Washington State: Knowledge, Behavior, Attitudes and Experiences* (Olympia, WA: Washington State Department of Financial Institutions, 2003); Victor Stango and Jonathan Zinman, *Debit or Credit: How People Choose to Pay*, Research Monograph (Madison, WI: Filene Research Institute, 2008).

[32] Brian Bucks and Karen Pence, *Do Homeowners Know Their House Values and Mortgage Terms* (Washington, DC: Federal Reserve Board of Governors, 2006).

adjustable-rate mortgages. Campbell[33] shows that three major financial mistakes—underparticipation in financial markets, lack of diversification, and poor choices in mortgage contracts—tend to be concentrated in low-income, low-education, minority groups.

Just as less financial literacy appears to lead households to poorer choices and financial outcomes, there is some evidence that financial planning—which, while not exactly the opposite of financial illiteracy, would nevertheless appear to require the acquisition of at least some financial information—can lead households to better financial outcomes and more wealth accumulation. Recent evidence shows that only 42 percent of workers have *ever* calculated the necessary resources to live comfortably in retirement.[34] Numerous studies have shown a positive correlation between planning and wealth accumulation.[35] The key question, of course, is whether the relationship between planning and wealth accumulation is causal. The primary challenge is that individuals with high levels of wealth are more likely to engage in planning than individuals with less wealth. The most credible evidence on this question is provided by Ameriks, Caplin, and Leahy,[36] who use specially constructed questions to generate a measure of a household's (otherwise normally unobserved) propensity to plan in general (e.g., for vacations) and show that that measure has an independent and large impact on wealth accumulation.[37]

[33] John Campbell, *Household Finance*, NBER Working Paper 12149 (Cambridge, MA: National Bureau of Economic Research, 2006).

[34] EBRI, The 2011 Retirement Confidence Survey: Confidence Drops to Record Lows, Reflecting "the New Normal." EBRI Issue Brief 355 (Washington, DC: Employee Benefits Research Institute, 2011).

[35] For U.S. households, see Annamaria Lusardi, "Information, Expectations, and Savings for Retirement," in *Behavioral Dimensions of Retirement Economics*, ed. Henry Aaron (Washington, DC: Brookings Institution Press and Russell Sage Foundation, 1999); John Ameriks, Andrew Caplin, and John Leahy, "Wealth Accumulation and the Propensity to Plan," *Quarterly Journal of Economics* 118, no. 3 (2003): 1007–46; Annamaria Lusardi and Jason Beeler, *Savings Between Cohorts: The Role of Planning*, Michigan Retirement Research Center Working Paper (Ann Arbor, MI: Michigan Retirement Research Center, 2006); and Annamaria Lusardi, *Planning and Saving for Retirement*, Dartmouth College Working Paper (Hanover, NH: Dartmouth College, 2003). Justine S. Hastings and Olivia S. Mitchell, *How Financial Literacy and Impatience Shape Retirement Wealth and Investment Behaviors*, NBER Working Paper 16740 (Cambridge, MA: National Bureau of Economic Research, 2011) obtain similar results for Chilean households.

[36] Ameriks, Caplin, and Leahy, "Wealth Accumulation and the Propensity to Plan."

[37] Annamaria Lusardi and Jason Beeler, *Savings Between Cohorts: The Role of Planning*, Michigan Retirement Research Center Working Paper (Ann Arbor, MI: Michigan Retirement Research Center, 2006) provide a different approach, estimating that reverse causality—higher wealth affecting planning—does not occur. To test this hypothesis, they use changes in regional house prices to measure the effect of accumulated wealth in the propensity to plan. Changes in regional house prices serve as an appropriate measure of exogenous changes in wealth, since they are unlikely to affect unobserved planning preferences. However, households may view such changes as temporary, and households may respond differently, in terms of planning, to changes in other kinds of wealth—for example, an inheritance. Lusardi, *Planning and Saving for Retirement*, uses information on respondents' siblings as an instrumental variable for the degree of planning and finds a significant impact of planning on wealth The validity of this approach, however, depends on whether the instrument is uncorrelated with tastes for saving and influence saving only through the planning variable.

Financial literacy has implications not only for individual welfare and saving behavior, but also for the nature of products offered in financial markets. For example, less financially literate households may subsidize financial products for more sophisticated investors. Woodward[38] shows that college-educated borrowers (who are more likely to be financially literate) pay an average of $1,500 less in broker fees at time of mortgage origination than borrowers with only a high school education. Campbell[39] speculates that this cross-subsidy may reduce the pace of innovation in financial products, since financially sophisticated households may prefer receiving the cross-subsidy over newer financial products.

The evidence from prior studies is also relevant to recent economic events. The finding that financial literacy is connected to behavior associated with the causes of the housing crisis—such as high-cost mortgages, excessive debt, and debt delinquency—indicates that poor financial literacy may have contributed to the severity of the recent downturn. Also, concern over low literacy rates among low-income individuals and minorities is heightened during an economic recession, as households with these characteristics are more likely to experience unemployment and other economic hardships.

The low levels of financial literacy among many American adults offer the possibility that raising financial literacy rates could help raise personal saving and improve financial and economic security in retirement.[40]

Proposal

One way to address gaps in the public's financial knowledge is through a mass media public information campaign designed to raise financial literacy. The campaign would need to be coupled with, and direct people to, an online site for financial information, to exploit the massive growth in online financial activity and information. Blanton[41] notes that in recent years, these sites have exploded in number. Blanton reports the existence of more than 4,000 personal finance websites.

The campaign should focus on the benefits of developing and implementing a financial plan, both because that is a direct action, which makes the campaign more likely to be successful than if the message is more diffuse (as discussed below), and because of the evidence, discussed above, that financial planning can help raise people's wealth accumulation.

Discussion

Efforts to improve financial literacy are now supported by a wide array of organizations, including private employers; federal, state, and local government agencies; commercial banks; consumer groups; community service organizations; and religious

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38 Susan E. Woodward, *Consumer Confusion in the Mortgage Market*, Working Paper (Palo Alto, CA: Sand Hill Econometrics, 2003).

39 Campbell, Household Finance.

40 Lusardi, Household Saving Behavior; Lusardi, Financial Literacy.

41 Kimberly Blanton, *Financial Literacy on the Web* (Boston, MA: Financial Security Project, Boston College, 2011).

organizations. Nevertheless, previous analyses of financial education on household saving generated mixed results and often were subject to a variety of potential concerns, notably the difficult task of disentangling the effects of a policy from the actions that a household would have taken in the policy's absence. This concern is not a narrow statistical issue; indeed, it is central to assessing what has been learned about the impact of financial literacy on saving. As one example, nonexperimental research often suggests that, among households in the lower end of the saving and wealth distribution, workplace financial education has helped raised retirement plan participation, contributions, and overall household saving. In contrast, the limited experimental evidence, which resolves some of the key problems in nonexperimental data, suggests smaller effects of workplace financial education on saving.

Well-known American public information campaigns have targeted behaviors such as smoking, sexual practices, diet, drug use, littering, and seat belt use. Public campaigns have even targeted saving behavior. During World War II, government agencies encouraged households to buy U.S. Saving Bonds. Likewise, Japan conducted a widespread campaign to raise saving in the 1950s and 1960s.[42] More recently, the Choose to Save Campaign was launched in the Washington, D.C., area in 1998. The campaign used a multidimensional approach toward saving promotion, including public service announcements on radio and TV, signs on local buses and subways, and a "Saving Game" designed to increase knowledge of saving-related topics.[43]

In 2003 through 2006, Ireland initiated a National Pension Awareness Campaign that sought to promote both better pension coverage among workers uncovered by a pension and more saving among covered workers. The campaign targeted workers aged 25 through 39, women, young graduates and job-seekers, and rural workers.[44] The campaign's primary strategy was to use an extensive advertising campaign to direct the targeted population to seek more information about pensions from either an employer, a financial institution, or a public website on pension information (http://www.pensionsboard.ie); the website included an online calculator that recommended a target pension contribution based on gender, current age, income, asset, and retirement age characteristics.

Multiple studies investigate efforts to change mass behavior and contain important lessons for a campaign to promote financial literacy. First, as with online financial decision tools, a key issue is the credibility of the source of information.[45] Because most information households receive currently comes from the financial sector, a campaign might emphasize independently provided information.

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[42] B. Douglas Bernheim, *The Vanishing Nest Egg: Reflections on Saving in America*, A Twentieth Century Fund Paper (New York, NY, Priority Press, 1991).

[43] Selected aspects of the campaign are available on the website www.choosetosave.org, including links to a retirement planning calculator (Ballpark E$timate), a longevity calculator, a payroll deduction calculator, and a retirement personality profiler quiz. Public service announcements and educational saving brochures are also available.

[44] Organisation for Economic Co-operation and Development, "OECD Conference on Financial Education" (2006), http://www.oecd.org/dataoecd/31/2/37396801.pdf.

[45] Leslie B. Snyder, "Health Communication Campaigns and Their Impact on Behavior," *Journal of Nutritional and Educational Behavior* 39 (2007): S32–S40.

A second key lesson is the importance of reaching the targeted audience. Hathaway and Khatiwada [46] find that the level of targeting is an important element of campaigns. One of the key public health campaigns of the past 50 years focused on smoking behavior. The "truth" campaign, designed by the Florida Department of Health, is often lauded as one of the most successful public health information campaigns.[47] It began as one of the first large-budget campaigns: Rather than using donated airtime that would reach fewer people, the organizers of the campaign purchased prime-time advertising spots. The increased effectiveness of such an approach demonstrates the importance of reaching the targeted audience.

Campaigns appear to be more successful when they subdivide the population into relatively homogenous groups and provide a tailored message for each group.[48] An alternative is to provide the same message to all members of a much larger group. This may economize on costs but dilute the power of the message for many people. One of the advantages of online efforts is that both the universal message and the specially focused message can be conveyed less expensively than in a traditional campaign. As a result, an online presence would likely be an integral part of a campaign. For example, one of the main goals of any written material or public messages would be to direct people to the appropriate website, where they could find comprehensive, credible information.

The literature also emphasizes the importance of messages that are frequent, provided at a time when people are ready to listen, and supported by other "messages" that society provides.[49] Interestingly, campaigns that are considered more controversial appear to be more effective.[50] Those that emphasize the novelty of information are more effective as well.[51] This raises the point that the message of a financial literacy campaign may optimally evolve over time, from the basic points that need to be made at the beginning about the need for saving, to teaching people how and where to save, to focusing on portfolio choices.

There are also substantial challenges to be met and caveats to be addressed with respect to the ability of campaigns to influence saving behavior. First, there is a dearth of evidence on the ability of public campaigns to influence financial decisions. In addition, a problem with drawing corollaries between previous public information campaigns and financial education is that the bottom line message for financial literacy is both more complex and less clear. The goals of many other public information campaigns have been quite straightforward—for example, stop smoking, buy bonds, wear seat belts. In contrast, the goal of a financial literacy campaign may be complex and not lend itself to a

[46] Ian Hathaway and Sameer Khatiwada, *Do Financial Education Programs Work?* The Federal Reserve Bank of Cleveland Working Paper 08-03 (Cleveland, OH: Federal Reserve Bank of Cleveland, 2008).

[47] Lorien C. Abroms and Edward W. Maibach, "The Effectiveness of Mass Communication to Change Public Behavior," *Annual Review of Public Health* 29 (2008): 219–34.

[48] Snyder, "Health Communication Campaigns and Their Impact on Behavior."

[49] Michael Siegel, "Mass Media Antismoking Campaigns: A Powerful Tool for Health Promotion," *Annals of Internal Medicine* 129, no. 2 (1998): 128–32; Snyder, "Health Communication Campaigns and Their Impact on Behavior."

[50] Siegal, "Mass Media Antismoking Campaigns."

[51] Abroms and Maibach, "The Effectiveness of Mass Communication to Change Public Behavior."

simple "sound bite." This may be one reason why "planning," as noted above, could be an effective campaign focus—it is a concrete, specific action that subsumes many of the other goals.

A second cautionary note is that the evidence suggests that public campaigns that try to change *habits* are less successful than those that require a one- or two-time change in behavior—for example, getting vaccinated.[52] In the context of saving, this may indicate that a message tailored toward a one-time action—such as "create a financial plan," or (less ambitiously) "direct your tax refund toward an IRA" or "enroll in your company's 401(k) plan"—might be more effective than asking households to save—an action that essentially occurs with each consumption decision. In addition, research has consistently shown that while public information campaigns can change attitudes, this change often does not translate into changes in behavior.[53]

Proposal 11: Create and Disseminate a Comprehensive Graphic for Financial Planning

Household financial planning can be challenging. Households need to consider retirement and precautionary saving, asset allocation, and levels of debt. They need to factor in family size and composition and related financial needs, such as housing and college costs, as well as life, property, and disability insurance. They should consider uncertainties related to employment, asset returns, health status, expected longevity, inflation, and other factors. These decisions have become more important and more difficult over time with the shift toward DC pension plans and longer retirement periods, the threat of future cuts in Social Security and Medicare, rising health care costs and college costs, and recent declines in housing and stock markets.

Households' financial planning efforts are often hampered by two additional challenges. First, many individuals lack basic financial literacy skills and knowledge. Second, although the number of available financial products and services has exploded in recent years, many have proven confusing or misleading, encumbering individuals' ability to identify high-quality financial products and unbiased, professional advice. In light of these considerations, it is not surprising that households often lack financial literacy and make poor financial choices, which can result in real economic hardship.[54]

Proposal

One way to address these issues is to develop financial guidelines simple enough to be explained in graphic form and disseminate the guidelines to nonexpert households to help bolster financial acumen and security. This would offer households guidelines that are simple, clear, and accessible; are tailored to individual situations; provide a focal

[52] Snyder, "Health Communication Campaigns and Their Impact on Behavior."

[53] Bas Verplanken and Wendy Wood, "Interventions to Break and Create Consumer Habits," *Journal of Public Policy and Marketing* 25, no. 1 (2006): 2–29.

[54] Several papers provide surveys and alternative perspectives on these issues, including Bucks and Pence, *Do Homeowners Know Their House Values and Mortgage Terms*; Gale, Harris, and Levine, *Raising Household Saving*; Moore, *Survey of Financial Literacy in Washington State*; and Anya Olsen and Kavin Whittman, "Effective Retirement Savings Programs: Design Features and Financial Education," *Social Security Bulletin* 67, no. 3 (2007): 53–72.

point for the development and review of financial products; and can be easily mass disseminated.[55]

Discussion

To motivate this discussion, we explore the nutritional guidelines disseminated by the U.S. Department of Agriculture (USDA). Financial and nutritional choices share several salient features. Both have direct effects on people's daily actions and well-being. Both are complicated by an increasing volume of misleading information. Both involve difficult trade-offs between short-run and long-run considerations. Both present problems that are complex and difficult to solve exactly, and yet simple rules of thumb appear to provide information of significant value to both. That is, it appears (and is a maintained hypothesis of this report) that a person can make fairly good choices simply by following basic rules of thumb or other simple decision rules.

The USDA guidelines have traditionally been presented in the form of a graphic depicting a food pyramid; in June 2011, the food pyramid was replaced with the graphic of a plate, called "MyPlate." Several features of the USDA's "comprehensive graphic" approach—both positive and cautionary—apply to financial literacy.

The positive features of the USDA's ongoing nutrition campaign help demonstrate the potential of a similar approach in financial literacy. First and foremost, the USDA's approach is intended to be simple, accurate, and comprehensive; it condenses an immense amount of complex technical information into a few rules that nonspecialists can understand and follow. Second, the approach addresses heterogeneity; because circumstances vary over an individual's lifetime, different sets of rules are developed and applied for different groups (USDA's MyPyramid has 12 variations). Third, the approach serves as a focal point for associated programs. For example, the invention of the food pyramid influenced the production choices of the agricultural sector and provided a way to monitor, evaluate, and categorize those products. Fourth, the approach can be easily disseminated to a wide audience, and the value of disseminating the information is enhanced to the extent that the graphic comes from an unbiased and trusted source.

Financial guidelines could aim to meet the same four criteria. First, they should be simple, accurate, and comprehensive. They should include rules of thumb or other comprehensible decision rules regarding saving (including retirement saving, precautionary saving, and saving for other goals), asset allocation, housing purchase and mortgages, credit card and other debt management, insurance (including property, life, and disability insurance) and other items. The guidelines should not be interpreted as a precise recommendation for individual financial planning any more than the food pyramid should be interpreted as a complete, specific diet for any individual. In addition, the guidelines should incorporate the benefits provided by public insurance programs, like the retirement, disability, and survivorship benefits provided by Social Security and the health insurance benefits provided by Medicare.

[55] For a complete discussion of this proposal, see William G. Gale and Benjamin H. Harris, *Developing and Disseminating Financial Guidelines for American Households* (Washington, DC: The Brookings Institution, 2011).

Second, alternative versions of the guidelines could be developed to reflect the divergent economic circumstances of people at different points in the life cycle, or who for other reasons face different economic situations. The following are examples of different types of households, with some of the key financial issues they face:

- New workers (understanding saving principles, initiating retirement saving, paying off student loans, controlling credit card debt, and saving for a house)
- Midcareer workers (protecting accumulated retirement assets against early withdrawal and high account fees)
- Near-retirees (making catch-up contributions and considering payout options from 401(k) plans)
- Retirees (managing financial assets, confronting higher health costs and estate planning)
- Low- and moderate-income households (understanding transactions accounts, government programs, debt management, the importance of precautionary saving, and higher replacement rates for Social Security)
- Students (managing bank accounts, credit card debt, and student loans and developing budgeting skills)
- New families (obtaining life insurance and saving for college)
- Women (managing interrupted careers, avoiding conservative investment strategies, and addressing longer life spans)[56]
- Hispanics and African Americans (navigating transactions accounts, obtaining financial counseling, and raising retirement saving participation)[57]

Third, the guidelines could be designed to be a focal point for the development of new, appropriate financial products and services (for example, by focusing on key product features that meet a particular need, such as a low-cost, diversified fund for investment purposes). The guidelines themselves would help create demand for such products. Suppliers whose products were in accordance with the guidelines could market their products as meeting government standards for financial soundness and security. This could help households identify sound financial advice and products. (The food equivalents are nutritional labels and statements such as “this product counts as 1 serving of carbohydrates” in a particular diet system.)

Fourth, the guidelines could be widely disseminated from an unbiased source of financial information and planning. One candidate for dissemination is the Consumer Financial Protection Bureau (CFPB), a newly created agency whose mission includes, among other responsibilities, the promotion of financial literacy. In the past, SSA mailed annual Social Security statements to all workers older than 25. A statement like this

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[56] See Leslie E. Papke, Lina Walker, and Michael Dworsky, *Retirement Security for Women: Progress to Date and Policies for Tomorrow* (Washington, DC: Retirement Security Project, The Brookings Institution, 2008).

[57] See Peter R. Orszag and Eric Rodriguez, *Retirement Security for Latinos: Bolstering Coverage, Savings and Adequacy* (Washington, DC: Retirement Security Project, The Brookings Institution, 2005).

would provide a natural opportunity to disseminate information. Currently, however, only nonbeneficiaries aged 60 and older still receive statements.

While a comprehensive graphic approach could be useful in improving financial outcomes, experience with food graphics and with other public campaigns foreshadows several problems. First, the development of the food pyramid was fraught with political wrangling and special interest considerations that have at least partially undermined its credibility, as well as its content and design. Second, mounting an effective public information campaigns presents some daunting obstacles, as previous campaigns have had limited success.[58] In fact, there is little evidence that the food pyramid or MyPlate has influenced public behavior. This is not to say that similar efforts cannot succeed, just that convincing evidence for or against public information campaigns of this type does not exist. Thus, the case for this proposal is a conceptual, rather than empirical, one.

[58] Abroms and Maibach, "The Effectiveness of Mass Communication to Change Public Behavior"; Gale, Harris, and Levine, *Raising Household Saving*; Siegel, "Mass Media Antismoking Campaigns"; Snyder, "Health Communication Campaigns and Their Impact on Behavior."