Opinion

Rubio's Obamacare-Like Retirement Model Is Flawed

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Senator Marco Rubio (R-Fla.) has several excellent ideas for improving the retirement savings and security of older Americans. However, his recent proposal to open up the federal Thrift Savings Plan to non-government workers is not one of them.

The Rubio plan could harm asset managers, because it would encourage investors to adopt government retirement-savings accounts that may not include actively managed mutual funds.

A potential GOP presidential candidate, Rubio has proposed that any American who does not have access to a retirement plan with his or her employer should have the option to enroll in the federal government's defined contribution plan, the Thrift Savings Plan.

The plan permits government employees in the legislative and executive branches to contribute pre-tax dollars — with an employer match — into a government-controlled account to save for retirement.

Each employee can choose to invest the proceeds in a mix of low-cost index funds, including large-cap equity, small-cap equity and international equity passive funds, as well as Treasury securities. The Treasury fund carries no credit risk, but there are other risks, such as the specter of rising interest rates.

While this concept sounds attractive, it will not be a satisfactory solution to the looming retirement crisis facing older Americans.

The real problem with the U.S. DC system is that Americans are not saving enough for their retirement. According to the Investment Company Institute, the average 401(k) account balance at the end of 2012 was $63,929 and the median account balance was $17,630.

The average individual retirement account balances for Americans are not much better. As of May 2013, more than 60 million household IRAs held more than $6.5 trillion in assets, implying an average account balance of about $108,000.

An equally disturbing statistic is that only about 15% of all U.S. households contribute to an IRA each year, a pattern that has existed at least since 2007, according to ICI.

Legislators need to consider increasing the incentives for individuals to save for their retirement, especially those who do not have access to an employer-sponsored retirement plan. IRA and 401(k) limits should be set at higher levels and the government should provide tax deductions more broadly for all income levels.

Congress should enact legislation to encourage small businesses to establish retirement plans. Congress should ease current administrative and regulatory burdens, especially for employers with fewer than 500 employees. This could include allowing smaller employers the flexibility to offer retirement plans without a required contribution or match.

Another way to improve the DC system is to focus more attention on the costs of retirement plans, from the administrative expenses to the investment-advisory fees. Individuals should have greater access to low-cost retirement offerings that will help them add value and compound positive returns over long periods of time.

Over a 25- or 30-year time period, a typical retirement account with high fees will be short by a surprisingly large amount, when compared to an account with significantly lower fees.

Those who want to reform the DC system will argue that the only way to increase savings is to mandate retirement contributions, either at the individual level or within employer-sponsored plans.

This is not a concept that will work in this country. It should not be on the table until Congress does more to increase voluntary savings and encourage the creation of more small-business retirement plans.

Since the primary problem facing the U.S. DC system is the individual savings rate and not access to savings vehicles, Rubio’s Thrift Saving Plan proposal addresses only one aspect of a complex problem.

It is interesting that Rubio, as a prominent opponent of Obamacare, is proposing such a government-oriented solution so soon after the botched implementation of the Affordable Care Act.

While the Thrift Savings Plan may work well for federal employees, it will be burdensome for the executive branch to create and manage retirement-investment accounts for millions of Americans.

Ironically, the original Obamacare proposal was based on the benefits framework that congressional and executive branch employees use. Now is not the time for the U.S. to create an Obamacare-like model for retirement savings, especially one with the potential to affect the mutual fund industry negatively.