What Happened to the ‘Auto-IRA’?

By Kerry Pechter *Wed, Aug 22, 2012*

Mark Iwry (pictured), an assistant Treasury Secretary, came into the current administration with hopes of making the "Automatic IRA," a workplace savings plan for people without a plan, a reality. But it became the subject of conspiracy theories and its prospects are now dim. Photo courtesy of the National Press Foundation.

Over the past decade, while the British were creating the National Employment Savings Trust, a “public option” workplace retirement plan that takes full effect this October, a small group in the U.S. was trying to promulgate a somewhat similar program here.

Called the “Automatic IRA,” the program would urge employers who don’t sponsor defined contribution plans to let their employees be auto-enrolled into a tax-deferred individual retirement account (IRA) and to let employees use the company payroll system to make automatic deferrals into it.

The policy goal in the U.S. was the same as the policy goal in the U.K.: To enable the millions of people who aren’t covered by DC plans to start saving in earnest, so that they would have more money in retirement and have less need to rely on public assistance.

But while the British pension wonks, after years of laborious trial, error, negotiation and legislation, made NEST a reality, their counterparts in America, despite early bipartisan support, have seen the Auto-IRA get mired in the “swamp”—as George W. Bush recently characterized it—of contemporary American politics.

At the height of its popularity, during the 2008 presidential campaign, the Auto-IRA appeared to have friends and champions in both political parties. But some political bloggers demonized it as a “retirement wealth and power grab” by the Obama administration, and the controversy over the Affordable Care Act soon upstaged it.

To be sure, the Auto-IRA still has a pulse. “There’s a bill in Congress right now,” said Mark Iwry, the Treasury official who, with David John of the Heritage Foundation, conceived the Auto-IRA about six years ago. But the Auto-IRA’s future is dim; its fate may well depend on the outcome of this fall’s elections.

The seed: ‘negative election’

The roots of the Auto-IRA concept, as Iwry tells the story, can be traced to the mid- 1990s. While working in the Clinton Treasury Department, Iwry learned about a technique involving passive enrollment of employees into defined contribution plans. It was called “negative election,” and he began exploring its potential for ramping up participation rates.

"We had heard of this notion of 'negative election,'" he told RIJ. "It was not widespread but the idea had cropped up. [In collecting feedback], we were asked, Is this legal? Or is it a violation [of IRS or ERISA code]? We decided that it was legal. But, more importantly, we wanted to make it legal, and we wanted to use it to encourage more participation in the plans."

Iwry doesn't claim to have invented auto-enrollment, but he's at least one of its authors and promoters. "We refined it and improved it and in 1998 Treasury and IRS issued a revenue ruling that described something we named 'auto-enrollment in a 401(k) plan.' So we made a high profile announcement and tried to tell the market, Here's an idea that you could try out."

[The "negative option" was a common feature of direct marketing during the 1980s and perhaps before then. If you didn't actively reject a junk mail solicitation, for instance, you might soon start receiving a classical music CD-of-the-month, accompanied by an invoice.]

"It was a little lonely promoting [auto-enrollment] in 1999," Iwry said. "When introducing it to businesses and consulting firms, we talked about why some employers were interested and not others, and how the participation rates of minorities and low income people tended to go up the most with auto-enrollment. It started to catch on."

Six years later, during the George W. Bush administration, a provision of the Pension Protection Act of 2006 provided retirement plan sponsors who were still uncertain about the legal implications of auto-enrollment with the explicit clarification they needed to adopt it.

By then, Iwry was temporarily out of government and working at the Brookings Institution, the liberal-leaning Washington think tank. While there, he and David John (below, right) of the Heritage Foundation, the conservative Washington think tank, began working on a way to apply the auto-enrollment concept beyond the 401(k) plan.

Designing the Auto-IRA

"We started with this simple notion: 'Can we extend auto-enrollment to the rest of population even though they don't have plans?'" Iwry told *RIJ.* "The next question was, 'What can we auto enroll them *into*?" The solution that naturally suggested itself was to have the employer create a payroll deduction savings plan. That's the key to the 401(k)—the savings comes out painlessly, and people don't have to write a check the way you traditionally have to do with an IRA. So we thought, how about if we ask employers to auto-enroll people into tax-favored savings accounts without having to sponsor a formal 401(k) plan?"

Like the creators of NEST in the U.K., Iwry and John did not want their program to compete with or crowd out 401(k) plans, but rather create a starter-kit that might lead to 401(k) sponsorship. Unlike the creators of NEST, they ruled out the idea of trying to convince government policymakers to make sponsorship of a full-sized retirement plan or contributions to an Auto-IRA mandatory for employers.

"We didn't want to try to require them to do this. We didn't want to cross the line into forcing them to offer plans. So we said, we'll leave small businesses with no obligations. But we'll ask them to allow employees to get direct-deposit part of their paychecks into an IRA, just as they automatically make a mortgage or car payment," Iwry said.

"When we developed the Auto-Ira, we realized that making employer contributions mandatory was a no-go," David John told RIJ in a recent interview. "In fact, we used the IRA as vehicle because employer contribution aren't allowed."

The whole project, of course, needed buy-in from the private sector, and Iwry and John were careful not to alienate or antagonize the private sector. "We chose not to ask employers to make a contribution because we wanted position the proposal as pro-employer—and one that didn't compete with 401(k). We didn't want the new initiative to have any whiff of competition with or crowding out of 401(k) plans," Iwry said. Since the contribution limits on IRAs were so much lower than those on 401(k) plans, the Auto-IRA would be weak competition at best.

"It was designed to pick up where the 401(k) left off," he added. "We all felt that anything we could do to nudge more employers toward sponsoring [formal 401(k)] plans would be positive. We also thought employers might want to step up to the 401(k) after they saw how much employees appreciated the benefit."

In the U.K., distributions from tax-deferred accounts are generally not allowed before retirement, but Iwry and John also saw that barring access would be non-starter in the U.S. "We thought about banning leakage, but our view was that there's too big a connection between the participants' willingness to contribute and their ability to get their money out if they desperately need it," Iwry said.

"We thought briefly about starting with a clean slate and creating the ideal anti-leakage policy for the Auto-IRA, but we were trying to keep it simple. The IRA itself already strikes a balance [in that respect]. It's not totally leaky or totally sticky. An IRA is an IRA; everyone knows what it is. We said, 'The Fidelitys and the Vanguards already know how to run IRAs, so let's use what's already there.' We also felt that once we got the plumbing in place, we could go back and tweak it," he added.

One part of the Auto-IRA design that remained vague was the designation of investment options. "Regarding the default investment, we haven't tried to design that part of it. We thought we should go with the general weight of investment opinion. We looked to the QDIAs [qualified default investment alternatives, such as target-date funds]. This was a saving agenda, for people who are not saving now," Iwry said.

"We weren't trying to make people into sophisticated investors," he added. "We wanted to limit [the investment options] to perhaps three choices, with one of them being the default and the others being something that was already commonplace in the 401(k) world. The employers who started this would get a tax credit, but it would be a small one because there would be hardly any cost to setting one up."

Support appears, and so do hostile bloggers

"David John and I formulated this and rolled it out in 2006. We wrote a paper, presented it at Heritage Foundation, had an event to roll the idea out. We got immediate interest and support from a variety of groups. We created the Retirement Security Project under the aegis of the Brookings Institute with funding from the Pew Charitable Trust.

"That was when things started to happen. The Hill contacted us. Gordon Smith and Jeff Bingaman sponsored Auto-IRA legislation in the Senate. Representatives Phil English and Richard Neal introduced it in the House.

"*The New York Times* endorsed it, saying it was the 'best pension idea' around. *The Washington Times* endorsed it. And in the 2008 campaign, candidate Obama endorsed it and put it in his campaign materials as his first retirement initiative. John McCain also endorsed it. AARP endorsed it. Laura Tyson, Martin Feldstein of Harvard, and ASPPA [the American Society of Pension Professional and Actuaries]—we got all their support. ASPPA like it because they saw that, while this was not an employer plan, just an IRA, it might encourage more employers to eventually sponsor plans."

"It was endorsed by Obama and McCain in the campaign," David John said. Whoever won the 2008 election, "we expected to be able to move ahead in 2009." After the Democrats won, Iwry joined the Obama administration as a Deputy Assistant Secretary for Retirement and Health Policy.

And they did move ahead. But the bipartisan support may have encouraged them to expand the program in ways that would provide anti-Obama administration bloggers with an opportunity to demonize it.

In mid-2009, Iwry met at the Treasury Department with a delegation of journalists from the National Press Foundation, and in a meeting at which *RIJ* was present, explained that the Auto-IRA contained several ambitious elements that would fill in some of its holes.

The improved Auto-IRA would enhance an existing tax break, the Saver's Credit, and make it refundable so that it would serve in lieu of an employer match. The initial contributions would go into a new government security, called R-bonds.

As *RIJ* reported in June 2009, "Managed by the government, the R–bond program would relieve private investment firms of the task of managing unprofitably small accounts. 'The money would be in the R bonds until the account gets big enough for the money to go to the private sector,' Iwry said."

When President Obama introduced the Auto-IRA in his 2010 budget, however, and when Auto-IRA legislation included a mandate that all but the smallest employers enroll employees into an Auto-IRA unless they opted out, the hitherto feel-good, bipartisan Auto-IRA suddenly became a lightning rod for conspiracy theories in the blogosphere and online publications in the U.S. and abroad.

Stories and even lurid political cartoons began to appear widely on the web. The Auto-IRA and the R-bonds were compared to Argentina's recent nationalization of defined contribution accounts. The American Lantern Press in South Carolina described "The Obama Administration's Secret Plan to Hijack Your 401(k)s and IRAs."

A headline on a blog at ohiomm.com asked, "Will the Government Nationalize Your Retirement Funds?" The EU Times website said, "US Said Preparing New Laws to Seize Americans Retirement Accounts," and a column by Ron Holland at lewrockwell.com was titled, "The New Auto-IRA is Just Highway Robbery."

Introduced at the same time and in the same budget at the Affordable Care Act, the Auto-IRA proposal became conflated with the health care proposal, and opponents of so-called "Obamacare" and its mandates became opponents of the Auto-IRA and its mandate.

In interviews, Iwry and John spoke only generally about the Auto-IRA being upstaged by the Affordable Care Act and falling victim to polarized Washington politics. "We went to draft the bill, and the same people were working on both health care and retirement, and health care became the first priority. After that, we lost a lot of momentum," John said. "Also, people have assumed that the mandates in the health care law are paralleled in the Auto-IRA. One employer said, 'Damn it, you just put in a bunch of new requirements for health care and now you want to stick on more with retirement.' But this was a rare situation where the longer you discussed it, the more support built. We ended up with 75% support."

"We have gone through a very turbulent period," Iwry told *RIJ*. "We had the financial crisis and health reform, and all the Congressional dynamics around that. With the way things have gone the past few years, in an atmosphere that is more partisan than both of the [2008] presidential candidates had hoped, it's been harder to get this through.

"With the financial crisis, the revenue issues have become more acute," he added. "The situation with the national debt has made it harder to get new ideas enacted unless they have really broad support. But the Auto-IRA doesn't cost much, so the deficit issue shouldn't be a showstopper for this. The cost is estimated to be only about 1% of the amount we spend as a tax expenditure on retirement plans, which is somewhere above $100 billion. A mere 1% increase [in the expenditure] would increase [retirement plan] coverage by a dramatic percentage."

Fading prospects

The Auto-IRA was again included in the Obama administration's budget for 2012, and a bill was re-introduced earlier this year by Rep. Richard Neal (D-Mass). It contains the much-vilified employer mandate to auto-enroll employees. For that reason, its prospects for passage are considered dim. At a conference last May, a reporter asked Dallas Salisbury, the president and CEO of the Employee Benefits Research Institute, whose members include many of the largest 401(k) plan providers and financial services firms in the country, what he thought its chances might be.

"As an observation, what we know is that mandates are not currently something that seems to be popular with policymakers or with the public," Salisbury said. "It is the mandate in the Affordable Care Act that is at the center of the Supreme Court challenge currently taking place. And the auto-IRA proposal puts a mandate on small employers. Members of Congress in both parties have said that the inclusion of the mandate makes that [auto-IRA proposal] a difficult policy to adopt. And many interest groups have said they would oppose that because of the mandate. So setting aside the merits of auto-IRA per se, as a practical matter, the current debate about mandates affects very much what the likely outcome in that area is.

"It makes it quite unlikely, in the near term, that you would see that proposal enacted," he added. "That is not a statement on whether they think more retirement savings is needed, it is a statement on current attitudes toward mandating that individuals or employers do things as opposed to having free choice."

The future of the Auto-IRA may well depend not only on the outcome of the presidential contest this year, but also the contest to control the House and Senate. Either way, the problem that the Auto-IRA intended to address—the lack of retirement plan coverage by about half of America's private-sector workers and a low savings rate among middle- and low-income Americans—remains. The consequences of not addressing that problem won't disappear.

"People really don't understand how little they'll be getting from Social Security," David John told RIJ. "Years ago, [New York Senator] Patrick Moynihan feared that people would think they'll be getting more from Social Security than they actually would, and wouldn't make other provisions [to save]. If we don't have a retirement savings system for everyone, there will be demand for more government services and benefits, funded by a tax on business."