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REIMAGINING RETIREMENT FOR THE GIG ECONOMY

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INTRODUCTION

The emergence of the so-called “gig economy” – employment situations in which a worker may spread his or her labor among several part-time or freelance arrangements with several different employers – has engendered quite a bit of commentary from policy experts and, increasingly, from politicians.

A November 2015 policy brief from Ian Adams of the R Street Institute¹ made the case that the existing system of employee benefits is ill-suited to these more flexible arrangements. Adams’ brief was part of a broader effort by a coalition of disparate groups – including the Aspen Institute, the American Action Forum, the Freelancers Union and numerous distinguished academics – who together signed an open letter calling for employee benefits to be made more flexible.² Signatories called for a thorough restructuring of existing

1. Ian Adams, “The Flexible Future of Work,” R Street Institute, Nov. 10, 2015. <http://www.rstreet.org/policy-study/the-flexible-future-of-work/>

2. Portable Benefits Coalition, “Common Ground for Independent Workers: Principles for Delivering a Stable and Flexible Safety Net for All Types of Work,” *Medium*, Nov. 9, 2015. <https://medium.com/the-wtf-economy/common-ground-for-independent-workers-83f3fbcf548f#.dkg0x1nuc>

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law, regulations and tax provisions to allow benefits to be portable between companies.

Our current system, the signatories argued, largely preserves the assumptions of 50 years ago: that people will work many years for the same company, and that it is that employer who generally will be responsible to see to their retirement needs. While pensions generally have already transitioned from defined benefit to defined contribution, it remains the case that most retirement saving is done through an employer retirement plan, even though there is nothing about saving money that necessitates an employer’s involvement. If this system ever were appropriate, it has become less so over time, as jobs have become much less secure and employees move rapidly from company to company.³

In that vein, it is worth considering how a new retirement-savings system – one sufficiently flexible and portable for

3. Employee Benefit Research Institute, “Employee Tenure Trend Lines, 1983-2010,” *Notes Vol. 31, No. 12, December 2010*. https://www.ebri.org/pdf/notespdf/EBRI_Notes_12-Dec10.Tenure-CEHCS.pdf; see also, Leora Friedberg and Michael T. Owyang, “Not Your Father’s Pension Plan: The Rise of 401(k) and Other Defined Contribution Plans,” *Federal Reserve Bank of St. Louis, January/February 2002*. <https://research.stlouisfed.org/publications/review/02/01/23-34Friedberg.pdf>

modern workers – might be constructed. But before we can hope to design that structure, we must first determine what features such a system would need.

Some high-level principles for reform are obvious. First, we should strive to build a system that is easy to use. Employees should be able to understand their benefits and manage them as smoothly as possible. At the moment, many employees do not take full advantage of their retirement benefits. This may be partly because they don't understand their value, or because they are afraid of the complexity and potential for tax penalties if they make a mistake.⁴

Second, compliance costs and fees should be as low as possible, for both employees and employers. Under the current system, employers who wish to maintain a full-featured benefits plan, such as a 401(k), incur such costs as per-participant fees, fidelity bonds and administrative fees. Less costly options are available, such as SIMPLE IRA plans, but these limit the ability of companies to offer 401(k) matching or profit-sharing bonuses.⁵ Far better would be if total costs were sufficiently low that neither companies nor employees had to compromise.

Third, we should remove unnecessary restrictions on the kinds of investments that can be made and the kinds of benefits that can be provided. For example, many companies provide temporary term-life insurance for their employees. But some employees might find permanent whole-life insurance more suitable for their needs, even if they have to pay the difference in cost themselves. Similarly, many 401(k) plans offer only a short list of mutual funds, with no way for participants to invest elsewhere. Even plans with the richest features offer few ways to invest in local businesses, for example. An ideal benefits system would be as flexible as possible. It would allow employees to design their financial lives the way they want and to take advantage of new financial opportunities that are impossible for policymakers to imagine today.

However, in designing a new system, we should be careful not to lose any of the key capabilities of the old one. Employee-benefits plans have developed other functions beyond simply

providing insurance and encouraging retirement savings. Attempting to replace the current benefits system without fully understanding what it does could lead to tremendous disruption of people's financial lives. We begin with a short inventory of some nonobvious uses of the current employee-benefits system.

Employee-benefits plans have developed other functions beyond simply providing insurance and encouraging retirement savings. Attempting to replace the current benefits system without fully understanding what it does could lead to tremendous disruption of people's financial lives.

First, 401(k) plans provide an important advantage over Individual Retirement Accounts: the ability to borrow from one's own savings. One might argue that borrowing from your retirement savings defeats the point, and that IRAs already allow withdrawals for qualified purposes, such as buying a first home. But most people will face severe financial setbacks long before they reach retirement age, when they gain unrestricted access to their funds. If they have channeled much of their savings into tax-advantaged vehicles that cannot be accessed, people will be forced to borrow externally (often at high interest) to make up for any cash-flow crunch. Those with 401(k) accounts often find the ability to borrow for short periods to be a godsend.

Second, employers are encouraged by the current system to reward their lower-paid employees for saving for retirement. Employers often provide contribution matching, or even profit-sharing grants, to their employees. This is because so-called Actual Deferral Percentage and Actual Contribution Percentage (ADP/ACP) tests, as well as "top-heavy" tests, limit the amount of money that highly compensated employees can invest in their 401(k) accounts unless total participation is sufficiently high. The interests of highly compensated employees are thus served by providing additional retirement savings for lesser-compensated employees.

Third, employers can use vesting schedules as rewards and punishments for their employees, discouraging them from leaving the company by offering deferred compensation if they stay long enough. This benefits employers by reducing employee turnover and the considerable costs associated with it. Additionally, having a vesting schedule makes employers more willing to provide employee matching and profit sharing in the first place, since they can protect themselves from paying "extra" to a bad employee.

Fourth, Employee Stock-Option Plans (ESOPs) allow employees to purchase the stock of their company at lower cost. This can provide a nonobvious benefit to company

4. William F. Bassett, Michael J. Fleming and Anthony P. Rodrigues, "How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions," Federal Reserve Bank of New York, No. 38, 1998. https://www.newyorkfed.org/research/staff_reports/sr38.html; James J. Choi, David Laibson and Brigitte C. Madrian, "\$100 Bills on the Sidewalk: Suboptimal Investment in 401(k) Plans," *Review of Economics and Statistics*, Vol. 93, No. 3: 748-763, 2011. <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3158583/>

5. Multiple plan types also contribute to a proliferation of investment-account registrations. Someone who has worked at several companies of varying size during his or her career might have accumulated a 401(k) account, a SIMPLE IRA account, a Traditional IRA account, a Roth IRA account, a Roth 401(k) account, a 403(b) account and a SEP IRA account, to say nothing of dedicated tax-advantaged savings plans for college education and other purposes. Reducing compliance costs and consolidating redundant plan designs would have the effect of making the system simpler to use overall.

founders — offering a way to sell one’s stake gradually, at favorable terms, without incurring a sudden tax liability and without disrupting company management by selling to an outsider. One can also exploit the ESOP structure to invest 401(k) savings in one’s own small business, by rolling assets into your new company’s retirement plan and using those assets to purchase company stock.

Once the inventory of uses is complete and we fully understand the requirements needed for the new portable-benefits system, we can make general recommendations for its design that are both compatible with the high-level principles noted above and that preserve key functions of the current system. Done correctly, a redesigned system can provide new benefits to both employees and employers without sacrificing any of the key features they enjoy today.

BORROWING FROM YOURSELF

Tax-advantaged retirement accounts present a trade-off. In exchange for receiving tax benefits, savers largely are prevented from accessing their money until they reach retirement age. If one makes a non-qualifying withdrawal from an IRA or 401(k), one will be hit with whatever taxes previously were deferred, as well as an additional 10 percent penalty.⁶ This is, of course, by design; the whole point is to promote saving for retirement, the point at which individuals no longer earn an income and must support themselves through prior savings (or be supported at public cost).

However, emergencies happen, and they are not often obliging enough to wait until you reach retirement age. The consequences of a sudden financial crunch can be devastating, resulting in ruined credit (and the cascading future effects of having a low credit score);⁷ foregone medical care or education; or even the loss of one’s job if, say, the car suddenly breaks down and cannot be repaired.⁸ Savings are crucial not merely for retirement, but also to handle such emergencies. Recognizing this, the law offers provisions for hardship

withdrawals from retirement accounts, such as health-care expenses or distributions upon divorce.⁹

But accumulating liquid savings has use even outside of emergencies. Some major purchases — like a car or a house, or more mundane things like a more efficient water heater — can improve a person’s long-term financial health significantly. To make such purchases requires the accumulation of “usefully large sums.”¹⁰ Not being able to accumulate such sums could prevent such purchases altogether. Alternatively, people could rely on credit to finance major purchases, with ongoing annual financing costs of 15-30 percent or more. These costs are likely to wipe out all the advantages of tax-deferred saving (at minimum), especially in an era of mediocre stock-market returns.¹¹

People can put aside money in taxable accounts, of course, but taxes on interest or capital gains erode the productivity of such savings, and make them more complex to manage. Tax-deferred savings are significantly more attractive than taxable ones because of their many subsidies. If you have limited dollars to save, you are likely to prefer tax-deferred saving in a 401(k) or IRA. But this has the effect of discouraging liquid savings and can distort purchasing decisions in detrimental ways. At the same time, those who expect to need their money before retirement will rationally choose against tax-deferred saving, working against the policy goal of securing their retirements. In this way, the illiquidity of retirement savings tends to work against poorer savers more than rich ones, since they have more pressing needs for an emergency fund or to save for major purchases.

To some extent, the law recognizes this, as well. IRAs have provisions to withdraw money to purchase a first home, as well as some other limited uses, such as qualifying education expenses.¹² However, the number of exceptions is fairly narrow. The general presumption is that retirement monies are earmarked for long-term savings, first and foremost.

But it is here that 401(k) accounts have an important advantage over IRAs: the ability to borrow money from your

6. Internal Revenue Service, “Topic 424 — 401(k) Plans,” last updated Jan. 4, 2016. <https://www.irs.gov/taxtopics/tc424.html>

7. Julapa Jagtiani and Wenli Li, “Credit Access after Consumer Bankruptcy Filing: New Evidence,” *American Bankruptcy Law Journal*, Vol. 89, No. 2: 327-361, 2015. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2269621; see also, Dean S. Karlan and Jonathan Zinman, “Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts,” Economic Growth Center, discussion paper No. 956, 2007. <http://www.econstor.eu/bitstream/10419/26995/1/593370082.PDF>; see also, Lea Shepard, “Seeking Solutions to Financial History Discrimination,” *Connecticut Law Review*, Vol. 46, No. 3: 993-1044, 2014. <http://connecticutlawreview.org/files/2014/04/8-Shepard.pdf>

8. For one example, see Matt Miller, “Pa. Court Sides with Low-Wage Worker Fired After She Couldn’t Afford a Car,” *Penn Live*, Sept. 4, 2013. http://www.pennlive.com/midstate/index.ssf/2013/09/pa_court_sides_with_low-wage_w.html

9. Internal Revenue Service, “Retirement Topics — Exceptions to Tax on Early Distributions,” last updated Sept. 1, 2015. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Tax-on-Early-Distributions>

10. Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven, “Portfolios of the Poor: How the World’s Poor Live on \$2 a Day,” Princeton University Press, 2009.

11. Geng Li and Paul A. Smith, “Borrowing from Yourself: 401(K) Loans and Household Balance Sheets,” SSRN, Aug. 12, 2008. <http://ssrn.com/abstract=1222734>

12. Internal Revenue Service, “Retirement Topics — Exceptions to Tax on Early Distributions,” last updated Sept. 1, 2015. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Tax-on-Early-Distributions>

account, for any reason, up to 50 percent of its value.¹³ Such borrowing is done at relatively low interest rates and repaid to one's own account, though the borrower misses any gains that his or her funds might have earned in the interim.¹⁴ Repayment usually is made through automatic payroll deductions. If the loan is repaid within five years, there are no tax consequences at all.

For loans that take longer than five years to repay, the balance is treated as an early withdrawal and taxed and penalized accordingly. Additionally, if the borrower loses his or her job, an outstanding loan must be paid back within 60 days or similarly risk being treated as an early withdrawal. Under this regulatory requirement, borrowers must come up with large amounts of money right when their ability to do so is curtailed, which is incredibly perverse.

The ability to borrow from one's own savings is quite powerful. It can allow people to make necessary major purchases, or to consolidate existing high-interest debt and rebuild their solvency. For those with poor credit, an available 401(k) account may be the only option available to finance needed purchases. Automatic payroll deductions also provide useful discipline to ensure repayment.

Borrowing from one's account has another important benefit, compared even to a qualified withdrawal: when a loan is repaid, it does not count against limits for new contributions. Conversely, an early withdrawal from an IRA or 401(k) cannot simply be "replaced"; if a plan participant cashed out \$50,000 for a short-term emergency, he or she cannot then return it to his or her account once his or her finances recover. The participant could invest only a maximum of \$5,500 per year (for an IRA). In the meanwhile, such "repayment" crowds out any new tax-deferred savings. That problem does not appear when you borrow from a 401(k).

Some will object that irresponsible borrowers will simply fritter away their borrowed money on needless purchases; they will be left with no savings and a large tax bill after five years.¹⁵ Many people will borrow from all available sources, right up to the very limit of their ability to get new credit. Critics would say providing access to more liquidity merely allows them more avenues for ruin. If a borrower faced a tax penalty for this form of early withdrawal, these critics

13. Note that the ability to borrow from a retirement plan is at the discretion of the sponsor company, who can define limits on how much borrowing to permit when the plan is established. See, Internal Revenue Service, "Retirement Plan FAQs regarding Loans," last updated Jan. 22, 2016. <https://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Loans>

14. You miss losses, too, which could be an unexpected benefit.

15. Donna Rosato, "The Hidden Cost of Taking a 401(k) Loan: Borrower's Remorse," *Time*, June 19, 2014. <http://time.com/money/2895936/the-hidden-cost-of-taking-a-401k-loan-borrowers-remorse/>

say, he or she would be more hesitant to consume his or her savings in this way.

Ultimately, if a person wants to spend himself or herself into poverty, there are many avenues to do so. Self-discipline is the necessary ingredient here, far more than artificial restrictions on how to spend one's money.

This is true, as far as it goes. But plan participants also would be less willing to invest tax-deferred money at all, since it might make more sense simply to park it in a bank account for ready access when it's needed. The critics' argument also underestimates the amount of borrowing that is quite rational for a borrower to need, even when making use of unusually expensive payday loans (which can charge upward of 300 percent effective interest annually).¹⁶ Given that, it would provide far more help to the poor to offer better and cheaper borrowing options that don't impose massive costs, than to maintain ineffective barriers to borrowing that end up doing no such thing.

Ultimately, if a person wants to spend himself or herself into poverty, there are many avenues to do so. Self-discipline is the necessary ingredient here, far more than artificial restrictions on how to spend one's money. For someone who is not wealthy, and for whom saving for large purchases and emergencies is difficult, the ability to borrow from a 401(k) will make that person more likely to contribute money in the first place. It also makes such contributions more useful, even long before retirement. The ability to borrow against a 401(k) is extremely important and ought to be preserved. Indeed, people ought to be able to borrow from their IRAs, as well.

EMPLOYER MATCHING AND PROFIT-SHARING

The current structure of 401(k) plans represents a bargain between the government and employers: the more money a company grants to its rank-and-file employees, the more money major shareholders and highly paid employees can put away for themselves.

In general, employees participating in a 401(k) plan are able to put aside a great deal of money tax-deferred: up to \$18,000

16. See, e.g., Gillian White, "Borrowing While Poor," *The Atlantic*, Nov. 5, 2015 <http://www.theatlantic.com/business/archive/2015/11/fixing-the-problem-of-payday-loans/414181/>; Neil Bhutta, Paige Marta Skiba and Jeremy Tobacman, "Payday Loan Choices and Consequences," *Journal of Money, Credit and Banking*, Vol. 47, No. 2-3: 223-260, 2015; Neil Bhutta, Jacob Goldin and Tatiana Homonoff, "Consumer Borrowing After Payday Loan Bans," working paper, Nov. 5, 2015. http://www.human.cornell.edu/pam/people/upload/ConsumerBorrowing_BhuttaGoldinHomonoff.pdf; Dean S. Karlan and Jonathan Zinman, "Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts," Economic Growth Center, Center discussion paper No. 956, 2007. <http://www.econstor.eu/bitstream/10419/26995/1/593370082.PDF>

per year, not including employer contributions and catch-up contributions for older employees.¹⁷ It is obvious that the bulk of this tax deferral will benefit better-paid employees, who can afford to divert such large sums from their income. Less well-compensated workers who can afford to put aside much less money from their paychecks will see little benefit, in relative terms. To counteract this disparity, IRS regulations give management a personal stake in the degree to which less-compensated employees save for retirement, as well.

The mechanism doing the work here is a series of “non-discrimination” administrative tests on plan assets: the ADP test, the ACP test and the “top-heavy” test. Plan administrators are required to analyze the distribution of assets within a plan, according to complicated formulas provided in the law. If a sufficiently large proportion of deferred savings in a given year comes from highly compensated employees (HCEs), the plan will fail the ADP and/or ACP tests; the company will either have to grant enough money to its non-highly compensated employees (NHCEs) to make up the difference, or else refund excess contributions to the HCEs.¹⁸ That could generate a large tax bill for the affected employees, and would limit the amount of retirement savings that HCEs can shelter from taxation.

Furthermore, if more than 60 percent of the money in the plan belongs to key employees (those who own large percentages of the company, or who are highly paid), then the plan has failed the top-heavy test; it must immediately pay non-key employees up to 3 percent of their salary as contributions to their accounts.¹⁹ Thus, management has a strong incentive to make sure that lesser-paid employees have enough assets in the plan. If they cannot afford to contribute themselves, the company will in some cases make contributions for them.

This is a major motivation for companies to provide generous employee matching and, in some cases, profit-sharing grants as well. In fact, the law provides a “safe harbor” exception for companies that provide sufficiently generous matching programs. Administrators of a 401(k) plan that offers a 4 percent dollar-for-dollar match, or a grant equal to 3 percent

of salary, would no longer need to apply the ACP, ADP or top-heavy tests. Key employees could then defer as much of their salary as they wish, up to the legal maximums.

Furthermore, if a company chooses to provide a profit-sharing plan to its employees, the amount granted to each employee is usually proportional to salary. Employees can receive profit-sharing grants up to the amount of their salary, or \$53,000, whichever is less.²⁰ As a result, using a profit-sharing plan allows highly paid employees to set aside much larger amounts of tax-deferred savings than otherwise would be possible.

Without some guarantee that bonus compensation will only go to those employees who ‘deserve it,’ many company officers would rather not offer employee matching at all. The ability to require a vesting period thus serves an important psychological function for decisionmakers.

In short, company managers have a few different reasons to provide generous retirement-plan benefits, such as employer matching and profit sharing. While some would offer rich benefits in any event, to attract and retain good employees, other managers are motivated chiefly to maximize the amount that they, as highly paid individuals, can accumulate in their 401(k) accounts. The current regulations thus provide incentives for companies to reward less affluent employees for saving for retirement.

As we redesign the retirement-saving system, we must be careful not to reduce the rewards for saving. We probably would want to provide highly paid management an incentive to share more with their employees. The current system does so by allowing for greater tax-sheltering for highly paid employees, and perhaps the next system should as well. If not, it must have some other means of encouragement, with the exact mechanism dependent on the designers’ specific policy goals. But some means should be in place.

VESTING OF BENEFITS

Companies also use employee benefits to reward employees for staying. First of all, many benefits plans are available only to full-time employees who have worked for a company a specified time period, usually six months or a year. This protects the company from the high administrative costs of adding employees to the plan in cases where an employee is not going to remain with the company very long or is otherwise not worth the extra cost. This also serves as an incentive for

17. Internal Revenue Service, “Retirement Topics — 401(k) and Profit-Sharing Plan Contribution Limits,” last updated Oct. 26, 2015. <https://www.irs.gov/Retirement-Plans/Plan-Participant-Employee/Retirement-Topics-401k-and-Profit-Sharing-Plan-Contribution-Limits>

18. This is much higher than the contribution limits for an Individual Retirement Account (IRA), which are \$5,500 per year. A result of this disparity is that individuals’ ability to save for retirement is partly dependent on a factor outside of their control: the decision of their employer to provide, or not to provide, a 401(k); see Internal Revenue Service, “401(k) Plan Fix-It Guide — The plan failed the 401(k) ADP and ACP nondiscrimination tests,” last updated Oct. 23, 2015. <https://www.irs.gov/Retirement-Plans/401k-Plan-Fix-It-Guide-The-Plan-Failed-The-401k-ADP-and-ACP-Nondiscrimination-Tests>

19. Internal Revenue Service, “401(k) Plan Fix-It Guide — The plan was top-heavy and required minimum contributions weren’t made to the plan,” last updated Oct. 23, 2015. <https://www.irs.gov/Retirement-Plans/401k-Plan-Fix-It-Guide-The-Plan-was-Top-Heavy-and-Required-Minimum-Contributions-Were-not-Made-to-The-Plan>

20. U. S. Department of Labor, “Profit Sharing Plans for Small Business,” accessed March 16, 2016. <http://www.dol.gov/ebsa/publications/profitsharing.html>

employees to perform well and remain with a company: hiring and training new employees is tremendously disruptive and costly, and many companies want to reduce employee turnover wherever possible.

A stronger reward for employee loyalty is found in the idea of vested benefits. When a company provides an employer match, or a profit-sharing distribution, the money often is not fully under the employee's ownership.²¹ It is common for such grants to vest (i.e., transfer to the employee's ownership) over several years, often three; companies want to avoid paying extra money to an employee who soon quits.

One might think it would make more sense for a company simply to defer the benefits, rather than giving-but-kind-of-not-giving the money to an employee upfront. But getting paid immediately allows the employee to start investing it, so that its value can, one hopes, compound. More importantly, once the money is transferred to the retirement plan, the employee can be assured the money remains there even if the company changes its benefits policy or becomes insolvent, solving a commitment problem. From the company's perspective, it also provides a non-payroll business expense, reducing current taxes.

More importantly, when company management is considering the design of a new plan, the thought of providing company matching or profit-sharing without some kind of vesting period is extremely unattractive. Without some guarantee that bonus compensation will only go to those employees who "deserve it," many company officers would rather not offer employee matching at all. The ability to require a vesting period thus serves an important psychological function for decisionmakers.

Regardless of the specific design of a future retirement-saving system, some mechanism should exist for employees to make grants that vest conditionally – for example, over three years. In the absence of such a mechanism, companies likely would be less willing to provide retirement grants, for fear they will pay extra money to transient employees.

On the other hand, it does not make sense to restrict access to a 401(k) altogether during the initial period of employment, especially if more workers will have transient relationships with several employers via "gigs." After all, why prevent a worker from setting aside money from his or her own paycheck if there is no additional cost to the company? A major factor for such restrictions is the cost and administrative overhead of adding new employees to a company plan; a redesign ought to remove this factor, as much as possible.

21. Technically, even voluntary contributions are not owned by the employee, just held for his or her benefit, as discussed later.

EMPLOYEE STOCK OPTION PLANS

A company retirement plan can also include an employee stock option plan, or ESOP. With an ESOP, employees are able to purchase shares of the company for whom they work, even if the stock isn't traded publicly. ESOPs have a mixed reputation. If a company implodes, as WorldCom and Enron did, and employees have too much of their savings tied up in company stock, they can be ruined.²² On the other hand, if a company is successful, having the chance to purchase even privately traded stock gradually has made many an employee quite wealthy.²³

But that only scratches the surface of why ESOPs are important. If a company's original owner wishes to do so, an ESOP can be used to distribute most or all of the company shares among the employees, transforming it into something akin to a cooperative. Employees who own significant amounts of their own company's stock are more motivated, less likely to switch jobs and exert more effort in the workplace (the same is true with other forms of cooperative capitalism, such as profit-sharing).²⁴

For the founder of a company who wants to sell out, an ESOP can also provide an excellent means to sell off the company to motivated buyers (i.e., the employees).²⁵ With an ESOP, the retirement plan itself borrows money to finance its initial purchase of shares from the owner, and repays its debt as the employees, in turn, buy shares from the plan. The sale of shares to the retirement plan can be structured in very flexible ways: either all at once, if the owner simply wants a big payday, or in smaller chunks over several years, so that the owner can avoid a large tax hit and retain control during the early transition years.

22. Lisa Meulbroek, "Company Stock in Pension Plans: How Costly Is It," The Pensions Institute: Discussion Paper PI-0205, March 2002. <http://pensions-institute.org/workingpapers/wp0205.pdf>; see also, David Million, "Worker Ownership Through 401(k) Retirement Plans: Enron's Cautionary Tale," *St. John's Law Review*, Vol. 76, No. 4: 835-854, 2002. <http://scholarship.law.stjohns.edu/cgi/viewcontent.cgi?article=1369&context=lawreview>

23. Outside of the usual examples in Silicon Valley, one can note the employees of WinCo Foods; see Mary Josephs, "Millionaire Grocery Clerks: The Amazing WinCo Foods Story," *Forbes*, Nov. 5, 2014. <http://www.forbes.com/sites/maryjosephs/2014/11/05/millionaire-grocery-clerks-the-amazing-wincos-foods-story/#6d34b07340bc>

24. Joseph R. Blasi, Richard B. Freeman, Chris Mackin and Douglas L. Kruse, "Creating a Bigger Pie? The Effects of Employee Ownership, Profit Sharing, and Stock Options on Workplace Performance," National Bureau of Economic Research, Working Paper No. 14230, 2008. <http://www.nber.org/papers/w14230>; see also, James C. Sesil, Maya K. Kroumova, Douglas L. Kruse and Joseph R. Blasi, "Broad-Based Employee Stock Options in the US: Company Performance and Characteristics," *Management Revue*, Vol. 18, No. 1: 5-23, 2007. <http://www.econstor.eu/bitstream/10419/78958/1/756696453.pdf>

25. See Nancy Mann Jackson, "ESOP Plans Let Founders Cash Out and Employees Cash In," *CNN Money*, June 17, 2010. http://money.cnn.com/2010/06/03/smallbusiness/esop_plans/; for an example, note the case of Harpoon Brewery: Chris Furnari, "Harpoon's ESOP Gives 48 Percent of Company to Employees," *Brewbound*, July 10, 2014. <http://www.brewbound.com/news/harpoons-esop-gives-48-percent-of-company-to-employees>

Using an ESOP thus removes the need to look for outside buyers, which can be a long and aggravating process. If there are few prospective buyers, a company owner might otherwise be forced to sell at a significant discount. In any acquisition, remaining employees can find their new boss might not have their best interests in mind.²⁶ An ESOP can thus safeguard the interests of the owner and the employees, who will become the new owners of their own company.

The key capability here is that employees need a way to use their retirement savings to buy stock in their own company at a potentially lower cost and even if non-employees do not have access. The many potential benefits of employee stock ownership should impel us to preserve this capability as we redesign the retirement-saving system.

PROBLEMS WITH THE RETIREMENT-BENEFITS SYSTEM

While we note that advantages of the current system should be preserved, we also should examine some features of the system that are unnecessary or even harmful. By making the retirement-saving framework more portable, we can create dramatic improvements in the experience of tens of millions of people.

The hassle of multiple retirement accounts – Linking one’s retirement savings to an employer creates considerable friction and expense for people who change employers. A person who has worked for several employers over a career can leave behind a trail of 401(k) accounts, one at each former employer. Each of them must be managed separately. You can choose to consolidate your accounts with your current employer or in a Rollover 401(k), but that typically requires paying commissions to the administrators or brokers of your current accounts. It is also easy simply to forget about old accounts, particularly for those who don’t want to deal with the complexity of managing them. As a result, investment accounts often go years without rebalancing, leaving their owners open to excessive investment risk.

To a lesser degree, the problem exists even with individually owned IRAs. As time goes on and one saves for different goals, a saver will tend to accumulate several different kinds of tax-advantaged accounts, such as Traditional IRAs, Roth IRAs, annuity products, education accounts and the like. Regardless of the exact structure of a given account, if one has to manage one’s 401(k) as well as one or more IRAs, it’s easy for the total aggregate portfolio to become unbalanced through neglect. Worse, our current system maximizes the cognitive load for older savers, those least able to handle the

26. I was once involved in advising a company whose owner wished to sell quickly, against the advice of our firm and others. This exact scenario played out; the firm sold for much less than it probably was worth, and many employees ended up quitting their jobs in frustration with the new owners.

SIDEBAR: ROBS

Recently, some enterprising financial firms have stretched the concept of an ESOP to the breaking point, developing a novel way for midcareer professionals to use their 401(k) savings to fund their own small business. The plan is called a “rollover for business startup,” or ROBS.¹

Starting a new business is quite risky. The ROBS mechanism surely goes beyond the realm of “retirement savings,” except insofar as owning a successful business would go further toward funding one’s retirement than would the typical 401(k) account. Still, many believe that there is a compelling public-policy interest to provide more access to capital for entrepreneurs.² Thus, the option to use one’s retirement savings to capitalize a business should not be dismissed out of hand.

Under a ROBS plan, when an entrepreneur founds a new company, he or she simultaneously establishes an associated 401(k) plan. The entrepreneur then rolls over the assets of his or her existing 401(k) account into the new plan and uses the money to buy company stock. Ultimately, the assets within the old 401(k) account become working capital for the company, while the company shares reside in the retirement-plan account of the founder. Over time, if the company succeeds, it could buy back its own shares and replenish the owner’s retirement account.

This seems, at first glance, like an abuse of the retirement-savings system, something that a redesign should quash and not encourage. Starting a new business is incredibly risky and allowing tax-advantaged retirement savings to be put toward that purpose would seem to work against prevailing policy goals.

By the same token, existing rules include provisions that allow savers to invest in many kinds of risky assets. One is already permitted to transfer existing savings into a self-directed retirement 401(k) plan or IRA and use those savings to purchase nearly any kind of asset.³ Indeed, there is already a cottage industry in using self-directed IRAs and 401(k)s to buy real estate.⁴ Restricting the kinds of assets one can hold in a retirement account would add significant complexity and would probably have few benefits that justify the effort.

Whether or not one believes such adventurous mechanisms are a good thing, their presence illustrates two points. First, some people greatly want to use their accumulated funds to buy more kinds of investments than conventionally are considered. Second, artificial restrictions on how one’s money can be used will eventually be worked around. As we design a new system, therefore, we should prefer a system that allows investors to access more kinds of investments, rather than fewer.

1. The author would like to disclose a limited contracting relationship he has with Guidant Financial, one of the main providers of ROBS plans.

2. This is the motivation behind the Small Business Administration’s several financing programs, as well as several aspects of securities-registration laws. For a more detailed discussion, consult my earlier paper, “Freeing Investor Capital for Small Business,” R Street Institute, June 23, 2015. <http://www.rstreet.org/policy-study/freeing-investor-capital-for-small-business/>

3. Examples can be found in the advertising webpages of several trust companies, such as <http://www.sdretirementplans.com/self-directed-401k-basics/401k-faqs/>

4. Paul Sullivan, “Tackling Real Estate in a Do-It-Yourself Approach to I.R.A.’s,” *New York Times*, April 20, 2012. <http://www.nytimes.com/2012/04/21/your-money/self-directed-iras-in-real-estate-need-investor-effort.html>

difficulty of keeping their investments straight. In general, it ought to be possible to consolidate the dozens of different account types into a few.

Friction in accessing retirement assets – Another problem with the current retirement-plan system is the difficulty in accessing one’s 401(k) assets. This usually comes up when an employee leaves the company and is left with a 401(k) account under the control of the previous employer. While it is possible to roll over retirement assets into a new 401(k) or into a Rollover IRA, doing so usually requires the prior employer’s approval.²⁷ For small companies, it is distressingly common for overworked human-resources staff to delay handling the paperwork or to forget about it altogether. For large companies, it sometimes takes a great deal of research to figure out which unique forms to send former employees. The process of moving one’s money from a previous employer can take weeks or months, and much aggravation.

Worse, it sometimes happens that the employee quits under acrimonious circumstances. Vindictive management can refuse approval to transfer a 401(k) account out of spite. In fact, some plans allow a company to confiscate the assets of small 401(k) accounts that have been left behind for too long. In such circumstances, it sometimes takes threatening legal action to get the old company to process the paperwork as it should. There is simply no reason why one’s former employer ought to be able to block access to retirement assets.

Fidelity bonds – The problem of employers withholding a former employee’s assets is possible because, under the current system, assets in employees’ 401(k) accounts do not actually belong to the employees. Instead, they belong to the sponsor company (the employer), and are held in trust for the employees’ eventual benefit. This system creates the additional risk that unscrupulous company managers will simply loot the retirement plan, since they have administrative control over the assets. To protect against that risk, companies are required to carry a form of insurance called a “fidelity bond” to compensate plan beneficiaries should administrators rob their own employees.²⁸

Unfortunately, many poorly managed plans do not maintain the required fidelity bonds in place. This opens a company to legal liability, and threatens employees with the loss of their savings. It’s hard to say what possible benefit there could be in having my retirement funds owned by my employer that would be worth the needless friction and legal liability created by this system.

27. Emily Brandon, “7 Obstacles to Rolling an Old 401(k) into a New One,” *U.S. News*, April 5, 2013. <http://money.usnews.com/money/blogs/planning-to-rotate/2013/04/05/7-obstacles-to-rolling-an-old-401k-into-a-new-one>

28. U.S. Department of Labor, “Protect Your Employee Benefit Plan with an ERISA Fidelity Bond,” accessed March 26, 2016. <http://www.dol.gov/ebsa/publications/erisa-fidelitybondplanprotection.html>

Insurance benefits – While not a major focus of this paper, a quick discussion of employer-provided insurance benefits may be useful, as well. Many companies offer life-insurance coverage for their employees, which usually pays out some multiple of an employee’s salary upon death, with limited options to buy more coverage. However, since these products are term-life insurance, coverage lasts only as long as the employee stays with the company. Since many employees will move between companies frequently, whatever insurance they might have had will expire as they move. Additionally, employees have no choice in which insurance company to purchase coverage from. While this may not be significant for many people, there are reasons some employers might care about this lost choice. Some might otherwise have been eligible to gain multipolicy discounts with their existing insurers. Some might object to particular insurance companies’ business practices. Or employees could have any other personal preference that free choice would accommodate.

More significantly, while term-life insurance may be preferable for some people at an early stage in their lives, that’s not true of all people or all periods. Many would prefer to purchase whole-life or universal-life policies. These have a higher initial cost than term-life, but will provide considerable savings later in life, when term-life insurance becomes increasingly expensive. Others might prefer a more complex instrument, such as a life insurance policy with a long-term-care insurance rider. Such riders can be tremendously valuable to those who need them, especially since stand-alone LTC insurance is increasingly hard to get.²⁹ Employees currently have few ways to get their employers to subsidize such products, and must be satisfied with term-life or with paying out of pocket.

Similar hurdles exist in the health-care arena. Some companies have tried to offer fixed cash payments to their employees to help them buy individual health insurance on the ACA exchanges, only to later find out that this was made illegal.³⁰ Other companies offer a “cafeteria plan” that allows employees to purchase optional insurance, such as supplemental health and disability.³¹ But employers and employees can also set aside up to \$2,550 per year tax-free in a Flexible Spending Account for qualified out-of-pocket medical expenses, allowing patients the choice of what qualifying services to buy.³² This is an excellent model to follow, not

29. Jamie Hopkins, “New and Unexpected Ways to Fund Long-Term Care Expenses,” *Forbes*, April 21, 2014. <http://www.forbes.com/sites/jamiehopkins/2014/04/21/new-and-unexpected-ways-to-fund-long-term-care-expenses/#69b0a7fb143c>

30. Joyce M. Rosenberg, “Health Care Law Makes Tax Season Tougher for Small Companies,” *Associated Press*, Feb. 3 2016.

31. Internal Revenue Service, “FAQs for Government Entities Regarding Cafeteria Plans,” last updated Jan. 19, 2016. <https://www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/FAQs-for-government-entities-regarding-Cafeteria-Plans>

32. A summary of FSAs can be found on a federal website here: <https://www.health-care.gov/flexible-spending-accounts/>

only for out-of-pocket medical expenses, but for insurance more generally—as we will see in the next section.

REDESIGNING RETIREMENT

With all of that in mind, how can we preserve the useful elements of the current retirement system, while creating something more streamlined and easier to use—both for traditional full-time employees and for those working for several employers at once?

I believe the answer is to erase the distinction between employer retirement plans and individual retirement accounts. Here’s how it might work.

An individual would have a set of uniquely identified “shell” accounts: one or perhaps two³³ earmarked for retirement savings; one earmarked for insurance products; and one for taxable salary. These accounts would be administered by a bank or trust company. Money that enters these shell accounts could then be invested in any permissible assets,³⁴ similar to how one can hold mutual funds (or even some hybrid insurance products, such as variable annuities) within a brokerage account today. Money deposited into a salary account could then be shunted forward into whatever bank account or accounts the worker prefers.³⁵

Just as employers currently deposit a worker’s paycheck into a bank account, so too could the worker tell them to divert some of that income (as well as any employer matching or profit sharing) into a retirement account. The worker could also contribute money into the retirement account from his or salary account, from external bank accounts or from a tax refund, in addition to having the employer or employers do so. In other words, the same account would serve as an IRA and a 401(k).

The retirement account would be solely under the worker’s ownership and control. Employers who provide retirement grants would have no control over the assets, and would thus avoid the expenses and liability that presently come with administering a retirement plan. Employers could choose, however, to make vested contributions by setting up an escrow account with the trust company. The beneficiary would be able to manage the account’s investments as he or

she sees fit, just as is currently the case with vested contributions. Once the specific vesting requirements are satisfied, the escrow account would dissolve into the worker’s retirement account.

Furthermore, a worker no longer would need the approval of a company’s HR department to make asset withdrawals — only the approval of the administering trust company. This would end an incredible amount of friction and hassle with the current process, for both employees and employers. It would also prevent companies from obstructing their former employees’ withdrawals out of spite.

In addition, a worker would be permitted to borrow from retirement savings, in the same way that participants can borrow from 401(k) accounts today. The borrowing process would be overseen by the trust company; the maximum amount would need to be proportional to the money that passes through the salary account (which would serve as the source for automatic repayments) — perhaps up to 50 percent of retirement assets.³⁶

Under this system, being terminated from a job no longer would trigger a 60-day deadline to repay loans from a plan, since the loan no longer would be linked to the employer in any way. This deadline presents the greatest danger for borrowing from one’s 401(k) in the current system. The proposed alternative represents a considerable improvement.

CONTRIBUTION MATCHING AND GRANTS

It’s fair to question what incentives an employer would have to match employee contributions under this system. One option is simply to retain the top-heavy formulae and safe harbors from the current system, even if administration would be slightly different, since there is no longer any “company” plan, per se. This has the advantage that companies would not suddenly have to get used to a new system of incentives, and could keep matching what they are already matching.

However, this would be much harder to do, since key employees’ retirement savings would no longer be under the employer’s control. Enforcing top-heavy tests, or limiting the amount that key employees can save based on the aggregate savings of a company’s employees, would be far less feasible, if it remained feasible at all.

But if we decide the current system of incentives is insufficient, excessive or simply too clunky, we could take the opportunity to revise the system to better match our goals.

33. One account for the equivalent of a Traditional pre-tax retirement account, and one for an after-tax Roth.

34. “Permissible assets” ought to include not only public securities and insurance products but also real estate, venture capital and securities issued by small businesses, such as crowdfunded securities. See my prior white paper, “Freeing Investor Capital for Small Business,” R Street Institute, June 23, 2015. <http://www.rstreet.org/policy-study/freeing-investor-capital-for-small-business/>

35. This has the additional benefit of adding security against identity-theft losses. With such a system, employers would not possess the details of your actual bank account or retirement accounts and the shell accounts could not be used for actual spending.

36. It is important to note that nothing in this design would *force* employees to route their pay through the salary-shell account. It would only be needed if they intend to borrow from their retirement savings. Otherwise, one could simply have his pay deposited to a normal bank account.

The precise way to do that will depend on the goals to be achieved.

One option is to make the safe-harbor contribution a mandatory feature, so that all employees automatically would receive a retirement grant from their employers equal to 3 percent of their earnings, or a dollar-for-dollar match of employee contributions up to 4 percent of earnings. This would remove the need for top-heaviness tests and promote consistency in employee compensation between companies. A significant drawback is that this would impose a new effective tax on employers, and would probably impose new administrative requirements for companies that previously did not have retirement plans at all. Such a requirement could be seen to substitute for Social Security since it would provide savings against retirement.³⁷ One way to lessen the negative impact would be to reduce employer payroll taxes accordingly. An argument also can be made that any new administrative burden is likely to be slight, since employer firms already have to deal with the hassle of periodic payroll taxes.

Mandatory contributions would likely have the side effect of crowding out voluntary employer matching (except to the degree that employers provide additional matching to make their total compensation package more valuable and not merely to satisfy regulatory requirements). Some may view this as a positive: a system that requires companies to take an interest in their employees' saving habits smacks of paternalism. Additionally, if an individual is earning income from several different employers at once, it becomes cumbersome to manage retirement contributions from each of them, rather than handling it at a single point: the shell account that receives employees' total salaries, which then can be allocated as the worker wishes.

However, receiving an unvarying employer grant, rather than an employer match, would have the effect (on the margin) of discouraging individuals from saving their own money for retirement, even if they still get the same total amount of retirement money from their employers.³⁸ Again, some might see this as a plus; individuals may have reasons not to sequester their savings in a retirement account, and perhaps ought to make that decision free from paternalistic nudging. Still, employer matching has been found to make a significant difference in employee savings rates. Given that American workers are widely acknowledged not to save

enough for retirement,³⁹ it seems there ought to be some role for matching voluntary savings.

In my view, forcing employers to provide retirement grants is the wrong approach. There ought to be scope for employers to provide voluntary retirement benefits of greater or lesser value; and there ought to be some reward (however slight) for providing more generous benefits. Perhaps the easiest way to do this would be to offer relatively small tax credits

There ought to be scope for employers to provide voluntary retirement benefits of greater or lesser value; and there ought to be some reward (however slight) for providing more generous benefits.

for qualifying employer matches or profit-sharing — for the sake of example, perhaps 10 percent of the amount, on top of the existing tax benefits. In that way, the company would be rewarded for encouraging all of its employees to save for retirement and there would be less need for restrictive formulas and complex compliance overhead. A company also would thus have the flexibility to choose a benefits package that best fits its needs and employee culture.

An alternative route would be for matching grants to come from the government itself.⁴⁰ This could take several forms, in addition to the existing tax-deferral subsidies. The government could simply deposit cash directly into the individual's retirement account, putting it under private ownership but incurring immediate fiscal costs. Perhaps the recipients' future Social Security income could be reduced by some lesser measure, as the present assets would serve the same function. Conversely, the Social Security Administration could provide the matching grant by increasing the individual's future Social Security income, deferring the additional benefit (and expense) while retaining government control of the notional assets. Yet another option would be for the individual making a retirement contribution to receive an offsetting tax credit of some kind—that way, the matching grant can be spent immediately, instead of decades later.

The important point is that the federal government already is intimately involved in citizens' balance sheets, both as they work and as they retire. This provides a whole host of

37. Those savings would be controlled by the individual and likely invested more productively than Social Security presently does, which would be a great advantage for savers.

38. John Beshears, James J. Choi, David Laibson and Brigitte C. Madrian, "The Impact of Employer Matching on Savings Plan Participation under Automatic Enrollment," in *Research Findings in the Economics of Aging, National Bureau of Economic Research*: 311-327, 2010. <http://www.nber.org/chapters/c8208>

39. See, e.g., Eduardo Porter, "Americans Aren't Saving Enough for Retirement, But One Change Could Help," *New York Times*, March 3 2015. <http://www.nytimes.com/2015/03/04/business/americans-arent-saving-enough-for-retirement-but-one-change-could-help.html>

40. In addition, depending on the policy goals to be achieved, the government could have means-tested grants or other mechanisms to award retirement money where it wishes.

mechanisms to reward savers. Careful design should seek a combination that causes the fewest harmful distortions in behavior. Regulators would have to be careful, however, not to recreate the current morass of duplicative programs that we presently are trying to untangle. I suspect that rewarding employers for providing retirement benefits is likely to be more effective in the long run than for the government to pay savers directly.

ESOPS AND LIMITED-ACCESS PURCHASES.

Another crucial design question for a system in which individuals' savings no longer would be linked to their employers, is how an ESOP would work. It might be useful to re-examine the concept of an ESOP from a functional perspective. Company stock is held in some mechanism that permits employees of the company, and they alone, to purchase the stock at favorable terms. The current "mechanism" is the company retirement plan, but all that is needed is some sort of trust or holding structure that would be able to hold company stock and to sell directly to particular qualifying buyers.

We could broaden the underlying concept here. In theory, we could imagine a mechanism where any arbitrary kind of asset can be sold only to an arbitrarily limited class of people, at arbitrary terms. Such limited classes of investments actually exist in securities law; unregistered securities can only be bought by Accredited Investors, or by friends and family of startup founders.⁴¹ The distributors of such investments currently are required to determine if their buyers qualify, typically by having them attest to their status with an appropriate document.

This example shows it's possible to sell an asset to a specified pool of buyers without using a company plan. It also shows that there is a more general need, beyond ESOPs, for a mechanism that can sell only to specific people. An ambitious goal would be to create a new prototype category for a holding company in securities law; upon such a company's creation, it would specify what kinds of assets it can hold, under what terms they could be sold and who qualifies to buy such assets. Such single-purpose holding companies could administer ESOPs, ROBS structures, non-registered investments for Accredited Investors and the like. It could even be used to administer the equity of firms such as cooperatives, who wish to market to their customers.

All the possible uses of such a holding company would be difficult to anticipate, and the ingenuity of companies is likely to surprise us. But the main advantage is that this structure would streamline compliance requirements for many regulations in many domains that limit who can purchase what with which assets.

41. Again, see my paper, "Freeing Investor Capital for Small Business."

FLEXIBLE INSURANCE SUBSIDIES

Under the proposed system, money directed into a worker's insurance shell account could be used to pay premiums for health insurance, as well as for life insurance or disability or even annuities.⁴² I could choose between term-life or whole-life or even more exotic products that fit my situation. The insurance would be independent of whichever employers I happen to be working for, or not working for, at the time. Importantly, the insurance contracts themselves should not benefit from tax deferral—only the money used to pay for ongoing premiums. In this way, a distinction is preserved between allocating money for ongoing insurance and saving for retirement.

What incentives would exist for companies or individuals to fund the insurance shell account? This will depend on the specific policy goals to be achieved. If there is a reason to want people to have health insurance and life insurance, in addition to their retirement savings, then it makes sense to offer more generous subsidies for insurance contributions than for retirement saving—up to a certain limit. Thus, people would tend to fund their insurance up to the maximum amount rewarded, and then switch to retirement saving.⁴³

It is worth noting that the distinction between "insurance" and "investments" is quite fluid. Permanent life insurance policies are often used as investment vehicles, as well. If you "overfund" a universal-life policy, the excess premiums can be invested without being subject to tax, since they are held in trust by the insurance company (until any of the excess is withdrawn from the insurance policy, at which point, gains are taxed). This is intended to help accumulate a reserve fund that can pay for future premiums, reducing the need for the policyholder to continue paying out of pocket. But many wealthy investors deliberately overfund their insurance policies for the sake of tax benefits, creating a sort of "super-Roth IRA."⁴⁴ Thus, the insurance policy ends up serving two purposes: providing protection in case of early death and providing tax-advantaged investing.

The line is even murkier with annuities. Traditionally, annuities had not been considered a type of life insurance, since they were designed to pay out during the lifetime of the policyholder and to stop upon death. But modern annuities (and particularly variable annuities) also offer a death benefit —

42. Not to mention other forms of insurance that do not yet exist. The open letter on portable benefits noted in Footnote 2 hints at creating a structure for sick days or paid time off that is independent of particular employers; most likely this would have to be structured as some sort of insurance product, with both the employer and employee as beneficiaries.

43. Companies themselves also could be rewarded for providing insurance grants, as they could be for retirement grants. Those incentives might differ from those for individuals. In this way, there might be a division of labor between the individual and the company, as far as who is more rewarded for which kinds of contributions.

44. Gary A. Borowiec, "Tax Relief Through Overfunding," *Financial Advisor*, March 7, 2014. <http://www.fa-mag.com/news/tax-relief-through-overfunding-17185.html>

usually smaller than what a dedicated life insurance policy would offer, but substantial nonetheless.⁴⁵ The main purpose of the death benefit is to offer policyholders most of their money back if they should die “too early.” But it’s also possible to buy additional riders on the policy to get larger death benefits, blurring the line between annuities and life insurance.

If one had a policy goal of sharply distinguishing insurance from investments, then it might be possible to earmark the insurance account strictly for policies that cannot carry a cash balance. That would permit life, health, supplemental and other insurance types, while excluding universal-life insurance and variable annuities. I believe such a policy to be unnecessary. There is no public-policy benefit, as far as I can see, to imposing such impediments to individuals for the sake of preserving an arbitrary division between insurance and investments. If individuals would rather have a smaller death benefit in exchange for a cash balance, or a long-term-care rider or any other offsetting benefit that we currently cannot envision, they should be able to do so even with funds granted from their employers.

This does slightly blur the line between the insurance account and the investment account, but that may not present an actual problem. Individuals would be able to purchase variable annuities with their tax-deferred investment account anyway, so the more limited pool of insurance-account money would probably be more useful when applied to health and life insurance. In any event, the potential problems with such a system are likely sufficiently small that we can wait to see what actually develops, rather than devoting excess attention to preventing problems that may never arise.

CONCLUSION

Whether or not our work environment truly is transitioning to a “gig economy” – marked with transient relationships between employers and contractors – or whether most people are still going to work in full-time jobs for stable employers, our present retirement-saving system clearly serves transient workers poorly. Nor does it necessarily serve full-time employees all that well, either.

Employees lose out on the most attractive features of our retirement system if their companies choose not to provide 401(k) plans. The investments that participants can choose between are often sharply limited to those a plan makes available, and the options sometimes perform poorly. Switching companies can create needless friction in managing one’s retirement accounts, and additional cost when accounts are rolled over to a new plan or a Rollover IRA. Finally, compa-

nies must incur unwelcome expense, administrative burdens and legal liability in order to provide their employees with a fully featured retirement plan.

There are many advantages to transitioning to a system of individualized retirement accounts that combine the best features of IRAs and 401(k)s. Much of the current system’s needless complexity would be eliminated, making individuals more likely to take advantage of the benefits of retirement saving. People would have more control over their finances, more options for their investments and more flexibility in the face of unexpected financial emergencies. Such reforms would advance fundamental policy goals: making our retirement system less restrictive, less costly and more widely available to everyone.

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45. U.S. Securities and Exchange Commission, “Variable Annuities: What You Should Know,” April 18, 2011. <https://www.sec.gov/investor/pubs/varannnty.htm#dben>