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Let's simplify retirement

Faced with so many plan choices, Americans often select nothing

The choices for how you structure your retirement plan are virtually limitless. But studies have shown that when people have a decision to make and are faced with too many choices, they tend to make no decision at all.

Psychology professor Barry Schwartz wrote about this in "The Paradox of Choice: Why More is Less." In one study

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referenced in the book, researchers set up two displays of gourmet jam at a food store. Ten times more product was sold when the choice was limited to six varieties compared to 24. Could it be that savings levels in our country are too low because there are just too many choices for savers?

Schwartz notes that we're faced with so many retirement planning choices that it's no surprise so many people put off decisions. Studies of retirement plans administered by Vanguard found that for every 10 mutual funds in a retirement plan, participation rates drop by 2 percent, with some employees even foregoing employer matching contributions.

Business owners often want to help their employees save part for retirement but must choose from among many options: 401(k), Simple IRA, SEP IRA, pension plans, profit sharing plans and more. There are different contribution limits for each type of plan and distribution rules are complicated which vary by type of plan.

Once invested in a plan, there can be hundreds of different types of accounts to choose from. Some plans allow for pre-tax contributions, Roth contributions and post-tax contributions or a combination of these, and some plans allow for in-plan conversion of funds between the accounts. Often, transactions made in one plan are not allowed in another plan because the complicated rules relating to retirement plans are interpreted differently by each plan administrator. There are even some investments in retirement accounts that may cause a tax liability. Is your head spinning yet?

Why not simplify the system so that we don't face so many layers of choice?

A new type of account, a Universal Savings Account, has been proposed by several congressmen. The plan is simple, and anyone over 18 can contribute up to $5,500 per year to it. The money can be invested however desired and withdrawn for any reason, without taxes or other penalties. Plans like this have been successful in Britain and Canada with wide adoption by people at all income levels and of all ages.

In the U.S., around 20 percent of people have Roth IRAs, but in Britain 43 percent hold these type of all-purpose savings accounts, and in Canada, the number is 54 percent with more than half of account holders contributing additional funds each year. Only a quarter of Americans that have Roth IRAs add to the accounts each year.

Single-purpose accounts like Roth IRAs have many rules for contributions and withdrawals, while all-purpose Universal Savings Accounts, or the British or Canadian equivalents, have no such rules. In the U.S., only 7 percent of those with incomes under $50,000 have Roth IRAs. In Britain, 55 percent of savings account holders have incomes under $25,000.

Frequently, I meet new clients who have accumulated large sums of money in bank accounts or in their retirement account but have not allocated those funds to an investment. I am sure the factors that Dr. Schwartz presents in his book are the primary reason for this.

A single type of account for all individuals whether they work for a large company, small company or are self-employed should be created to replace the numerous choices that now exist. Going a bit further:

- Balances should be allowed to be rolled over into the new plans.
- The plan should allow something like $25,000 in annual contributions, comparable to the British plan.
- Withdrawal restrictions should be removed so that no one would hesitate to invest.
- The accounts should be as simple to open as a checking account at a local bank.

As a financial planner, much of my work involves making our clients' investment decisions simpler or at least more understandable. If the rules affecting investment decisions were simplified, I believe that individuals would more readily choose to save and invest for a better future. NHBR

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