They Just Don’t Get It

By Editor Test *Thu, Mar 7, 2013*

It understandably drives the 401(k) industry nuts to hear professors and regulators proposing to cut the tax incentives for the business owners who sponsor workplace plans or for those who contribute the largest amounts to plans.

At the ASPPA/NAPA 401(k) Summit in Las Vegas this week, you could hear a lot of defensive anger at the government and at academics for their efforts to shrink the tax expenditure for retirement savings or kill it entirely.

A cynic might accuse the retirement industry of biting the hand that feeds when it attacks Uncle Sam, since tax deferral is the mother’s milk of the business. But occupants of the House-that-ERISA-Built are not unjustified when they say that bureaucrats and Ivory Tower experts—my epithets, not theirs—*don’t get it*.

Here’s the disconnect. To certain policy kibitizers, Ivy League professors and reportedly the White House, some of the $50 billion to $70 billion that the government “spends” each year to incentivize Americans to save for retirement is wasted on upper-income DC plan participants who would have saved for retirement anyway.

These mainly liberal policymakers and academics would prefer to cap the tax break for well-to-do participants at 28% (compared with the maximum of 39.6%) and use some of the tax expenditure to help undersavers save more and/or to extend the availability of workplace retirement plans to the currently underserved half of the working population.

ASPPA (American Society of Pension Professionals and Actuaries), which lobbies on behalf of plan advisors and service providers, is particularly upset about last years’ “Danish” study, published by the National Bureau of Economic Research. In it, academics with excellent credentials produced evidence that tax incentives have little positive impact on the mass of participants.

What don’t the policymakers and academics understand? They don’t get that the 401(k) industry, like the beer industry or the fast food industry or the arts or the “gaming” industry, relies on its largest customers and contributors for a disproportionate amount of its revenues.

The biggest contributors to 401(k) plans cover a disproportion of the plan expenses (unless perhaps the plan has a flat administrative fee). And small business owners, the wealthiest of whom who can save almost $20,000 in taxes each year by contributing the maximum to their plans, are the ones who often decide whether to sponsor a plan for employees or not.

These are the people whom the retirement industry wants to incentivize—not to save more per se, but to support the 401(k) business. The industry wants to reward these crucial customers *more*. It understandably drives the industry nuts to hear New England professors and Beltway theorists proposing to *reduce* the incentives for high rollers. They’ll just take their chips someplace else.

But if the policymakers live in a utopian fantasy to some extent, so does the 401(k) industry. Its fantasy is that auto-enrollment and auto-escalation and behavioral tricks will propel the mass of participants to retirement with accounts fat enough to replace (along with Social Security) as much as 85% of their peak salaries every year from age 65 to age 90.

Of course they want people to save more—for the same reason that Starbuck’s wants you to drink more lattes. AUM drives their business. But only a slim minority of plan participants will ever save enough to finance a long retirement, let alone finance a rising share of their health care costs and legacies for their kids. Most people are going to need insurance products, as a component of overall savings, to help themselves and society deal with the cost of rising longevity.

Besides the rivalry between these utopian visions, another rivalry manifested itself at the ASPPA/NAPA Summit. That’s the rivalry between those who see the reform activities of the Department of Labor and the actions of plaintiff’s attorneys (the legal equivalents of short-sellers) as an opportunity and those who see them as threats.

It’s the rivalry between entrenched retirement interests, which desperately want to hold onto the increasingly-hard-to-justify extra 50 bps they’ve been surreptitiously charging participants for years, and the smaller service providers who hope to use the new climate of transparency and fee competition to steal business from the profiteers. It will be interesting to watch the game play out.