

Saving for Retirement: Household Decisionmaking and Policy Options

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Saving for Retirement: Household Decisionmaking and Policy Options

Retirement saving and financial planning have become more important for achieving financial security during retirement. After three decades of growth, employer-sponsored defined contribution (DC) plans and tax-favored Individual Retirement Accounts (IRAs) have become two important retirement income sources for many Americans. About 52% of U.S. households had retirement assets in DC plans or IRAs in 2016. In the past few decades, the major responsibility of retirement investing and planning has shifted from the employer to the American worker. With DC plans and IRAs, people typically need to make decisions about how much to contribute each year, how to invest their retirement wealth over a lifetime, and how to withdraw their funds in retirement without outliving their assets. Making these decisions may require complicated calculations involving uncertainty about future conditions, such as expectations about inflation and market returns, estimates about health care expenditures, and projections about family members' longevity. Some people may find it difficult to navigate the various options and decisions.

American families with different income levels and different access to retirement savings vehicles may have different retirement savings needs.

- Households with adequate savings in retirement accounts or on track for adequate retirement income may include employees with high incomes and existing retirement plans, such as those who have employer-sponsored pensions or who diligently fund their retirement plans. Retirement savings policies for those families may focus on protecting their investment wealth by regulating investment disclosure and management, facilitating investment choices, and regulating to ensure appropriate investment advice.
- Some middle-income families with little or no retirement savings or retirement income beyond Social Security may not be on track for adequate retirement income. Some of those families may find saving for retirement difficult for financial reasons. Others may not be eligible to participate in an employer-sponsored retirement savings plan, making saving for retirement more challenging. Families who may have difficulty maintaining their preretirement living standards during retirement may benefit from policies to increase participation and contributions in retirement plans.
- For some lowest-income families, Social Security and Supplemental Security Income (SSI) generally replace a substantial proportion of preretirement earned income. Income from DC plans and IRAs is typically a small proportion of their retirement income. If these families are not on track for adequate retirement income, policy changes in SSI and other government income support programs may be an appropriate way to help these families meet basic needs in retirement.

Behavioral research suggests that humans tend to have biases in rather predictable patterns. For example, the number, order, and structure of options, as well as the process around the choice, can change decisions for many people. Although consumers might not be aware of these biases when making financial decisions, research suggests that these biases can be used to encourage consumers to save more for retirement and make better retirement decisions.

Using best practices from behavioral research, policymakers may consider how to best structure retirement accounts and retirement planning decisions to help more people achieve retirement security. Common policy options around saving for retirement tend to relate to (1) retirement account features, (2) investment policies, and (3) financial literacy. For example, some retirement account features that may help consumers save more for retirement include making payroll-deductible retirement savings accounts available to every citizen, automatic enrollment of participants into retirement savings accounts, and automatic escalation of participants' contributions. In addition, how retirement account information and investment options are disclosed may impact consumer decisionmaking. People may also find retirement planning challenging because of limited financial management, knowledge, and skills (or financial literacy).

In 2019, Congress passed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act; P.L. 116-94, Division O). One of the act's goals was to encourage retirement savings, for example, by expanding Americans' DC plan access through employers and making changes to DC plans to try to make retirement decisionmaking easier.

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Introduction

Many Americans have more responsibility for their retirement planning today than in the recent past. Over the past three decades, the number of employees covered by employer-sponsored defined benefit (DB) pension plans has fallen, while an increasing percentage of workers are covered by employer-sponsored defined contribution (DC) pension plans.¹ From the early 1990s (1992-1993) to 2019, the percentage of private-sector workers who were covered by DB plans decreased from 32% to 12%, and the percentage of those workers who participated in DC plans increased from 35% to 47%.²

DB pension plans usually offer a lifetime annuity that is typically based on employees' tenure and wages and is funded solely by employers.³ In contrast, employer-sponsored DC plans, such as a 401(k), are retirement savings accounts funded through tax-deductible contributions by the worker (frequently matched in part or fully by the employer).⁴ Employees with self-directed DC plans need to decide how much income to contribute to retirement accounts each year and how to invest these contributions to maximize their retirement wealth. The shift from DB to DC retirement plans means, among other things, that individuals and families over time have had to assume more responsibility for managing their retirement finances.

Additionally, individuals or married couples who have employment earnings can also establish Individual Retirement Accounts (IRAs) to accumulate funds for retirement on a tax-advantaged basis.⁵ Over time, IRA account balances may contain both direct contributions and rollovers of certain DC accounts from previous employers.

In 2016, about 30% of households had IRAs.⁶ Similar to those with DC plans, households with IRA plans need to decide how much income to contribute to these accounts and how to manage their investments.

¹ See Sebastian Devlin-Foltz, Alice M. Henriques, and John Sabelhaus, *The Evolution of Retirement Wealth*, Board of Governors of the Federal Reserve System (Federal Reserve), 2015, at <https://www.federalreserve.gov/econresdata/feds/2015/files/2015009pap.pdf>.

² See U.S. Bureau of Labor Statistics (BLS), National Compensation Survey (NCS), "Table 2. Retirement Benefits: Access, Participation, and Take-up Rates, Private Industry Workers," March 2019, at <https://www.bls.gov/ncs/ebs/benefits/2019/ownership/private/table02a.pdf> (hereinafter NCS, "Table 2. Retirement Benefits: Private Industry Workers," 2019); and Stephanie L. Costo, "Trends in Retirement Plan Coverage over the Last Decade," *Monthly Labor Review*, February 2006, at <https://www.bls.gov/opub/mlr/2006/02/art5full.pdf>. This report focuses on private-sector workers. For federal employees and retirement savings, see CRS Report RL30387, *Federal Employees' Retirement System: The Role of the Thrift Savings Plan*, by Katelin P. Isaacs. Among state and local government employees, about 76% participated in defined benefit (DB) plans, compared with 17% in defined contribution (DC) plans in 2019. Therefore, DB plans might be more relevant to the retirement income for state and local government workers. See BLS, NCS, "Table 2. Retirement Benefits: Access, Participation, and Take-up Rates, State and Local Government Workers," March 2019, at <https://www.bls.gov/ncs/ebs/benefits/2019/ownership/govt/table02a.pdf>.

³ In DB plans, workers receive monthly benefits in retirement (called annuities) based on an employee's income, age, and/or length of service. For DB plans, typically only the employer contributes to the plan on behalf of the employee. In DB plans, the worker has a claim to the monthly benefit payable at retirement and not to any assets.

⁴ In DC plans, contributions and returns generally accumulate independently of job tenure, though employer contributions may require the employee to meet a minimum vesting requirement.

⁵ Contributions in Individual Retirement Accounts (IRAs) may be made on a pre-tax basis in traditional IRAs or on a post-tax basis in Roth IRAs. CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by Elizabeth A. Myers.

⁶ CRS analysis of the 2016 Survey of Consumer Finances (SCF). The SCF is a triennial survey conducted on behalf of the Federal Reserve. It contains detailed information on U.S. household finances, such as the amount and types of assets owned, the amount and types of debt owed, and detailed demographic information on the head of the household.

Financial decisions related to retirement accounts have become more complex. The tax implications of different retirement vehicles can be complicated. In addition, individuals generally have access to more investment product offerings within retirement accounts, further complicating these decisions.⁷

Americans are also on average living longer than in the past. Life expectancy at age 65 has increased over the past century or so, from 11.9 years in around 1900 (on average, living to about 77 years old) to 19.2 years in 2010 (on average, living to about 84 years old).⁸ Moreover, the likelihood of a 65 year old living past 90 years old rose from 25% for women and 10% for men in 1965 to 34% for women and 22% for men in 2015.⁹ While some Americans may be physically able to and choose to work longer and retire at an older age, this increase in life expectancy means that many individuals need to plan for a longer period in retirement than in the past, making saving and financial planning more important for maintaining their preretirement standard of living.

For these reasons, household financial decisionmaking relating to retirement is both difficult and important. Currently, retirement planning includes many decisions relating to saving, investing, and decumulating (or spending down) retirement wealth over a person's lifetime. Making these decisions successfully may require complicated calculations involving uncertainty about the future—for example, how high (or low) inflation and market returns will be, how much future health care will cost, and how long family members may be able to work and will live. Given the variety of options and decisions to make, researchers claim that many households may find planning for retirement to be overwhelming or intimidating.¹⁰

People may also find retirement planning challenging because of limited financial management experience, knowledge, and skills (or *financial literacy*).¹¹ Insufficient financial literacy can reduce investment returns and is associated with less retirement planning and less wealth accumulation.¹² Retirement generally happens only once for a household. Unlike other financial domains, such as auto loans, for which a family might shop every few years, many people do not have prior experience to inform their own retirement needs. For these reasons, planning for retirement can be particularly challenging.

Given this retirement savings context, in 2019, Congress passed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act; P.L. 116-94, Division O). One of the goals of

and spouse. For more information, see Federal Reserve, SCF, at <https://www.federalreserve.gov/econres/scfindex.htm>.

⁷ Annamaria Lusardi, *Financial Literacy and Financial Decision-Making in Older Adults*, American Society on Aging, 2012, at <https://www.asaging.org/blog/financial-literacy-and-financial-decision-making-older-adults>.

⁸ Loraine A. West et al., *65+ in the United States: 2010*, Census Bureau, Current Population Reports, June 2014, p. 25, at <https://www.census.gov/content/dam/Census/library/publications/2014/demo/p23-212.pdf>.

⁹ The Hamilton Project, Brookings Institute, *Probability of a 65-Year-Old Living to a Given Age, by Sex and Year*, June 23, 2015, at https://www.hamiltonproject.org/charts/probability_of_a_65_year_old_living_to_a_given_age_by_sex_and_year. Although life expectancy has generally been increasing over time in the United States, researchers have long documented that it is lower for individuals with lower socioeconomic status (SES) compared with individuals with higher SES. See CRS Report R44846, *The Growing Gap in Life Expectancy by Income: Recent Evidence and Implications for the Social Security Retirement Age*, by Katelin P. Isaacs and Sharmila Choudhury.

¹⁰ Sheena S. Iyengar, Wei Jiang, and Gur Huberman, *How Much Choice is Too Much?: Contributions to 401(k) Retirement Plans*, Pension Research Council, Working Paper, 2003 (hereinafter Iyengar, Jiang, and Huberman, 2003).

¹¹ Annamaria Lusardi and Olivia Mitchell, "The Economic Importance of Financial Literacy: Theory and Evidence," *Journal of Economic Literature*, vol. 52, no. 1 (2014), p. 34 (hereinafter Lusardi and Mitchell, 2014).

¹² Lusardi and Mitchell, 2014, pp. 24-44.

this act was to encourage saving for retirement—for example, through expanding Americans’ DC plan access through employers and making changes to DC plans to try to make retirement decisionmaking easier.¹³

This report focuses on household decisions related to saving for retirement in DC plans and IRAs. First, it discusses household finances and retirement savings. Then, it summarizes relevant consumer decisionmaking research. Lastly, it discusses policy options to encourage plan sponsors to modify retirement savings accounts so that people may increase their participation and savings in those accounts. Related policy issues discussed in this report include the following:

- availability, automatic enrollment, and automatic escalation in retirement saving accounts;
- matching of individuals’ contributions in retirement accounts;
- financial literacy of the working-age population;
- retirement account information disclosure and reporting;
- investment options and management of retirement accounts;
- fiduciary and investment advice related to retirement savings;
- maximum age allowed for contributions to retirement accounts;
- leakage and early withdrawal rules for retirement accounts; and
- converting savings into retirement income.

Retirement Savings and Household Finances

Individuals and households frequently save for retirement in DC plans, IRAs, or both. About 52% of U.S. households had retirement assets in DC plans or IRAs in 2016.¹⁴ Other parts of a household’s finances, such as debts, emergency savings, and employment outcomes, may also affect retirement security over time. Research has offered mixed conclusions regarding whether Americans overall have enough savings for retirement.¹⁵ Some research suggests that certain subgroups of the population may need to be saving more to fund retirement.¹⁶

DC Pension Plans and IRAs¹⁷

People may have retirement savings in a variety of tax-advantaged plans, such as DC plans or IRAs. An individual or household also may simultaneously have DC plans and IRAs.

DC plans are available only to workers whose employers sponsor such plans.¹⁸ For those plans, employees contribute a percentage of their wages, on a pre-tax basis, to a retirement savings

¹³ See CRS In Focus IF11174, *The SECURE Act and the Retirement Enhancement and Savings Act Tax Proposals (H.R. 1994 and S. 972)*, by Jane G. Gravelle.

¹⁴ CRS analysis of the 2016 SCF.

¹⁵ See Vickie L. Bajtelsmit and Anna Rappaport, “Retirement Adequacy in the United States,” *Journal of Financial Service Professionals*, vol. 72, no. 6 (November 2018), pp. 71-86 (hereinafter Bajtelsmit and Rappaport, 2018). This journal article summarizes main findings in related studies.

¹⁶ Bajtelsmit and Rappaport, 2018.

¹⁷ For more information about DC plans, see CRS Report R40707, *401(k) Plans and Retirement Savings: Issues for Congress*, by John J. Topoleski; for more information about IRAs, see CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by Elizabeth A. Myers.

¹⁸ The most common types of DC plans are 401(k), 403(b), 457(b), the Thrift Savings Plan (TSP), Savings Incentive

account established by the employer. Employers may also make a contribution to the plan equal to some or all of the worker's contribution (called a "match").¹⁹ Both contributions and gains are tax deferred until withdrawn. Beginning in 2006, employers with 401(k) and 403(b) sponsored plans were able to create qualified retirement accounts where employees could make contributions using *after-tax* income, which are usually referred to as Roth 401(k) and Roth 403(b).²⁰ Withdrawals from a Roth-type plan are generally tax-free if the taxpayer meets the applicable distribution requirements.

IRAs are tax-advantaged accounts that eligible individuals (or married couples) can establish to accumulate funds for retirement.²¹ IRAs are available to any worker with taxable compensation, as defined by the Internal Revenue Service (IRS).²² As with 401(k)s, there are two types of IRAs: traditional and Roth. For traditional IRAs, contributions may be tax-deductible, depending on whether the contributor or the contributor's spouse (if present) has participated in a pension plan at his or her place of employment and their income level.²³ In retirement, withdrawals from traditional IRAs are generally included in the IRA owner's taxable income. Any individual who has taxable compensation for the purpose of an IRA and whose income is under specified limits may establish and contribute to a Roth IRA.²⁴ Contributions to Roth IRAs are not tax-deductible, and qualified distributions are not taxable.²⁵

IRAs are often used to receive the balance of a DC retirement account as part of a *rollover*. A rollover is the transfer of assets from one retirement plan to another (typically to an IRA) upon separation from the original employer, either at job change or at retirement.²⁶

Match Plan for Employees (SIMPLE), and Simplified Employee Pension (SEP). 401(k), 403(b) and 457(b) plans are named for the sections of the Internal Revenue Code that authorize the plans. Private-sector employers sponsor 401(k) plans, public school systems and nonprofit organizations sponsor 403(b) plans, and state and local governments sponsor 457(b) plans. The federal government sponsors the TSP. SIMPLE and SEP plans are for small business employees.

¹⁹ An employee may contribute up to \$19,500 (\$26,000 if 50 or older) per year to a 401(k) plan in 2020. The contribution limit is adjusted annually for increases in the national wage. For more information, see Internal Revenue Service (IRS), *2020 Limitations Adjusted As Provided in Section 415 (d), etc.*, Notice 2019-59, at <https://www.irs.gov/pub/irs-drop/n-19-59.pdf>.

²⁰ Roth 401(k) and Roth 403(b) are authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16).

²¹ Individuals may contribute up to \$6,000 (\$7,000 if 50 or older) in 2020 to an IRA. The contribution limit is adjusted annually for increases in the national wage. For more information, see CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by Elizabeth A. Myers.

²² Compensation for purposes of an IRA may include wages and salaries, commissions, self-employment income, alimony and separate maintenance pay, and nontaxable combat pay. For more information, see IRS, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A, p .6, at <https://www.irs.gov/pub/irs-pdf/p590a.pdf>.

²³ For more information, see IRS, "IRA Deduction Limits," December 20, 2019, at <https://www.irs.gov/retirement-plans/ira-deduction-limits>.

²⁴ No contributions are allowed in Roth IRAs in 2020 if income is greater than \$206,000 for married filing jointly or qualifying widow(er); \$139,000 for single, head of household, or married filing separately and who did not live with a spouse at any time during the year; and \$10,000 for married filing separately and who lived with a spouse at any time during the year.

²⁵ Qualified distributions from a Roth IRA must satisfy both of the following conditions: (1) they are made after the five-year period beginning with the first taxable year for which a Roth IRA contribution was made, and (2) they are made on or after the age of 59½, because of disability, to a beneficiary or estate after death, or to purchase, build, or rebuild a first home up to a \$10,000 lifetime limit.

²⁶ Within traditional IRAs, more funds flowed in through rollovers from employer-sponsored pension plans than from regular contributions. For example, in 2016 (the latest year for which such data are available) funds from rollovers were \$430.8 billion, whereas funds from contributions were only \$18.3 billion. In contrast, funds flowing in to Roth IRAs

Household Retirement Assets, 1989-2016

In response to the shift in retirement savings vehicles from DB to DC plans, household retirement assets, such as funds in DC plans and IRAs, have grown over time. **Figure 1** shows the percentage of U.S. households that had assets in retirement savings accounts (excluding future benefit estimates in DB plans or Social Security) and median retirement assets among those households from 1989 to 2016.²⁷ In 1989, about 37% of U.S. households had retirement assets; by 2016, this had increased to 52%.²⁸ The median retirement assets among households participating in DC plans and IRAs also increased during this time, from \$20,524 in 1989 (inflation adjusted) to \$60,000 in 2016.²⁹

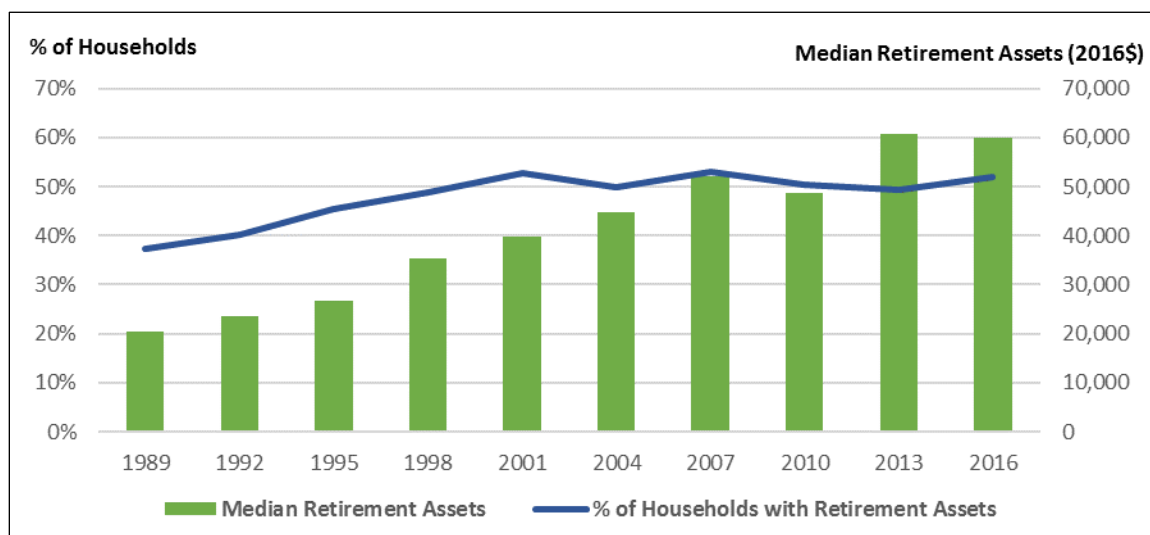
from rollovers were \$8.6 billion in 2016, whereas funds from contributions were \$22.2 billion. For statistical tables of IRA plans, see IRS, Statistics of Income (SOI) Division, “SOI Tax Stats—Accumulation and Distribution of Individual Retirement Arrangements,” at <https://www.irs.gov/statistics/soi-tax-stats-accumulation-and-distribution-of-individual-retirement-arrangements#tables>.

²⁷ The SCF includes the following tax-advantaged accounts for retirement assets: DC plans and IRAs, Profit Sharing Plans, Supplementary Retirement Annuities, Cash Balance Plans, Portable Cash Option Plans, etc. Importantly, estimates of future income from DB pensions or from Social Security are not included in the calculations of retirement assets. For more information on the SCF, see Federal Reserve, *Codebook for 2016 Survey of Consumer Finances*, at <https://www.federalreserve.gov/econres/files/codebk2016.txt>. The definitions of retirement assets and other summary statistics used by the Federal Reserve are available at <https://www.federalreserve.gov/econres/files/bulletin.macro.txt>.

²⁸ For comparison, in 2000, there were \$5.0 trillion in DB plan assets and \$5.6 trillion in DC plans and IRAs. In the first quarter of 2020, there were about \$9.1 trillion assets in DB plans and \$17.4 trillion in DC plans and IRAs. See Investment Company Institute (ICI), *Defined Contribution Plan Participants’ Activities, First Quarter 2020*, May 2020, at https://www.ici.org/pressroom/news/20_recordkeeper_1q20 (hereinafter ICI, *DC Plan Participants’ Activities, First Quarter, 2020*).

²⁹ The median lies at the middle of the retirement assets distribution. Half of the households have higher retirement assets, and half have lower retirement assets. The measure of average retirement assets is generally higher than the median amount because a relatively small percentage of households have very high retirement assets. From 1989 to 2016, the average measure of retirement assets increased from \$70,991 to \$228,725 based on the SCF (adjusted to 2016 dollars based on the Consumer Price Index for All Urban Consumers [CPI-U]). The median is generally considered to be a more informative measure of retirement assets.

Figure 1. Percentage of Households with Retirement Assets and Median Retirement Assets, 1989-2016



Source: Congressional Research Service analysis of the Survey of Consumer Finances (1989-2016).

Notes: Retirement assets include account balances in defined contribution plans, Individual Retirement Accounts, and tax-advantaged accounts. Estimates of future income from defined benefit pensions or from Social Security are not included in the calculations of retirement assets. Median retirement assets are for households with retirement assets. Values have been adjusted to 2016 dollars based on the Consumer Price Index for All Urban Consumers.

Annual contributions to DC plans are generally much larger than for IRAs. In 2016, about 38.8% of working taxpayers made contributions to DC plans, with an average annual amount of \$5,204 among those who chose to contribute;³⁰ whereas only 3.0% of taxpayers made contributions to traditional IRAs and 4.5% to Roth IRAs, with an average annual contribution of \$4,184 and \$3,441, respectively.³¹ The annual contribution limit for DC plans is generally higher than that for IRAs. In 2020, the annual contribution limit for 401(k)s is \$19,500 (with a \$6,500 catch-up contribution for those aged 50 and older), and the combined limit for traditional IRAs or Roth IRAs is \$6,000 (with an additional \$1,000 catch-up contribution for those aged 50 and older). However, because a large number of DC plan holders roll over their accounts into an IRA at job separation, the overall assets in IRAs are larger than in DC plans (\$11.0 trillion compared to \$8.9 trillion at the end of 2019).³²

Retirement Income and Saving Adequacy

Whether people have adequate retirement savings to achieve financial security in retirement has been the subject of debate and research over the last few decades. Retirement researchers and financial planners generally agree that there are two primary ways to assess income adequacy in retirement—whether income can meet basic needs (such as being above the poverty line) and

³⁰ IRS, SOI Division, “SOI Tax Stats—Individual Information Return Form W2 Statistics,” at <https://www.irs.gov/statistics/soi-tax-stats-individual-information-return-form-w2-statistics>.

³¹ IRS, SOI Division, “SOI Tax Stats—Accumulation and Distribution of Individual Retirement Arrangements (IRA),” at <https://www.irs.gov/statistics/soi-tax-stats-accumulation-and-distribution-of-individual-retirement-arrangements#tables>.

³² ICI, *DC Plan Participants’ Activities, First Quarter, 2020*.

whether income is sufficient to maintain a preretirement standard of living.³³ Programs such as Supplemental Security Income (SSI) and other public assistance are designed to ensure that eligible individuals have a minimum level of resources.³⁴ In contrast, programs such as Social Security and DB or DC plans are designed to help workers accumulate enough resources to maintain their preretirement standard of living. Social Security benefits are calculated to replace a greater share of career-average earnings for low-paid workers than for high-paid workers.³⁵ Therefore, Social Security benefits generally comprise a much higher share of retirement income for low earners than for high earners who have substantial amounts of other assets, mainly DB or DC retirement plans or private pensions.³⁶

Some studies suggest that more than half of U.S. households are on track to be adequately financially prepared for retirement.³⁷ These households may include employees with high income and those who have DB pensions or participated in employer-sponsored DC plans, as well as those who are diligently funding their retirement plans and taking advantage of employer matches throughout their career. Retirement savings policies for such families may focus on protecting their investment wealth by regulating investment disclosure and management, facilitating investment choices, and regulating to ensure appropriate investment advice and distribution information.

For lower-income households, SSI and Social Security may provide most of the retirement resources a family has during retirement. One study using administrative-linked survey data shows that, on average, for elderly families in the lowest 20% of the income distribution, about 90% of their retirement income is from Social Security and SSI, and less than 1% is from DC plans or IRAs.³⁸ This may be because some low-income families do not have income to save after meeting regular daily expenses during their working years. Another study shows that it may be optimal for very low earners not to engage in retirement savings because Social Security replaces a sufficient portion of their preretirement earnings.³⁹ Policy changes in Social Security or SSI might better target these families to ensure they are able to meet basic needs in retirement.⁴⁰

People who are not sufficiently preparing for retirement may include certain middle-income families with little or no retirement savings beyond Social Security. Some of those families may find saving for retirement difficult for financial reasons; others may not be eligible to participate in an employer-sponsored retirement saving plan,⁴¹ making saving for retirement more

³³ U.S. Congressional Budget Office, *Measuring the Adequacy of Retirement Income: A Primer*, October 2017, at <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53191-retirementadequacy.pdf>.

³⁴ Other public assistance mainly includes housing subsidies, the Supplemental Nutrition Assistance Program, refundable tax credits, and the Low Income Home Energy Assistance Program. For more information about Supplemental Security Income (SSI), see CRS In Focus IF10482, *Supplemental Security Income (SSI)*, by William R. Morton; and for information regarding how different resources affect the poverty rate among elderly Americans, see CRS Report R45791, *Poverty Among Americans Aged 65 and Older*, by Zhe Li and Joseph Dalaker.

³⁵ For more information on Social Security, see CRS Report R42035, *Social Security Primer*, by Barry F. Huston.

³⁶ See ICI, “Who Participates in Retirement Plans, 2016,” *ICI Research Perspective*, vol. 25, no. 6 (August 2019), at <https://www.ici.org/pdf/per25-06.pdf>.

³⁷ For summaries of retirement adequacy studies, see Bajtelsmit and Rappaport, 2018, pp. 71-86.

³⁸ Adam Bee and Joshua Mitchell, *Do Older Americans Have More Income Than We Think?*, Census Bureau, SESHD, Working Paper no. 2017-39, July 2017, at <https://www.census.gov/content/dam/Census/library/working-papers/2017/demo/SEHSD-WP2017-39.pdf>.

³⁹ Jason S. Scott et al., *Can Low Retirement Savings be Rationalized?*, National Bureau of Economic Research (NBER), Working Paper no. 26784, February 2020.

⁴⁰ See CRS Report R45791, *Poverty Among Americans Aged 65 and Older*, by Zhe Li and Joseph Dalaker.

⁴¹ IRAs are available to any worker with taxable wages. See footnote 22.

challenging. Families who may have difficulty maintaining their preretirement living standards in retirement could benefit from policies to increase participation and contributions in retirement plans.

Other Influences on Households' Finances That Could Impact Saving for Retirement

Families often have many financial goals during their working years, in addition to preparing for retirement.⁴² For example, they may want to pay down debt and save for emergencies, home purchases, a child's education, or other large expenses. People also often invest in their education or in a small business to increase their earnings potential over time. These financial decisions can affect financial well-being both now and in the future.

This section of the report discusses three notable areas of many households' finances which could make saving for retirement more challenging: household debt, a lack of emergency savings, and employment and health uncertainties among older workers.

Household Debt

In addition to retirement savings, other parts of a household's finances may affect their income adequacy in retirement. For example, a family with a substantial amount of outstanding mortgage debt near or in retirement may need to use retirement savings to pay mortgage expenses, thus resulting in insufficient income to meet regular expenses or health-related costs. Data suggest that more households are holding debt into retirement in recent years, particularly mortgage debt.⁴³ Elderly people with large outstanding mortgages or other loans may need to work longer or face financial insecurity during their retirement years.

Emergency Savings

A lack of emergency savings may be another potential risk to retirement planning. U.S. households on average tend to have relatively low levels of *liquid* wealth, such as money in a savings account, and a relatively high incidence of credit card borrowing.⁴⁴ In 2017, 42% of households did not set aside any money that year for emergency expenses.⁴⁵ Therefore, a sizable portion of the adult population reports they would have difficulty meeting an unexpected expense. If faced with a \$400 unexpected expense, 39% of adults say they would borrow, sell something, or not be able to cover the expense.⁴⁶

People with little emergency savings may borrow or withdraw from retirement savings accounts to fund emergencies, thus reducing the retirement funds available to grow for the future. As

⁴² For more information about consumer and household finance, see CRS Report R45813, *An Overview of Consumer Finance and Policy Issues*, by Cheryl R. Cooper.

⁴³ See CRS Report R45911, *Household Debt Among Older Americans, 1989-2016*, by Zhe Li.

⁴⁴ John Beshears et al., *Behavioral Household Finance*, NBER, Working Paper no. 24854, July 2018, p. 4 (hereinafter Beshears et al., 2018).

⁴⁵ Gerald Apaam et al., *FDIC National Survey of Unbanked and Underbanked Households*, October 2018, p. 43, at <https://www.fdic.gov/householdsurvey/2017/2017report.pdf>.

⁴⁶ Federal Reserve, *Report on the Economic Well-Being of U.S. Households in 2018*, May 2019, p. 2, at <https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf>.

described in more detail later in this report,⁴⁷ one source for borrowing funds may be 401(k) loans.⁴⁸ These loans allow individuals to borrow funds from their 401(k) accounts, but consumers may face the risk of defaulting on the loan. Data suggest that close to 37% of active plan participants borrow from their 401(k) in a five-year period.⁴⁹ Early withdrawals from retirement accounts, including cash-outs at job separation, are also common in the United States. Despite the higher tax penalties from early retirement account withdrawals, research estimates at least 26% of households take money from their accounts for nonretirement spending needs.⁵⁰ Household events, such as unexpected reductions in income or marital changes, seem to increase the likelihood of early withdrawals.⁵¹

Employment and Health Uncertainties Among Older Workers

Other risks in retirement planning are future uncertainties, such as unexpected job loss or health conditions, which can reduce earnings and thus retirement wealth accumulation. Over the working years of a family, the decade or two right before retirement can be critical. Earlier in one's working years, many families are focused on other financial goals, such as paying off student loan debt, owning a home, and maintaining expenses associated with raising children. Therefore, later working years are often when people focus more on retirement planning, perhaps catching up with savings or paying off a home. Yet workers who are 50 years old or older may face increased uncertainty about their work future during this critical time.

Layoffs and illnesses in the family are common for those over age 50. One study estimates that 66% of older workers experience an unexpected job loss or health condition hindering employment before turning 65 years old.⁵² For those who lose their jobs, older workers are likely to experience larger wage losses than their younger counterparts upon reemployment.⁵³ In addition, research suggests that people with health issues may overestimate how long they can work, and often their health worsens before the age at which they plan to retire.⁵⁴ Evidence suggests that financial losses from losing a job or a health condition impeding work can impact

⁴⁷ For more details, see the "Hardship Withdrawals and Loans in Retirement Plans" section of this report.

⁴⁸ In 2018, more than 58 million American workers were active 401(k) participants. DC plans may (but are not required to) allow individuals to withdraw funds for a financial difficulty, referred to as a *hardship distribution*. For more information, see CRS In Focus IF11472, *Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses*, by John J. Topoleski and Elizabeth A. Myers. For the number of 401(k) participants, see "Frequently Asked Questions About 401(k) Plan Research," April 2020, at https://www.ici.org/policy/retirement/plan/401k/faqs_401k.

⁴⁹ NBER, "Borrowing from 401(k)s," *Bulletin on Aging and Health*, no. 2 (2015), at <https://www.nber.org/aginghealth/2015no2/w21102.html>.

⁵⁰ Matt Fellowes and Katy Willemin, *The Retirement Breach in Defined Contribution Plans: Size, Causes, and Solutions*, HelloWallet, January 2013, at <https://www.scribd.com/document/222463705/Retirement-Breach-In-Defined-Contribution-Plans-from-HelloWallet>.

⁵¹ Robert Argento, Victoria Bryant, and John Sabelhaus, "Early Withdrawals from Retirement Accounts during the Great Recession," *Contemporary Economic Policy*, vol. 33, no. 1 (January 2015), pp. 14-18.

⁵² Richard Johnson and Peter Gosselin, *How Secure is Employment at Older Ages?*, Urban Institute, December 2018, pp. 7-8, at https://www.urban.org/sites/default/files/publication/99570/how_secure_is_employment_at_older_ages_2.pdf (hereinafter Johnson and Gosselin, 2018).

⁵³ Richard W. Johnson and Corina Mommaerts, *Age Differences in Job Loss, Job Search, and Reemployment*, Urban Institute, January 2011, at <https://www.urban.org/sites/default/files/publication/27086/412284-Age-Differences-in-Job-Loss-Job-Search-and-Reemployment.PDF>.

⁵⁴ Alicia H. Munnell, Matthew S. Rutledge, and Geoffrey T. Sanzenbacher, "Retiring Earlier than Planned: What Matters Most?," *Center for Retirement Research at Boston College*, February 2019, Working Paper no. 19-3, at https://crr.bc.edu/wp-content/uploads/2019/01/IB_19-3.pdf.

households for years after the initial employment loss.⁵⁵ These disruptions in earnings can impact future retirement security, potentially reducing a family's ability to save and reducing future Social Security benefits. These employment and health disruptions can also lead people to tap into existing retirement savings to make ends meet between jobs or to retire earlier than expected. For example, several studies have found that negative health shocks among older workers are likely to lead to early retirement.⁵⁶

Household Decisionmaking in Retirement Savings

As discussed earlier in this report, household decisionmaking related to retirement has become more important over time. The shift from DB to DC retirement plans requires families to assume more responsibility for managing their retirement and making decisions about retirement account contributions and investments, as well as making decisions about how to draw down these funds in retirement. For this reason, understanding household decisionmaking in retirement planning is important, particularly when considering retirement savings policy issues and the impact of different policy options on retirement security.

Economic Decisionmaking and the Life-Cycle Model

The *life-cycle model* is a prevalent economic hypothesis that assumes households usually want to keep consumption levels stable over time.⁵⁷ For example, severely reducing consumption one month may be more painful for people than the pleasure of a much higher household consumption level in another month. Therefore, people save and invest during their careers in order to afford a stable income across their lives, including in retirement. This model suggests that wealth should increase as people age, which generally fits household financial data in the United States.⁵⁸ In this theory, households adjust their savings rate during their working years rationally, based on interest rates, investment returns, life expectancy, Social Security or pension benefits, and other relevant factors. Evidence exists that some households adjust their retirement planning based on these types of factors.⁵⁹ However, in the United States, income and

⁵⁵ Johnson and Gosselin, 2018, p. 15.

⁵⁶ See Debra S. Dwyer and Jianting Hu, "Retirement Expectations and Realizations: The Role of Health Shocks and Economic Factors," in *Forecasting Retirement Needs and Retirement Wealth*, eds. Olivia S. Mitchell, P. Brett Hammond, and Anna M. Rappaport (Philadelphia, PA: University of Pennsylvania Press, 2000), pp. 274-287; Ronald Hagan, Andrew M. Jones, and Nigel Rice, "Health and Retirement in Europe," *International Journal of Environmental Research and Public Health*, vol. 6, no. 10 (October 2009), pp. 2676-2695; and Richard Disney, Carl Emmerson, and Matthew Wakefield, "Ill Health and Retirement in Britain: A Panel Data-Based Analysis," *Journal of Health Economics*, vol. 25, no. 4 (July 2006), pp. 621-649. One study also finds that American men and African Americans are more likely than other groups to exit labor market due to health shocks. See Dalton Conley and Jason Thompson, "The Effects of Health and Wealth Shocks on Retirement Decisions," *Federal Reserve Bank of St. Louis Review*, vol. 95, no. 5 (September/October 2013), pp. 389-404.

⁵⁷ Franco Modigliani, "The Life Cycle Hypothesis of Saving, the Demand for Wealth and the Supply of Capital," *Social Research*, vol. 33, no. 2 (Summer 1966), pp. 160-217.

⁵⁸ Jesse Bricker et al., "Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 103, no. 3 (September 2017), p. 13, at <https://www.federalreserve.gov/publications/files/scf17.pdf>.

⁵⁹ For example, many research papers find some households save more for retirement when pension or social security benefits decrease. See Orazio P. Attanasio and Agar Brugiavini, "Social Security and Households' Saving," *The Quarterly Journal of Economics*, vol. 118, no. 3 (August 2003), pp. 1075-1119; Gary V. Engelhardt and Anil Kumar, "Pensions and Household Wealth Accumulation," *The Journal of Human Resources*, vol. 46, no. 1 (January 2011), pp. 203-236; and Orazio P. Attanasio and Susann Rohwedder, "Pension Wealth and Household Saving: Evidence from Pension Reforms in the United Kingdom," *The American Economic Review*, vol. 93, no. 5 (December 2003), pp. 1499-

consumption move together more closely than the life-cycle model would predict, suggesting some households may not save enough for their retirement needs or other lower-income periods.⁶⁰

Mainstream economic theory asserts that competitive free markets generally lead to efficient distributions of goods and services to maximize value for society.⁶¹ If certain conditions hold, policy interventions cannot improve on the financial decisions that consumers make based on their unique situations and preferences. For this reason, some policymakers are hesitant to disrupt free markets, based on the theory that prices determined by market forces lead to efficient outcomes without intervention. However, in these theoretical frameworks, a free market may become inefficient due to departures from standard economic assumptions, which includes assuming that consumers and firms act rationally with perfect information. When these assumptions do not hold, it may cause a reduction in economic efficiency and consumer welfare. In these cases, government policy can potentially bring the market to a more efficient outcome, maximizing social welfare. Yet, policymakers often find it challenging to determine whether a policy intervention will help or harm a particular market to reach its efficient outcome.

The following section discusses behavioral biases, which are a specific departure from the rational decisionmaking condition associated with theoretical economic efficiency. This departure is particularly important for understanding people's decisionmaking in saving for retirement and investment markets. When people act with predictable biases, markets may become less efficient, and government policy—such as consumer disclosures or other plan design requirements—may be appropriate. However, these policies may also lead to unintended outcomes, which should be taken into account.

Behavioral Research and Retirement Savings Decisionmaking

Behavioral research suggests that people tend to have biases in rather predictable patterns.⁶² This research suggests that the human brain has evolved to quickly make judgments in bounded, rational ways, using *heuristics*—or mental shortcuts—to make decisions. These heuristics generally help people make appropriate decisions quickly and easily, but they can sometimes result in choices that make the decisionmaker worse off financially. For example, the number, order, and structure of options, as well as the process around the choice, can change decisions for many people.

A few of these biases tend to be particularly important for understanding retirement planning decisionmaking:⁶³

Choice Architecture. Research suggests that how financial decisions are framed can affect consumer decisionmaking. Framing can affect decisions in many ways.

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⁶⁰ Beshears et al., 2018, p. 4.

⁶¹ N. Gregory Mankiw, “Chapter 7,” in *Principles of Microeconomics*, 7th ed. (South-Western College Pub, 2014).

⁶² Daniel Kahneman, *Thinking Fast and Slow* (New York: Farrar, Straus and Giroux, 2011); and Dan Ariely, *Predictably Irrational: The Hidden Forces that Shape our Decisions* (New York: HarperCollins Publishers, 2008).

⁶³ For a more comprehensive overview of behavioral research related to retirement saving decisions, see Melissa Knoll, “The Role of Behavioral Economics and Behavioral Decision Making in Americans’ Retirement Savings Decisions,” *Social Security, Office of Retirement and Disability Policy, Social Security Bulletin*, vol. 70, no. 4 (2010), at <https://www.ssa.gov/policy/docs/ssb/v70n4/v70n4p1.html>.

- **Anchoring.** People can be influenced, or *anchored*, by an initial number, even if it is unrelated to their next choice.⁶⁴ In one illustration of this concept, researchers had subjects spin a wheel of fortune with numbers between 0 and 100, then asked them the percentage of African countries in the United Nations. The random number generated in the first stage subconsciously affected subjects' guesses in the second stage, even though they were not related. Therefore, without the anchor, people's estimates likely would have been different. In the retirement savings context, the automatic contribution rate in 401(k)s and the percent of salary at which employers provide maximum matches may be anchors that influence how much a person decides to put toward retirement savings.⁶⁵
- **Defaults.** People can also be influenced by *defaults* established in how a decision is framed.⁶⁶ For example, employees are more likely to be enrolled in a 401(k) plan if an employer defaults them into it than if they actively need to make a choice to participate.⁶⁷
- **Choice Overload.** When making decisions, people often find it difficult to navigate complexity, such as many choices to choose from or items to consider. In the retirement savings context, this means that more investment fund options in retirement savings plans can sometimes lead to procrastination or failure to make a decision.⁶⁸ Choice overload can also lead to poor decisionmaking, as some research suggests that fewer choices in retirement savings plans might lead to better retirement investment decisions.⁶⁹
- **Asset Allocation and Diversification.** People tend to naively make diversification choices when making allocation decisions. For example, in the retirement context, when making decisions about how much to invest in a collection of funds, some people choose to spread their investments evenly across available funds (whether financially appropriate for their situation or not).⁷⁰

Biases Toward the Future. Research suggests that common cognitive biases towards the future can also affect consumer decisionmaking.

- **Present Bias.** When people tend to put more value on having something now, rather than in the future—even when there is a large benefit for waiting—this

⁶⁴ Amos Tversky and Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," *Science*, vol. 185, no. 4157 (September 27, 1974), pp. 1124-1131.

⁶⁵ John Beshears et al., "The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States," in *Lessons from Pension Reform in the Americas*, ed. Stephen J. Kay and Tapen Sinha (New York: Oxford University Press, 2008), pp. 59-87 (hereinafter Beshears et al., 2008).

⁶⁶ Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (New York: Penguin Books [USA] Inc., 2008).

⁶⁷ Brigitte C. Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics*, vol. 116, no. 4 (November 2001), pp. 1149-1187 (hereinafter Madrian and Shea, 2001); and Robert L. Clark and Denis Pelletier, *Impact of Defaults in Retirement Saving Plans: Public Employee Plans*, NBER, Working Paper no. 2623, September 2019.

⁶⁸ Iyengar, Jiang, and Huberman, 2003.

⁶⁹ Donald B. Keim and Olivia S. Mitchell, *Simplifying Choices in Defined Contribution Retirement Plan Design*, NBER, Working Paper no. 21854, January 2016.

⁷⁰ Shlomo Benartzi and Richard H. Thaler, "Naive Diversification Strategies in Defined Contribution Saving Plans," *American Economic Review*, vol. 91, no. 1 (March 2001).

behavior is called *present bias*.⁷¹ For example, in the retirement context, people tend to have a preference for lump sums over annuities, independent of risk considerations. Research suggests that people with more present bias tend to save less for retirement when controlling for other factors.⁷²

- **Self-Control.** Even when people decide they should do something, such as saving for the future or choosing a retirement plan, self-control and procrastination may prevent them from following their intentions.⁷³ These human biases might lead consumers to make financial decisions that are not optimal, such as undersaving.⁷⁴

Although consumers might not be aware of these biases when making financial decisions, firms may take advantage of them to attract consumers. For example, choice architecture biases might influence how marketing materials are developed, emphasizing certain terms—such as high past investment return rate—to make a financial product seem more desirable to consumers. In addition, product features may be developed to take advantage of people’s present bias or self-control mistakes. Less knowledgeable retirement savers’ decisionmaking might be more sensitive to choice architecture biases.⁷⁵

Biases can also be used to encourage people to save more for retirement and make better retirement decisions. For example, some research suggests that choice architecture environments can make retirement more salient (e.g., annual consumer disclosures that project future retirement income may lead to more retirement savings).⁷⁶ Moreover, how saving and investment options are framed may help some people make better retirement decisions. For example, some research suggests that preference checklists, which list factors—such as perceived health, life expectancy, and risk of outliving one’s resources—that people should consider when making a retirement decision, may improve retirement decisionmaking.⁷⁷

Although these techniques can be used to encourage socially beneficial goals, such as planning and saving more for retirement, changing the choice environment can also sometimes have perverse impacts. For example, defaulting people at a fixed savings rate can increase participation in retirement plans on average but may discourage some people from making an active decision when they start a new job to increase the contribution rate from the default to a higher level. For these people, the lower contribution rate may lead to less retirement savings over time. Likewise, defaulting people into life-cycle retirement investment plans may lead to more appropriate long-

⁷¹ Richard Thaler, “Some Empirical Evidence on Dynamic Inconsistency,” *Economic Letters*, vol. 8 (1981), pp. 201-207.

⁷² Gopi Shah Goda et al., *The Role of Time Preferences and Exponential-Growth Bias in Retirement Savings*, NBER, Working Paper no. 21482, August 2015.

⁷³ Kungl. Vetenskapsakademien: The Royal Swedish Academy of Sciences, *Richard H. Thaler: Integrating Economics with Psychology*, Scientific Background on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2017, October 3, 2017, pp. 10-14, at <https://www.nobelprize.org/uploads/2018/06/advanced-economicsciences2017-1.pdf>.

⁷⁴ H.M. Shefrin and Richard Thaler, “An Economic Theory of Self-Control,” *Journal of Political Economy*, vol. 89, no. 2 (April 1981), pp. 392-406.

⁷⁵ Anders Anderson and David T. Robinson, *Who Feels the Nudge? Knowledge, Self-Awareness and Retirement Savings Decisions*, NBER, Working Paper no. 25061, September 2018.

⁷⁶ Mathias Dolls et al., *Do Savings Increase in Response to Salient Information about Retirement and Expected Pensions?*, NBER, Working Paper no. 22684, September 2016.

⁷⁷ Eric Johnson et al., *Preference Checklists: Selective and Effective Choice Architecture for Retirement Decisions*, TIAA Institute, Research Dialogue Issue no. 127, June 2016, at https://www.tiaainstitute.org/sites/default/files/presentations/2017-02/rd_selective_effective_choice_architecture_for_retirement_decisions_1.pdf.

term investment decisions on average, but the investment default also may encourage fewer people to make active decisions or put them in a plan that may conflict with other savings vehicles.⁷⁸ Moreover, although defaulting people into 401(k)s can increase the number of people who save for retirement, it may also lead to increased consumer debt⁷⁹ without large impacts on household net worth over time.⁸⁰

Policy Options Related to Household Retirement Savings

Some Americans are on track for retirement security, but others may not be saving enough or might fall off track before reaching retirement. Public policy may be able to encourage more retirement saving for those not saving enough. Moreover, for households on track with saving for retirement, public policy may be important to help these families protect their investment wealth.

Taking into consideration the behavioral aspects around plan design discussed above, this section discusses policy options that may enhance retirement savings among certain population subgroups. Evaluating how each policy option affects retirement planning and consumer decisionmaking is important for understanding the policy's ultimate impact on household retirement security.

Availability, Automatic Enrollment, and Automatic Escalation

Three common policy tools to encourage more retirement savings are (1) increasing the availability of retirement accounts, (2) automatic enrollment into retirement accounts when available, and (3) automatic escalation of contributions.

Availability

Because of the growing importance of retirement savings, many researchers and policymakers believe U.S. workers generally should have easy access to a payroll deduction-based retirement savings plan. In March 2019, about 64% of private-sector workers had access to DC retirement plans.⁸¹ IRAs are available to all earners, but unlike a DC plan, they generally do not link automatically with a payroll deduction. Two approaches have been developed to expand the

⁷⁸ Gopi Shah Goda et al., “Do Defaults have Spillover Effects? The Effect of the Default Asset on Retirement Plan Contributions,” paper presented at the 20th Annual Joint Meeting of the Retirement Research Consortium, Washington, DC, August 2018, at <http://www.nber.org/2018rrc/summaries/1.3%20-%20Goda,%20Levy,%20Manchester,%20Sojourner,%20Tasoff.pdf>.

⁷⁹ This research study found that when the U.S. Army moved to automatic enrollment in the TSP at a 3% default contribution rate, both the number of employees contributing and the average contribution rate increased; but the move also significantly increased auto loan and mortgage balances. See John Beshears et al., *Borrowing to Save? The Impact of Automatic Enrollment on Debt*, NBER, Working Paper no. 25876, May 2019 (hereinafter Beshears et al., 2019).

⁸⁰ Using data from 34 U.S. 401(k) plans, this research study estimated that, on average, although automatic enrollment into 401(k) plans increases savings in the plan in the short run, employees tend to respond by saving less in the future; so the long-term impact of automatic enrollment on retirement savings is not significant on average and significant only for the lowest lifetime earnings groups. See Taha Choukhmane, “Default Options and Retirement Saving Dynamics,” June 10, 2019, at <https://cepr.org/sites/default/files/Choukhmane%20%282019%29%20-%20Default%20Options.pdf> (hereinafter Choukhmane, 2019).

⁸¹ NCS, “Table 2. Retirement Benefits: Private Industry Workers,” 2019.

availability of retirement savings plans: (1) extending DC plans to more employees and (2) establishing mandatory employer-provided payroll deduction-based IRAs.

Part-time workers and workers in small businesses are less likely to have access to employer-sponsored DC plans than other workers. About 73% of full-time private-sector workers had access to DC plans in 2019, compared with 35% of part-time workers. Additionally, about 82% of workers in companies with 500 or more employees had access to DC plans, compared with 48% of those in companies with 49 or fewer employees.⁸² In order to increase DC plan participation for part-time and small-business workers, the SECURE Act requires employers to offer DC plans to long-term part-time employees who work more than 500 hours per year over three consecutive years, while increasing the startup retirement plan tax credit for small businesses from \$500 to \$5,000 per year for three years.⁸³

Another approach is to make payroll deductions to IRAs mandatory for employers who do not offer a retirement plan.⁸⁴ Some states have passed legislation to implement auto-IRAs, which require employers who do not offer a retirement plan to automatically enroll their workers in an IRA-based savings program sponsored by the state.⁸⁵ In most cases, workers can opt out. S. 2370, the Automatic IRA Act of 2019, proposes a nationwide auto-IRA for workers of employers who do not offer a retirement plan; H.R. 2120 and S. 1053 introduced in the 116th Congress, the Saving for the Future Act, would set up a universal personal savings account for workers who do not have an employer-sponsored DC or IRA-type plan. The Obama Administration also proposed a similar universal auto-IRA program.⁸⁶

Automatic Enrollment

Accessibility to payroll deduction-based DC or IRA plans may not guarantee consumer participation. In some retirement savings plans, participants must make an active decision to enroll, choose a percentage of their income to save, and choose how to invest these funds. In March 2019, among the private-sector workers who had access to DC plans, 74% of them were enrolled in a payroll deduction-based plan.⁸⁷

Automatic enrollment—in which employees are automatically signed up unless they opt out—can be successful in overcoming consumer biases that can impede signing up, leading to much higher

⁸² NCS, “Table 2. Retirement Benefits: Private Industry Workers,” 2019.

⁸³ This new rule goes into effect beginning in 2021. Employers will need to make necessary modifications to their administrative systems by no later than January 1, 2021, to account for the potential future eligibility of those long-term part-time employees. Because of the long-term requirement of three consecutive years, the mandated participation of those employees under this provision will be delayed until 2024.

⁸⁴ Some differences between a 401(k) plan and an IRA include the following: 401(k) plans are covered by the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), but IRAs are generally exempt; establishing and administering 401(k)s may be more complicated than IRAs; employer contributions can be available in 401(k)s but not in IRAs; loans subject to certain limits are available in 401(k)s but not in IRAs; and contribution limits to IRAs are lower than to 401(k)s.

⁸⁵ California, Connecticut, Illinois, Maryland, New Jersey, and Oregon, plus Seattle, WA, have created similar state-run auto-IRA programs. See Georgetown University McCourt School of Public Policy, Center for Retirement Initiatives, “State-Facilitated Retirement Savings Programs: A Snapshot of Program Design Features,” State Brief 20-02, February 29, 2020, at https://cri.georgetown.edu/wp-content/uploads/2018/12/CRI-State-Brief-States_SnapShotPlanDesign-Feb-20-2020.pdf.

⁸⁶ White House, Office of the Press Secretary, “Fact Sheet: Opportunity for All: Securing a Dignified Retirement for all Americans,” January 29, 2014, at <https://obamawhitehouse.archives.gov/the-press-office/2014/01/29/fact-sheet-opportunity-all-securing-dignified-retirement-all-americans>.

⁸⁷ NCS, “Table 2. Retirement Benefits: Private Industry Workers,” 2019.

enrollment in DC plans.⁸⁸ The Pension Protection Act of 2006 (PPA; P.L. 109-280) included a provision to encourage firms to adopt automatic enrollment. After PPA's enactment, evidence suggests that the percentage of U.S. employers automatically enrolling employees into 401(k) plans has increased considerably. In 2005, before the PPA's enactment, about 19% of employers with 401(k) plans automatically enrolled their employees,⁸⁹ compared with 58% in 2009 and 61% in 2017.⁹⁰ Another study, using restricted microdata from the National Compensation Survey, found that the share of workers with automatic enrollment 401(k) plans increased from 3.9% in 2002 (before PPA) to 32.3% in 2012 (after PPA).⁹¹ To further encourage automatic enrollment plans, the SECURE Act provides a \$500 tax credit to small businesses that adopt automatic enrollment. In addition, proposed nationwide auto-IRA programs also would generally include an automatic enrollment requirement (such as S. 2370, H.R. 2120, and S. 1053 introduced in the 116th Congress).

Research generally finds that IRAs with automatic enrollment boost retirement contributions among low- and moderate-wage individuals.⁹² A similar effect is found in the expansion of certain DC plans.⁹³ However, automatic enrollment in retirement savings plans may increase savings in retirement accounts by increasing debt or reducing saving for other purposes. One recent study found that automatic enrollment in retirement accounts may cause increases in auto loans and first lien mortgage balances.⁹⁴ Another recent study found that automatic enrollment may not necessarily have large impacts on household net worth over time.⁹⁵

Automatic Escalation

About three-quarters of automatic enrollment plans use an initial savings rate of 3% of earnings.⁹⁶ Research shows that when offered the default rate, many participants will passively accept it; however, if they had been forced to choose their savings rate, some would have selected a higher rate.⁹⁷ Because participants may passively accept the initial savings rate and are less likely to

⁸⁸ Shlomo Benartzi and Roger Lewin, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans* (New York: Penguin, 2012); and Madrian and Shea, 2001, pp. 1149-1187.

⁸⁹ Shlomo Benartzi and Richard H. Thaler, "Behavioral Economics and the Retirement Savings Crisis," *Science*, vol. 339 (March 2013), pp. 1152-1153 (hereinafter Benartzi and Thaler, 2013).

⁹⁰ Plan Sponsor Council of America, *61st Annual Survey*, Table 111, 2018.

⁹¹ Barbara A. Butrica, Keenan Dworak-Fisher, and Pamela Perun, *Pension Plan Structures before and after the Pension Protection Act of 2006*, The Urban Institute, September 2015.

⁹² See U.S. Government Accountability Office (GAO), *Automatic IRAs: Lower-Earning Households Could Realize Increases in Retirement Income*, GAO-13-699, August 2013, at <https://www.gao.gov/products/GAO-13-699>; Barbara A. Butrica and Richard W. Johnson, *How Much Might Automatic IRAs Improve Retirement Security for Low- and Moderate-Wage Workers?* The Urban Institute, July 2011, at <https://www.urban.org/sites/default/files/publication/27386/412360-How-Much-Might-Automatic-IRAs-Improve-Retirement-Security-for-Low-and-Moderate-Wage-Workers-.PDF>; and Jack VanDerhei, "Auto-IRAs: How Much Would They Increase the Probability of 'Successful' Retirements and Decrease Retirement Deficits? Preliminary Evidence from EBRI's Retirement Security Projection Model®," Employee Benefit Research Institute (EBRI), *EBRI Notes*, vol. 36, no. 6 (June 2015), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2620846.

⁹³ Jack VanDerhei, *What if OregonSaves Went National: A Look at the Impact on Retirement Income Adequacy*, October 2019, EBRI, Issue Brief no. 494, at https://www.ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_494_oregonsaves-31oct19.pdf?sfvrsn=8bd43c2f_6.

⁹⁴ Beshears et al., 2019.

⁹⁵ Choukhmane, 2019.

⁹⁶ Vanguard Group, *How America Saves 2012*, 2012.

⁹⁷ Beshears et al., 2008, pp. 59-87; and Madrian and Shea, 2001, pp. 1149-1187.

consider increasing the rate after enrolling into an account, some researchers have indicated that these participants may insufficiently save for retirement and have suggested automatic escalation based on behavioral research.⁹⁸ A typical approach to automatic escalation is to ask employees to commit to a future increase in their retirement savings rate, often linked with pay raises, until a preset limit is reached, or the employee chooses to opt out. One research study estimated that automatic escalation would substantially boost annual savings.⁹⁹ In 2017, about a quarter of DC plans provided an automatic escalation to some or all plan participants.¹⁰⁰ In addition, many legislative proposals that would require automatic enrollment include an automatic escalation provision (e.g., H.R. 2120 and S. 1053 introduced in the 116th Congress).

Matching of Retirement Contributions

The vast majority of employer-sponsored retirement savings plans include an employer match to incentivize employees to save for retirement and to save at higher levels.¹⁰¹ A typical structure of the employer match provides a dollar-for-dollar match (i.e., 100%) up to a certain threshold (such as 4% of salary).¹⁰² Several recent legislative proposals (e.g., H.R. 2120 and S. 1053 introduced in the 116th Congress) include a matching provision either from the employer or the federal government.¹⁰³

Although most studies suggest that matching contributions could increase the participation and contributions in saving plans, the impact is often less significant than nonfinancial approaches, such as automatic enrollment.¹⁰⁴ For individuals already enrolled in a retirement plan, matching has a small effect on contributions.¹⁰⁵ However, the match threshold tends to serve as a strong anchor when individuals decide how much to save.¹⁰⁶ Therefore, some researchers suggest that a lower match rate with a higher match threshold may be a more effective way to increase contributions in saving plans.¹⁰⁷

In evaluating how matching affects retirement savings among low-income individuals, the empirical evidence is less decisive. Some researchers find that a higher match increases contributions for low-income individuals;¹⁰⁸ others find that the match-based savings structure

⁹⁸ Benartzi and Thaler, 2013, pp. 1152-1153.

⁹⁹ Benartzi and Thaler, 2013. The study estimates that automatic escalation could increase annual savings by \$7.4 billion if the average annual compensation is assumed to be \$60,000.

¹⁰⁰ Plan Sponsor Council of America, *61st Annual Survey*, 2018, Table 121.

¹⁰¹ Plan Sponsor Council of America, *61st Annual Survey*, 2018, Table 42. In 2017, more than 96% of DC-type plans made some matching contributions.

¹⁰² Plan Sponsor Council of America, *61st Annual Survey*, 2018, Tables 42 and 47. Based on the survey, in 2017, employers on average contributed 4% of eligible participants' annual payroll into 401(k) plans.

¹⁰³ H.R. 2120 and S. 1053 in the 116th Congress (Saving for the Future Act) would also require minimum employer contributions in universal personal savings accounts.

¹⁰⁴ Brigitte C. Madrian, *Matching Contributions and Savings Outcome: A Behavioral Economics Perspective*, NBER, Working Paper no. 18220, July 2012 (hereinafter Madrian, 2012).

¹⁰⁵ Madrian, 2012.

¹⁰⁶ James J. Choi, David Laibson, and Brigitte C. Madrian, "\$100 Bills on the Sidewalk: Violations of No-Arbitrage in 401(k) Accounts," *The Review of Economics and Statistics*, vol. 93, no. 3 (2011), pp. 748-763, at <https://dash.harvard.edu/handle/1/9647368> (hereinafter Choi, Laibson, and Madrian, 2011).

¹⁰⁷ Choi, Laibson, and Madrian, 2011.

¹⁰⁸ Gur Huberman, Sheena S. Iyengar, and Wei Jiang, "Defined Contribution Pension Plans: Determinants of Participation and Contribution Rates," *Journal of Financial Services Research*, vol. 31, no. 1 (2007), pp. 1-32.

has no significant effect on the net worth of very low-income families.¹⁰⁹ Given the relatively higher cost of matching strategies, other policies may be more cost-effective at boosting savings contributions among low-income families.

Financial Literacy

Consumers generally have to make a variety of financial decisions when planning for retirement, including which tax-advantaged accounts to use, how much to save each year (in each account), and which investments to choose. Research suggests that higher financial literacy is strongly correlated with saving and retirement planning.¹¹⁰ In general, however, financial literacy—the “knowledge and understanding of financial concepts and choices”¹¹¹—is relatively low in the United States.¹¹² Those with low levels of financial literacy often get lower returns in financial markets (e.g., by shunning the stock market or choosing investment options with higher fees).¹¹³ Moreover, a lack of emergency savings, which may be due to inadequate financial literacy or financial management, may lead to retirement fund leakage and hardship loans. Due to these reasons, in part, research suggests that financial literacy may have an impact on household wealth accumulation, independent from educational attainment.¹¹⁴ Also for these reasons, some policymakers are interested in increasing Americans’ financial literacy related to retirement savings and planning.

The Financial Literacy and Education Commission (FLEC) coordinates financial literacy and education efforts across relevant federal government agencies.¹¹⁵ Within agencies that participate in the FLEC, the Department of Labor’s Employee Benefits Security Administration (DOL/EBSA) is the primary agency educating the public on workplace retirement savings plans, and the Securities and Exchange Commission (SEC) is the primary agency responsible for

¹⁰⁹ Gregory Mills et al., “Effects of Individual Development Accounts on Asset Purchases and Saving Behavior: Evidence from a Controlled Experiment,” *Journal of Public Economics*, vol. 92, nos. 5-6 (2008), pp. 1509-1530.

¹¹⁰ Lusardi and Mitchell, 2014, pp. 22, 25-26.

¹¹¹ Consumer Financial Protection Bureau, *Financial Literacy Annual Report*, December 2018, p. 5, at https://files.consumerfinance.gov/f/documents/bcfp_financial-literacy_annual-report_2018.pdf.

¹¹² Lusardi and Mitchell, 2014, p. 34. Financial literacy related to investment decisions is often measured by standard questions related to compound interest, inflation, and risk diversification:

- 1) Suppose you had \$100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow: [more than \$102, exactly \$102, less than \$102? Do not know, refuse to answer.]
- 2) Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, would you be able to buy: [more than, exactly the same as, or less than today with the money in this account? Do not know; refuse to answer.]
- 3) Do you think that the following statement is true or false? “Buying a single company stock usually provides a safer return than a stock mutual fund.” [True, False, Do not know; refuse to answer.]

For more information, see Lusardi and Mitchell, 2014, p. 9.

¹¹³ Lusardi and Mitchell, 2014, p. 24.

¹¹⁴ The relationship between financial literacy and wealth accumulation is not due to educational attainment generally. When education level is controlled for, financial literacy still has a significant impact on wealth accumulation. See Lusardi and Mitchell, 2014, pp. 23-24.

¹¹⁵ Recently, the Treasury Department released a report with recommended actions to improve the operations of the Financial Literacy and Education Commission (FLEC). See U.S. Department of the Treasury, *Federal Financial Literacy Reform: Coordinating and Improving Financial Literacy Efforts*, July 2019, at <https://home.treasury.gov/system/files/136/FFLRCoordinatingImprovingFinancialLiteracyEfforts.pdf> (hereinafter Treasury, *Federal Financial Literacy Reform*, 2019).

investment information.¹¹⁶ The government's goals relating to financial literacy include supporting the development of core financial competencies in consumers through access to effective information, financial education resources, and programs so consumers can make informed financial decisions.¹¹⁷ Congress continues to show interest in improving financial literacy around retirement planning.¹¹⁸ For example, S. 975 and H.R. 2005 introduced in the 116th Congress, the Women's Retirement Protection Act, include financial literacy education grants for retirement planning programs and a link to the Consumer Financial Protection Bureau's website with retirement planning information on mandated consumer disclosures.

Information Disclosure and Reporting

As described in the retirement plan design section of this report, choice architecture, or the way financial decisions are framed, can affect consumer decisionmaking.¹¹⁹ For this reason, retirement account disclosures and reporting to consumers are important, because they can influence consumer decisionmaking, impacting retirement security in the future. Given low financial literacy, retirement plan disclosures may suggest to uninformed consumers what information is important or whether most people make similar decisions. For this reason, the federal government mandates particular information related to retirement accounts to be disclosed regularly, such as the value of investments, fees and expenses, and other retirement plan terms.¹²⁰

Congress continues to show interest in improving retirement account disclosures and reporting requirements to help consumers make better retirement decisions, such as including design features to better allow consumers to compare investments, fees, and other important retirement decisions. For example, the SECURE Act requires plans to provide participants with a lifetime retirement income projection based on their current DC plan account balance to make it easier for people to determine whether they are saving enough for retirement. In addition, S. 1431 introduced in the 116th Congress would consolidate retirement plan disclosures and benchmark disclosures for investment funds to make these disclosures more usable and facilitate easier comparisons of investment products. Lastly, S. 975 and H.R. 2005 introduced in the 116th Congress (the Women's Retirement Protection Act) would create additional targeted notices (e.g., additional spousal disclosures and consent requirements so people are aware of retirement decisions that may have perverse or unintended consequences for their spouse's retirement security, such as beneficiary or retirement plan changes).

¹¹⁶ For more information on the major agency efforts around retirement planning and financial literacy, see Treasury, *Federal Financial Literacy Reform*, 2019, pp. 30-37.

¹¹⁷ FLEC, *Promoting Financial Success in the United States: National Strategy for Financial Literacy*, 2011, pp. 8-9, at [https://www.treasury.gov/resource-center/financial-education/Documents/NationalStrategyBook_12310%20\(2\).pdf](https://www.treasury.gov/resource-center/financial-education/Documents/NationalStrategyBook_12310%20(2).pdf); and FLEC, *Promoting Financial Success in the United States: National Strategy for Financial Literacy 2016 Update*, 2016, at <https://www.treasury.gov/resource-center/financial-education/Documents/National%20Strategy%202016%20Update.pdf>.

¹¹⁸ For example, see U.S. Congress, Senate Committee on Health, Education, Labor, and Pensions, Subcommittee on Primary Health and Retirement Security, *Financial Literacy: the Starting Point for a Secure Retirement*, 115th Cong., 2nd sess., August 21, 2018.

¹¹⁹ For more detail, see the "Behavioral Research and Retirement Savings Decisionmaking" section of this report.

¹²⁰ For example, a guide from the Department of Labor (DOL) on reporting and disclosure requirements for employee benefit plans can be found at DOL, Employee Benefits Security Administration (EBSA), *Reporting and Disclosure Guide for Employee Benefit Plans*, September 2017, at <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/our-activities/resource-center/publications/reporting-and-disclosure-guide-for-employee-benefit-plans.pdf>.

Investment Options and Management

In addition to how retirement decisions are framed, choice overload and diversification biases can affect consumer decisionmaking. Limiting or curating investment options can sometimes help people make appropriate retirement decisions.¹²¹ Moreover, annuity options¹²² in retirement plans to cover the risk of outliving one's retirement assets can sometimes improve retirees' outcomes.¹²³ In addition, simplifying the management or lowering costs can make retirement plans more accessible for consumers. For these reasons, Congress continues to show interest in improving retirement investment options and management to improve consumer decisionmaking and, ultimately, retirement security for consumers.

The SECURE Act now makes it easier for 401(k) plans to offer annuities.¹²⁴ The act also aims to reduce employer costs for providing retirement accounts to their workers, particularly for small businesses (e.g., through tax incentives and multiple employer plans), which allow businesses to pool administrative responsibilities when offering retirement plans to employees. In addition, H.R. 2120 and S. 1053 introduced in the 116th Congress would make consumer management of retirement accounts easier by providing retirement accounts for self-employed workers or employees without a retirement account option at their workplace.

Fiduciary and Investment Advice

As described in this report, retirement planning may be complex, and individuals sometimes rely on financial services professionals to assist them with their investment choices, tax planning, or other decisions. Sometimes, financial services professionals are compensated by commissions from investment funds or other incentives, which may lead to conflicts of interest or recommendations that are not in the best interest of their clients. For these reasons, the federal government sets certain standards for financial services professionals, depending on their roles and actions.

To protect the interests of pension plan participants and beneficiaries, Congress passed the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). ERISA set the standards that pension plans (such as employer-sponsored DC plans) must follow, including requiring that those who oversee pension plans (such as plan sponsors and administrators) have a *fiduciary duty* to operate these plans prudently and in the sole interests of plan participants.¹²⁵

¹²¹ Donald B. Keim and Olivia S. Mitchell, *Simplifying Choices in Defined Contribution Retirement Plan Design*, NBER, Working Paper no. 21854, January 2016.

¹²² Annuity products provide consumers a set monthly income for life after a particular age, which can mitigate the risk of retirees outliving their money. The financial product is often a combination of insurance and a managed investment vehicle.

¹²³ Vanya Horneff, Raimond Maurer, and Olivia S. Mitchell, *Putting the Pension Back in 401(k) Plans: Optimal Versus Default Longevity Income Annuities*, NBER, Working Paper no. 22717, October 2016.

¹²⁴ The Setting Every Community Up for Retirement Enhancement Act (SECURE Act; P.L. 116-94, Division O) provides a fiduciary safe harbor for plan sponsors to select lifetime income providers. In 401(k) and other DC plans, employers who comply with ERISA's fiduciary safe harbor rules are free of liability when selecting an insurance company to provide the annuity. The provision responds to employers' concerns about liability exposure if the selected insurance company proves unable, years later, to meet its obligations under the annuity contracts. In this way, the SECURE Act makes it easier to offer annuities in DC plans by removing ambiguity about the applicable fiduciary standard.

¹²⁵ What constitutes *investment advice* within pension and retirement plans has been controversial. In 2016, DOL finalized a rule that redefined and expanded the term, therefore expanding who has a fiduciary duty. Under the prior regulation, securities brokers and dealers who provided services to retirement plans and who were not fiduciaries were

During the late 1980s and early 1990s, the landscape for the delivery of investment advice began to shift as broker-dealers increasingly offered financial advisory services somewhat akin to investment advisers, including investment and retirement planning. In 2019, the SEC finalized a best interest standard for broker-dealer investment professionals, requiring them to act in the best interest of a customer when making recommendations.¹²⁶ This standard is widely perceived to be more rigorous than the prior suitability standard for broker-dealers but less rigorous than a fiduciary rule standard.¹²⁷ This new standard continues to be controversial, as some argue that the higher fiduciary standard is necessary to protect consumers when receiving retirement advice,¹²⁸ and others propose setting ERISA's investment advice standards closer to the SEC's best interest standard.¹²⁹

Age Requirements for Retirement Contributions and Withdrawals

The SECURE Act increased some of the age limits for retirement contributions and withdrawals. Before 2020, only workers younger than 70½ years old at the end of the calendar year were eligible to contribute to a traditional IRA. The SECURE Act eliminated this maximum age contribution requirement.¹³⁰ In addition, before 2020, traditional IRAs required an account holder to take required minimum distributions (RMDs) starting on April 1 in the calendar year after turning 70½ years old. The IRS also required that account holders start receiving RMDs from their 401(k) plans after turning 70½ years old, or if still employed, the year the employee retires. The SECURE Act increased the age at which RMDs begin to 72.¹³¹

not required to act in the sole interests of plan participants. Rather, their recommendations had to meet a suitability standard, which requires that recommendations be suitable for the plan participant, given factors such as an individual's income, risk tolerance, and investment objectives. Under DOL's 2016 regulation, brokers and dealers are generally considered to be fiduciaries when they provide recommendations to participants in retirement plans. Although some argued that retirement investment advice should meet a high standard because of the importance of retirement security and the rise of DC funds, others argued that a higher standard could discourage financial services professionals from providing advice due to a higher compliance requirement and possible increased litigation. Currently, the fiduciary rule has been struck down by the Fifth Circuit Court of Appeals. The ruling is available at <http://www.ca5.uscourts.gov/opinions/pub/17/17-10238-CV0.pdf>. For more information on DOL's 2016 rule, see CRS Report R44884, *Department of Labor's 2016 Fiduciary Rule: Background and Issues*, by John J. Topoleski and Gary Shorter.

¹²⁶ For more information on the Securities and Exchange Commission's (SEC's) best interest proposal, see CRS In Focus IF11073, *The SEC's Best Interest Proposal for Advice Given by Broker-Dealers*, by Gary Shorter; and CRS Report R46115, *Regulation Best Interest (Reg BI): The SEC's Rule for Broker-Dealers*, by Gary Shorter.

¹²⁷ In addition, the SEC finalized a new consumer disclosure, "Form CRS Relationship Summary," to help inform retail investors of the nature of their relationship with the financial professional. For more information, see SEC, "SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals," press release, June 5, 2019, at <https://www.sec.gov/news/press-release/2019-89>.

¹²⁸ Letter from Ranking Member of the House Financial Services Committee Maxine Waters et al., to SEC Chairman Jay Clayton, September 12, 2018, at https://financialservices.house.gov/uploadedfiles/cmw_-_reg_bi_to_sec_-_9.12.2018.pdf.

¹²⁹ DOL proposed a rule allowing new exemptions for investment advice fiduciaries to align these standards more closely with the SEC's advice standards. See DOL, "U.S. Department of Labor Proposes to Improve Investment Advice and Enhance Financial Choices for Workers and Retirees," press release, June 29, 2020, at <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200629>.

¹³⁰ Under current law, no maximum contribution age exists for Roth IRAs and 401(k) plans.

¹³¹ Under current law, there is no minimum distribution requirement for Roth IRAs. §2203 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) suspends required minimum distributions (RMDs) for 2020. A special rule applies the RMD suspension to individuals who took their first RMD from January 1, 2020, to April 1, 2020. Individuals who received their RMDs in 2020—prior to the enactment of the CARES Act—may be able to roll over these amounts to IRAs or other retirement plans, if rollover rules are followed. Among other requirements,

Congress changed these age limits for retirement savings accounts due to increases in life expectancy and the rise of people working longer.¹³² During 1969 to 1971, the time before IRAs were first authorized in 1974,¹³³ the average life expectancy at age 65 was about 15.0 years (13.0 years for men and 16.8 years for women); by 2017, it had increased to 19.4 years (18.0 years for men and 20.6 years for women).¹³⁴ Americans are also working longer. In the early 1980s, about 10% of Americans aged 70 and older worked at some time during the year (17% of men and 6% of women); in 2018, the share increased to almost 16% (21% of men and 12% of women).¹³⁵ Because withdrawals from DC plans are taxable, such withdrawals may push workers into a higher income tax bracket, thus discouraging older adults from working.¹³⁶ Therefore, increasing the required distribution age in these plans might incentivize certain eligible employees to work longer.

Retirement Account Leakage

Retirement savings accounts are designed to allow people to set aside wages for use during retirement. Preretirement withdrawals or loans from retirement savings accounts, sometimes described as “leakages,” may reduce long-term retirement savings. To discourage withdrawing retirement wealth early, preretirement distributions are generally subject to a 10% early withdrawal tax penalty unless the plan participant is over 59½ years old, or the funds are used for specific purposes designated in law.¹³⁷ Leakages from retirement plans can take a variety of forms, including cashing out plan assets upon separation from an employer and leakages due to households’ financial needs—“hardship” withdrawals from the plan prior to retirement or borrowing against plan assets.

rollovers must be completed within 60 days of the distribution. For more information, see CRS In Focus IF11472, *Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses*, by John J. Topoleski and Elizabeth A. Myers.

¹³² U.S. House Committee on Ways and Means, Chairman Richard E. Neal, *The Setting Every Community Up For Retirement Enhancement Act of 2019*, at <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SECURE%20Act%20section%20by%20section.pdf>.

¹³³ ERISA (P.L. 93-406).

¹³⁴ Elizabeth Arias and Jiaquan Xu, “United States Life Table, 2017,” *National Vital Statistics Reports*, vol. 68, no. 7 (June 24, 2019), Table 21, at https://www.cdc.gov/nchs/data/nvsr/nvsr68/nvsr68_07-508.pdf. According to the National Vital Statistics System, 15.0 years was the average life expectancy for men and women aged 65 during 1969 to 1971 (i.e., men and women aged 65 would, on average, be expected to live another 15 years, or to age 80); and 19.4 years in 2017 (i.e., men and women aged 65 would, on average, be expected to live another 19.4 years, or to age 84.4).

¹³⁵ CRS analysis of data from the U.S. Census Bureau, Current Population Survey, 1974-2019 Annual Social and Economic Supplements. The share of working men aged 70 and older was higher in the 1970s than in the 1980s. In 1974, 23% of men aged 70 and older worked some time during the year.

¹³⁶ Damir Cosic and Richard W. Johnson, *How Much Does Work Pay at Older Ages?*, The Urban Institute, November 2019.

¹³⁷ The exceptions to the 10% additional tax are listed at 26 U.S.C. §72(t)—examples include disability, death, and medical expenses that exceed 7.5% of adjusted gross income; some instances related to domestic relations orders; and calls to active duty. §2202 of the CARES Act exempts qualified individuals affected by Coronavirus Disease 2019 (COVID-19) from the 10% early withdrawal penalty for distributions (1) up to \$100,000, and (2) taken from January 1, 2020, through December 31, 2020. Qualified individuals are individuals (1) who tested positive for COVID-19 or those with a spouse or dependent who tested positive for COVID-19; (2) facing financial difficulties due to being quarantined, furloughed, laid off, or unable to work due to lack of child care or reduced work hours as a result of COVID-19; or (3) whose business closed or reduced hours as a result of COVID-19. Plan administrators may rely on employees’ certifications as proof that they are qualified individuals. For more information, see CRS In Focus IF11472, *Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses*, by John J. Topoleski and Elizabeth A. Myers.

Cash-Outs at Job Separation

Among all types of retirement account leakages, cash-outs from DC plans at job separation can result in the largest amounts of leakage and the greatest proportional loss in retirement savings.¹³⁸ Retirement plan participants may keep their accounts in a former employer's plan if the balance is greater than \$5,000,¹³⁹ roll over the account into a new employers' retirement plan or an IRA, or receive the account balance directly as a distribution from the plan (usually subject to a tax penalty). Current law requires that employers transfer retirement account balances above \$1,000 but below \$5,000 to an IRA when a job change occurs, absent an election from the participant.¹⁴⁰ Individuals may keep the balance in this IRA account or take the balance out.

Certain policies aim to reduce cash-outs. The PPA requires employers to provide notice to departing employees about the consequences of cashing out their retirement savings. Some policies recommend employers provide separating participants with projections of their account balance under different scenarios, ranging from keeping all assets in their tax-deferred retirement account to cashing out the entire account as a lump sum. These types of disclosures aim to discourage consumers from choosing to cash out their retirement plan when they leave their job.

Hardship Withdrawals and Loans in Retirement Plans

Other ways to access retirement assets early include hardship withdrawals and loans against retirement assets. These types of retirement account leakage are usually due to household financial needs, such as major purchases or emergency expenses. Policies limiting or prohibiting these types of leakage could help to preserve retirement assets, but they might also induce workers to save less in DC plans or IRAs, to shift their savings to other types of assets, or to borrow more to meet consumption needs.

Hardship withdrawal requirements differ between DC plans and IRAs.¹⁴¹ For 401(k) plans, hardship distributions are subject to a tax penalty and can include expenses such as first-time home purchase costs (excluding mortgage payments), certain postsecondary tuition expenses, certain medical expenses, payments to prevent eviction or foreclosure, and expenses related to damages from a federally declared disaster.¹⁴² Withdrawals from IRAs have fewer restrictions than 401(k) plans and can be cashed out for any purpose.¹⁴³ In addition, the tax penalty can be avoided for first-time home purchases (up to \$10,000) and postsecondary education. The share of

¹³⁸ Leakages have remained relatively steady based on Survey of Income and Program Participation data collected in 1998, 2003, and 2006. Estimates based those data show that more than 70% of total leakage amounts reported by 401(k) participants are from cash-outs at job separation. See GAO, *401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers Retirement Savings*, GAO-09-715, August 2009, at <https://www.gao.gov/products/GAO-09-715>.

¹³⁹ Internal Revenue Code of 1986 (P.L. 99-514), §411(a)(11).

¹⁴⁰ The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16).

¹⁴¹ See CRS In Focus IF11369, *Early Withdrawals from Individual Retirement Accounts (IRAs) and 401(k) Plans*, by Elizabeth A. Myers.

¹⁴² For regulations regarding deemed hardship distributions, see 26 C.F.R §1.401(k)-1(d)(3)(B). Prior to 2019, participants were unable to (1) make contributions for a six-month period following a hardship distribution or (2) take a hardship distribution before requesting a plan loan. §§41113 and 41114 of the Bipartisan Budget Act of 2018 (P.L. 115-123) eliminated these requirements. P.L. 115-123 also expanded the types of contributions and earnings that can be received as hardship distributions to include employee contributions, qualified nonelective and matching contributions, and related earnings.

¹⁴³ Early withdrawals from Roth IRAs are generally subject to different rules. See CRS In Focus IF11369, *Early Withdrawals from Individual Retirement Accounts (IRAs) and 401(k) Plans*, by Elizabeth A. Myers.

DC plan participants, including 401(k) plan participants, who take hardship withdrawals is relatively low—in 2018, about 1.6% of DC plan participants took hardship withdrawals.¹⁴⁴ IRA withdrawals are more common—based on data from the IRS, about 12% of taxpayers who had traditional IRA accounts and were below age 60 took distributions in 2016.¹⁴⁵ Research has found that those with low incomes, few assets, and who were younger were more likely to take early withdrawals from retirement plans.¹⁴⁶

Policymakers debate whether hardship withdrawal rules should be expanded or tightened. Some proposals expand qualified withdrawals for certain occasions when many households have special financial needs. For example, the SECURE Act allows certain penalty-free withdrawals from retirement plans if a child is born or adopted. However, others argue that the hardship distribution qualifications for 401(k) plans are too broad and give participants access to money for circumstances that are both voluntary and foreseeable, such as first-time home purchase costs. Policies that allow more qualifying withdrawals may encourage more retirement savings but also may reduce long-term retirement savings accumulations.

Another type of leakage is borrowing against plan assets. The Internal Revenue Code allows participants in employer-sponsored retirement plans to borrow against their accounts, but plans are not required to allow such loans. Loans are not permitted against IRAs.¹⁴⁷ According to the Investment Company Institute, the share of eligible DC plan participants who had loans outstanding increased from 15.3% in 2008 to 18.5% in 2011, likely due to financial stress during the 2007-2009 recession. Loan rates fell to 16.7% at the end of 2018.¹⁴⁸ The amount of loan defaults in 401(k) plans is relatively small compared with the asset base.¹⁴⁹ Unlike hardship distributions, loans are not subject to income taxes or the early withdrawal penalty if repayments continue on schedule.¹⁵⁰ Loan defaults in 401(k)s are generally treated as a distribution from the plan, subject to income tax and possibly an early distribution penalty. Starting in 2018, if a participant were to leave his or her job with an outstanding 401(k) loan, the loan would be treated

¹⁴⁴ ICI, “Defined Contribution Plan Participants’ Activities, 2018,” May 2019, at https://www.ici.org/pdf/ppr_18_rec_survey.pdf (hereinafter ICI, “DC Plan Participants’ Activities, 2018”).

¹⁴⁵ The amount of distributions accounted for 2% of the total balance in those traditional IRAs. See IRS, SOI Division, *Accumulation and Distribution of Individual Retirement Arrangements (IRA)*, at <https://www.irs.gov/statistics/soi-tax-stats-accumulation-and-distribution-of-individual-retirement-arrangements#tables>.

¹⁴⁶ Barbara A. Butrica, Sheila R. Zedlewski, and Philip Issa, *Understanding Early Withdrawals from Retirement Accounts*, The Urban Institute, May 2010, at <https://www.urban.org/sites/default/files/publication/28706/412107-Understanding-Early-Withdrawals-from-Retirement-Accounts.PDF>.

¹⁴⁷ Money in an IRA can, in effect, be “borrowed” for 60 days (once per 12 months) because the law states that any distribution from an IRA that is not deposited in the same or another IRA within 60 days is a taxable distribution (26 U.S.C. §408(d)).

¹⁴⁸ ICI, “DC Plan Participants’ Activities, 2018.”

¹⁴⁹ In 2016, outstanding participant loans made up only 1.4% (\$66.6 billion) of the \$4.7 trillion in 401(k) plan assets. A study estimates that \$6 billion on average annually flows out of 401(k) plans as a result of loan defaults. See DOL, EBSA, *Private Pension Plan Bulletin: Abstract of 2016 Form 5500 Annual Reports*, December 2018, at <https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2016.pdf>; and Timothy Lu et al., *Borrowing From The Future: 401(k) Plan Loans and Loan Defaults*, NBER, Working Paper no. 21102, April 2015.

¹⁵⁰ Other reasons that borrowing from a 401(k) plan is usually preferable to taking a hardship withdrawal include the following: with a loan, the account balance is not permanently reduced because the loan will be repaid into the account, generally within five years; and unlike a hardship distribution, after which employee contributions must be suspended for six months, the participant can continue to contribute to the plan while the loan is outstanding.

as an early withdrawal (possibly subject to tax penalty) if it is not repaid by the due date of the tax return for the year when the participant leaves the job.¹⁵¹

Research shows that the existence of a loan feature may encourage workers to enroll in the retirement plan and to allocate more of their salary into the plan.¹⁵² But concerns also exist that by using loans, people risk taking on too much debt, defaulting on their loans, and harming their future retirement security. For example, the SECURE Act contains a provision to prohibit qualified employer plans from making loans through credit cards and other similar arrangements.¹⁵³

Converting Savings into Retirement Income

At retirement, account holders—such as those with 401(k) plans and IRAs—generally need to decide how to convert account balances into income. Withdrawals mostly are taken in the form of lump-sum distributions or periodic withdrawals. Households may face the risk of either outliving their resources by withdrawing too much during earlier years or consuming too little by spending too conservatively. People may also have to make investment decisions on the remaining assets in their retirement accounts.

One option for drawing down retirement assets is to purchase an annuity using part of retirement account balances. Annuities may take different forms. A *life annuity*—also called an immediate annuity—is an insurance contract that provides guaranteed income payments for life in return for an initial lump-sum premium. A life annuity pays income to the purchaser for as long as he or she lives and, in the case of a joint and survivor annuity, for as long as the surviving spouse lives. Another annuity product, the Advanced Life Deferred Annuity, can be purchased at retirement with a smaller share of accumulated assets and payments beginning at a later age, such as 85. People can also purchase an inflation-adjusted annuity that provides annual increases in income.¹⁵⁴ Annuities can be used to reduce the likelihood that people may outlive their resources and to alleviate some post-retirement investment risks.¹⁵⁵ One recent study shows that annuity

¹⁵¹ An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (P.L. 115-97).

¹⁵² Research on the impact of the availability of a loan feature on 401(k) plan participation and contributions has found either positive effects or no significant impact. For example, one study found that adding a loan option increases 401(k) plan participation but did not find a conclusive impact on contributions. See John Beshears et al., *The Impact of 401(k) Loans on Saving*, NBER, Retirement Research Center Paper no. NB 09-05, September 2010. Another study found no impact of loans on participation rates, but concludes that the loan option increases the contribution rate by 10% among nonhighly paid participants. See Olivia Mitchell, Stephen P. Utkus, and Tongxuan Yang, “Turning Workers into Savers? Incentives, Liquidity, and Choice in 401(k) Plan Design,” *National Tax Journal*, vol. 60 (2007), pp. 469-489. A 1997 report from GAO shows that the availability of loans in employer provisions slightly increases participation. See GAO, *401(k) Pension Plans: Loan Provisions Enhance Participation But May Affect Income Security for Some*, GAO/HEHS-98-5, October 1997, at <https://www.gao.gov/archive/1998/he98005.pdf>.

¹⁵³ §2203 of the CARES Act modifies rules governing DC plan loans for qualified individuals during 2020 by increasing the maximum possible loan amount and extending debt repayment dates. Qualified individuals are defined in the same way as footnote 136. For more information, see CRS In Focus IF11472, *Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses*, by John J. Topoleski and Elizabeth A. Myers.

¹⁵⁴ In the inflation-adjusted annuity, the annual increases usually are paid for by a lower initial monthly annuity income or a higher premium.

¹⁵⁵ Some annuities allow the purchaser to share in investment gains from growth in equity markets as a way to offset the effects of inflation. These annuities also require the purchaser to share in the investment losses if markets fall.

strategies can be used to delay Social Security claiming,¹⁵⁶ thus resulting in a higher lifetime income.¹⁵⁷

Despite the potential advantages of annuities, the market for life annuities remains relatively small in the United States compared with other retirement financial products.¹⁵⁸ Several reasons may explain why the demand for annuities is low. For example, some people may already feel they have a sufficient amount of annuitized income from Social Security. In addition, about a third of people aged 65 and older have annuity income from DB pensions.¹⁵⁹ Another reason may be that the relatively high fees and expenses charged by insurance companies deter people's willingness to purchase life annuities.¹⁶⁰ Further, annuity contracts are not easily canceled, and many individuals fear that after purchasing an annuity, they may later need a large sum of money to pay for unexpected expenses (e.g., long-term care or health expenses).¹⁶¹ In addition, some people might be reluctant to purchase an annuity because they desire to leave a bequest to their heirs.¹⁶²

Disclosures can be designed to help retirement account holders make retirement account withdrawal decisions. As described earlier in this report, the SECURE Act requires plans to provide participants with a lifetime retirement income projection in at least one statement per year. Such statements for retirees can provide an estimated withdrawal anchor to help retirees make decisions. However, the lifetime income disclosure is an estimate and probably could not take personalized post-retirement investment risks into account.

Plan sponsors can be encouraged to offer more annuity options to participants. Currently, relatively few 401(k) plans provide the opportunity for retiring workers to convert all or part of their 401(k) accounts into life annuities at retirement.¹⁶³ As discussed earlier in this report, the SECURE Act makes it easier for 401(k) plans to offer annuities. However, some researchers suggest that defaulting some portion of 401(k) plan assets into an annuity would likely result in more account holders using an annuity investment product, rather than offering annuities as an option.¹⁶⁴ In terms of the timing of annuity decisions, one recent study finds that the take-up rate

¹⁵⁶ Delaying Social Security claiming from age 62 to 70 can increase potential Social Security monthly benefits. See CRS Report R44670, *The Social Security Retirement Age*, by Zhe Li.

¹⁵⁷ Alicia H. Munnell, Gal Wettstein, and Wenliang Hou, *How Best to Annuitize Defined Contribution Assets?*, Center for Retirement Research, Boston College, Working Paper CRR WP 2019-13, October 2019 (hereinafter Munnell, Wettstein, and Hou, 2019).

¹⁵⁸ In 2018, sales of single premium immediate annuities amounted to only \$9.7 billion. In comparison, total long-term care expenditures for the elderly amounted to roughly \$150 billion. See Munnell, Wettstein, and Hou, 2019.

¹⁵⁹ Edward N. Wolff, *The Decline of African-American and Hispanic Wealth since the Great Recession*, NBER, Working Paper no. 25198, 2008.

¹⁶⁰ See David McCarthy and Olivia S. Mitchell, "Estimating International Adverse Selection in Annuities," *North American Actuarial Journal*, vol. 6, no. 4 (October 2002), pp. 38-54; and Jeffrey R. Brown et al., *The Role of Annuity Markets in Financing Retirement*, (Cambridge, MA: The Massachusetts Institute of Technology Press, 2001).

¹⁶¹ See James M. Poterba, Steven Venti, and David Wise, "The Composition and Drawdown of Wealth in Retirement," *Journal of Economic Perspectives*, vol. 25, no. 4 (2011), pp. 95-118; and Society of Actuaries, "2017 Risks and Process of Retirement Survey," 2017, at <https://www.soa.org/globalassets/assets/files/resources/research-report/2018/risk-process-retirement.pdf>.

¹⁶² Lee M. Lockwood, "Bequest Motives and the Annuity Puzzle," *Review of Economic Dynamics*, vol. 15, no. 2 (2012), pp. 226-243.

¹⁶³ See CRS Report R40707, *401(k) Plans and Retirement Savings: Issues for Congress*, by John J. Topoleski.

¹⁶⁴ Munnell, Wettstein, and Hou, 2019.

would be higher if participants were required to make annuity decisions a decade before retirement.¹⁶⁵

Conclusion

Due to the growth in DC plans and IRAs, it follows that Americans are more responsible for managing their retirement, from a financial perspective, than in the recent past. This change has required people to take on more responsibility for making informed decisions about retirement planning and has put more risk on individuals and households.

New policies, employer initiatives, or financial products could make retirement planning decisions less difficult or aim to reduce major risk exposures for households. For example, as described in this report, information disclosure, financial literacy, and high-quality investment advice and products can help people navigate retirement decisions. In general, a better understanding of consumer decisionmaking in shaping a household's finances during its working years may be important for supporting a secure retirement.

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¹⁶⁵ Anran Chen, Steven Haberman, and Stephen Thomas, "The implication of the hyperbolic discount model for the annuitisation decisions," *Journal of Pension Economics & Finance*, vol. 19, no. 3 (July 2020), pp. 372–391.