Post

search plan. The research plan would identify innovation
as innovations are tried, as evaluation results come in
what seemed promising truly is. Further, innovators shoul
be possible within the confines of current law through
d allow an innovation to be implemented and evaluated.

Why we need a learning system

Current participation rates, both in terms of employers sponsoring plans and employees participating, fall short of the levels that will produce retirement security. How we get from here to there is not self-evident. The pension challenge has similarities to reducing smoking, increasing consumption of fruits and vegetables, and getting people to keep from texting while driving a car. The goal is clear. The path is not. No single policy change will yield success. Success, if it is attained, will likely be the result of many changes.

There are many ideas about innovations that hold promise to get more employers to offer plans, more employees to participate and employees who participate to save more. But without trying them out, without carefully evaluating them, we will not know if the promise of these innovations is real. We need to try out ideas, evaluate them, and use what we learn in the process of trying them to develop new ideas. Repeating this cycle will make for a learning pension system.

Recent innovation has been largely in defined contribution plans. Decisions that lead to retirement to make as part of consumption later. Getting it right require security. Getting it wrong means not having retirement security.

The decisions made by defined contribution plan participants often are at odds with the behavior predicted by standard economic models. In the lifecycle model of savings and consumption, individuals want to smooth consumption across their working and retirement years. To do this they accumulate savings during working years, do so at a rate that will allow them to have similar consumption levels in retirement years as in their working years, and use tools like annuities to realize a smooth path of consumption in their retirement years. Observed behaviors mock the models.

The life cycle model predicts how people will behave when they go to work for an employer who offers a defined contribution plan. The moment you become eligible to participate, you will sign up, and apart from such circumstances as being the beneficiary of a trust fund that provides generous payments late in life, you will put as much money into the plan as you are allowed. However, an abundance of evidence has shown that does not happen.[1]

Evidence from innovations in defined contribution plans has shown participants are strongly influenced by defaults. If the default says you must make an affirmative decision to enroll, many people wind up not enrolling. However, if the default says you are enrolled and must do something to disenroll, then a lot more people participate in the employer's plan. Rather than rational, calculating, and forward looking decisionmakers who do the same thing regardless of which way the default operates, plan participants and would be participants have proven to be influenced by institutional arrangements and how they frame decisions.

Having a set of policies in place that lead to better decisions requires answers to many empirical questions. Current institutional arrangements are not set up to frame or answer these questions.

The Pension Protection Act of 2006 (PPA 2006) set out the rules under which an employer could make automatic enrollment a feature of its plan. Those contributions had to go somewhere, and the PPA made clear that a default allocation of a default enrollment contribution would be treated as a participant exercising control and not a prohibited action by a fiduciary.

The evolution of this provision shows the limitations and difficulties in the current model of policy innovation. Automatic enrollment and default allocation could be seen as something that was inconsistent with the law. At a minimum, plan sponsors might be worried about the legal risk they faced if they implemented automatic enrollment. The pioneers managed that risk through a private letter ruling. The employer who sought the private letter ruling could implement innovations, but so could others who used the contours of the private letter ruling as a template for their own changes. Economists later worked with benefits consultants to obtain data about what happened as a result of the innovation. Their findings showed that more employees participated when the default shifted from employee action required to enroll to employee action required to disenroll. In time, the statutory framework caught up in the PPA of 2006.

The automatic enrollment and default allocation experience defines the current model for pension policy innovation and suggests one way future innovation might happen. First, an innovative employer wants to try out an idea. Second, the employer secures the regulatory approval required to move forward with the idea. Third, the results of the policy innovation become known. Fourth, the policy world responds.

The relative popularity of defined contribution plans does not mean that defined benefit plans are an evolutionary dead end. Instead it shows the challenges to new approaches in this area.

Through the "Conversation on Coverage" process many individuals with backgrounds that ranged from unions to large employers to financial institutions developed a set of mechanisms that could lead to an increase in pension coverage and retirement savings. One goal of the plans proposed in 2007 by conversation participants was to devise plans that were less complex, potentially interesting employers that currently do not offer plans. (The "Conversation on Coverage" process and the plans the conversation proposed are documented on its web site, http://www.conversationoncoverage.org/)

One of the plans that emerged in that process was a defined-benefit plan, a "plain old pension plan" or POPP. Government published tables would determine contribution amounts. Employers would have the ability to keep plan costs in line with how good a year they have. One was a hybrid of

[1] Another report in this series, Christian Weller's "Fun with Numbers: Disclosing Risk to Individual Investors," reviews this evidence. http://www.economicsecurityproject.org/documents/Weller_report.pdf

defined benefit and defined contribution, the Guaranteed Account Plan (GAP.) It would combine individual accounts with guarantees of investment performance. Like a defined benefit plan, it would

What a research and demonstration authority could do

The Pension Protection Act of 2006 provided the statutory space for employers to compensate for one form of inertia, failing to sign up for an employers plan, but did not address other forms of inertia, for

agenda would not be a rule, the Secretary could be required to publish a proposed agenda in the *Federal Register* and solicit comment before adopting a final plan. The value of the agenda will be in its ability to distill what researchers and participants believe is important and inspire innovation.

Transparency in the Secretary's activity under the demonstration authority could include a requirement that the Secretary post on the Department's web site a summary of any demonstration project the Secretary is considering and the requirement that the summary be posted for at least 30 days before the Secretary approves a demonstration.

If you build it, will they come?

The research agenda would make the innovation process proactive by identifying ideas the Secretary believes worth trying. The real test of the research agenda is whether it inspires would-be innovators to step forward.

As in other domains, innovation in pensions requires entrepreneurs. Policy innovations are a form of public good. They benefit not only the innovator but also all who put the innovation to use. The costs in terms of the effort to move an innovation through the bureaucratic process fall on one plan sponsor but the benefits, should the innovation be more widely adopted, accrue to all those who adopt the innovation.

Benefits consultants serve the role of policy entrepreneurs in pensions. If a benefits consultancy pitches an innovation to a plan sponsor, sees it through the demonstration approval process and helps the plan sponsor to implement it, a demonstration will happen.

Other forms of entrepreneurship might bring about participation by employers below the size of those that use large benefits consultants. For example, an association of non-profits might take on the task of applying for a demonstration waiver to implement a plan like one of those proposed by the Conversation on Coverage participants.

Conclusion

There is much to be learned about how the features of plan design can lead to a more secure retirement for American workers. Demonstrations can provide the evidence about the impact innovations might have. By learning what makes a difference and what does not, American workers can benefit from a more nuanced regulatory regime that provides incentives that make a more secure retirement more likely.

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