Combined Retirement Income/Retiree Health Account Would Simplify Employees' Ability to Save for Both Needs in a Single Vehicle

Simplifying Retirement Savings Schemes And Vehicles Should Boost Participation Rates and Improve Decision Making

In recent one-on-one interviews with a cross section of HR Policy Association members, employers made it clear that they and their employees agree that the complex web of retiree living and medical savings plans unnecessarily complicate employees' ability to save for retirement in a defined contribution environment. Today, there are at least 17 different tax-advantaged employer- or individually-based vehicles available that distinguish between saving for retirement and health care expenses. However, with employer-provided retiree health care fading away, and medical expenses already consuming a significant portion of retirees' living costs, this distinction no longer makes sense. In fact, the dizzying array of overlapping eligibility requirements, contribution limits and tax treatments may actually leave the American labor force less well prepared for their retirement. For this reason, in its recently published monograph, *The Future of Retirement Security*, HR Policy Association has recommended consolidation of existing savings vehicles into a single vehicle with one set of rules.

Current System Does Not Reflect the Needs of Today's Highly Mobile Workforce

Neither traditional defined benefit (DB) pension plans nor the large number of defined contribution plans fits today's more mobile workforce. The Bureau of Labor Statistics estimates that late baby boomers, those born between 1957 and 1964, held an average of 10.2 jobs between the ages of 18 and 38. Unlike previous generations, this one has so far continued to hold a large number of relatively short-duration jobs, even as they approach middle age. Among jobs started by workers when they were ages 28 to 32, 50 percent ended in less than a year, and 82 percent ended in fewer than 5 years. This turnover trend conflicts with the very design of a DB plan, which rewards long-tenured employees with the largest pension. However, among defined contribution plans, an individual who frequently changes jobs may hold any number of incompatible retirement savings accounts, particularly if he or she moves between public, private, and self-employment. Holding multiple accounts, each subject to different rules and tax treatments, makes coordination between them very complicated and may contribute to lack of employee action on retirement preparation.

Vehicle Needed for Retiree Health Savings Increased life expectancy means that future retirees will require health care insurance coverage for 20 years or more beyond the traditional retirement age of 65. Yet, the number of those who can rely on employer-provided retiree health insurance is sharply declining. According to the Employee Benefit Research Institute, the percentage of firms with 200 or more employees offering retiree health insurance declined from 40 percent in 1999 to 35 percent in 2005. As a result, estimates of the additional savings required for 65-year-old couples who retire without employer-sponsored health insurance range from a low of $200,000 to $778,000 or more if they live to age 100. Currently, only two health-related savings programs allow employees to save for retiree health costs: Health Savings Accounts (HSAs) and Medical Savings Accounts (for smaller employers). HSAs provide a portable savings vehicle much like a 401(k), but the maximum amount that may be saved is still too small to prefund retiree health care. Other health care savings devices for active employees, including flexible spending accounts and health reimbursement arrangements, are neither portable nor designed for long-term retiree health security.

Combined Accounts Will Benefit Employers and Their Employees In our interviews, large employers have expressed interest in combining tax-advantaged savings for retiree health and retirement income into a single vehicle with one simple set of rules. This option would provide obvious advantages for employees and employers, including a single account where workers could easily gauge the adequacy of their total retirement savings. It would also limit the cost and complexity of contributing and holding retirement resources in multiple accounts. Because a single combined account would be more easily supervised than several smaller ones, employees would be better able to monitor their financial condition, pursue a single investment strategy, and evaluate the adequacy of their retirement savings. Single accounts would also simplify the administration of retiree benefits for employers, employees, and regulators.

Congressional Action Needed to Create a Simplified Account A significant hurdle to creating a single retirement security account is that significant legislative changes are required. Congress may need to unwind as many as a dozen current retirement and retiree health programs under the federal tax code and ERISA. This is likely to be a complex legal and political maneuver, as it is difficult to remove tax advantaged savings programs once they have been enacted. Each savings tool has its own constituency, from the financial products companies that provide and service them to the companies and employees who use them. In addition, simplifying savings products will potentially reduce tax revenues, as more employees may be inclined to participate. This situation may be unique, however, as there seems to be widespread agreement in concept, even among some financial services firms, that reducing and simplifying savings tools is sound public policy. Alternatively, Congress could create a new simplified savings option in addition to existing vehicles and then give employees the choice of which system to use.

Conclusion: A Simple Solution Needed Spreading savings over a variety of accounts is inefficient and unnecessarily complicates employees' decision making, making it less likely they will even participate in a savings plan. In addition, more savings "buckets" increase employer administrative costs and increase the chance that employees will realize lower returns on their investment. The goal here is simple—to allow employees accumulate adequate resources while working to meet living, health insurance, and other health care needs in retirement. The solution should also be simple—a single account to save for both retirement and retiree health care expenses.

Staff Contact Tim Bartl (tbartl@hrpolicy.org)