Defined Contribution-Based Purchasing Platform Gives Opportunity to Maximize Retirement Savings

Giving Employees the Flexibility and Assistance to Allocate Retirement Savings Among Different Benefits Allows for Changes in Savings Practices Based on Life Stage

As more employers migrate from defined benefit (DB) to defined contribution (DC) savings plans, employees must assume more responsibility for their own retirement security. Accumulating a sufficiently large retirement fund requires discipline and consistency. However, while many employees have improved their savings behavior, the evidence so far suggests that many will not have sufficient savings to ensure a secure retirement. One benefit of DC savings plans is that they can be designed to give employees the flexibility to customize how retirement savings are allocated to meet their unique needs. One idea that is growing in popularity in the marketplace is a benefits purchasing platform that allows employees to allocate retirement savings among different retirement benefits, including retirement savings, retiree health care, life insurance, and long-term care. HR Policy has recommended expansion of such platforms in its policy monograph The Future of Retirement Security, because they have the potential to simplify the retirement savings process and encourage more employees to actively save for retirement.

Shift to Defined Contribution Plans Has Increased Employee Flexibility Since the 1970s, there has been a dramatic shift away from employer-funded DB plans to employee-funded DC plans. In 1980, 28 percent of all workers were exclusively covered by a DB plan, 8 percent by only a DC plan, and 11 percent by some combination of the two. By 1999 the role of DB and DC plans had reversed, with some 14 percent of the work force covered by a combination of DB and DC plans. Although DC plans lack the security provided by traditional DB plans, the flexibility and portability of DC plans provide an opportunity for a more secure retirement to a larger share of the population, especially younger workers and those who switch jobs regularly. The key is getting employees to participate early and to contribute sufficient amounts.

Americans Not Saving Enough For Retirement There is growing concern among employers and policy makers that despite employers' best efforts to promote their DC plans, current participation rates and contribution amounts are not sufficient to ensure retirement security. As reported by Vanguard, young employees save the least amount of money for retirement, putting aside approximately 5 percent of their income, versus an average for all ages of 7.3 percent. Similarly, only about 39 percent of lower paid employees – those earning less than $30,000 – participate compared with 89 percent for those making $100,000 or more. These low participation and savings rates among younger and less well-paid employees reflect low levels of disposable income in these groups. The challenge for younger and less well-paid employees then is to create greater savings from the same benefit package without sacrificing the income needed to cover living expenses. One way to do this is to give employees more flexibility over how their employer-provide benefits are allocated.

Flexible Benefit Approach Matches Benefits and Savings to a Stage in Life A coordinated and comprehensive suite of investment products purchased through an existing DC plan may allow younger employees to jump start their savings and allow older employees the flexibility to adjust the mix of retirement products as they age. The flexibility underlying such "purchasing platforms" is designed to encourage long-term retirement savings.

Purchasing Platform Based on DC Account. The products typically work like this: both the employee and employer would contribute funds into a single DC-based savings account. From this account, the employee could choose to purchase units of different existing benefits, such as 401(k) savings, life insurance, retiree health coverage, or long-term care insurance. Any funds left over may be dedicated to a long-term savings vehicle. Under this "cafeteria"-style plan, the employee would choose to purchase only the amounts needed to suit his or her circumstances. For example, an employer could choose to match employee retirement savings up to a certain amount, pre-fund a health savings account or make a general contribution to the account. From the available funds, the employee might choose to maximize the value of their employer's match by forgoing life and long-term care insurance and placing the funds into the retirement plan.

Mix of Benefits Selected According to Current, Future Life Needs. The exact mix of benefits that the employee chooses to purchase would likely depend upon his or her age and marital status. For example, a young, unmarried, and childless employee might find it advantageous not to purchase life insurance and apply the employer's subsidy towards his or her retirement savings. On the other hand, a older, married worker with minor children might be better off with lower retirement savings, a life insurance policy, and savings for retiree health and college education. Similarly, a young, healthy employee might choose a high deductible health plan and roll any savings on medical expenses into their retiree medical savings account. This "super-flexibility" concept would allow workers to select the precise mix of benefits needed in response to certain milestones, or life events, such as marriage, birth of a child, or purchase of a home. Extending this model to include automatic adjustments for major lifestyle changes such as the birth of a child could help to maximize an employee's overall financial security throughout his or her career. Employee financial education and benefits advice would be an important part of implementing this concept.

Purchasing Platform a Stepping Stone to Simplified DC Benefits? Ideally, reforming the tax code to create a single savings account would require considerably less effort on the part of employers and employees to set up, manage and administer. However, in the current fiscal situation, it is unlikely that Congress would be willing to undertake such a massive overhaul of the retirement and health care savings system. Thus, by merely serving as the holding vehicle for the employer and employee funds, the purchasing platform option avoids many of the complicated statutory and regulatory changes that creating a single all-purpose account requires. Unlike a single account, the different products within this suite could retain their existing tax treatments to reward or discourage certain activities.