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A Step in the Right Direction?

In his State of the Union address on January 28th, 2014, President Obama announced his plans for a government-sponsored retirement account designed to help millions of Americans in building a nest egg for retirement. The next day he signed a presidential memo directing the Department of the Treasury to create what has been deemed "myRA", short for My Retirement Account.

The myRA program was designed for the millions of low- to middle-income, Americans without access to an employer sponsored retirement plan. Much like a Roth IRA, after-tax earnings can be contributed up to the annual limit and will be withdrawn in the future potentially tax-free. An account can be opened with $25 and minimum contributions of $5, which can be contributed through automatic payroll deductions. The account will be solely invested in U.S. Government savings bonds and will earn the same interest as the Thrift Savings Plans' Government Securities Investment Fund (G Fund) that is offered to federal workers. These accounts are backed by the full faith and credit of the government, therefore the principal investment cannot be lost. Participants are allowed to withdraw money at any time, up to the amount they have contributed, without penalty. However, any earned interest withdrawn before age 59 ½ will be taxed at the current rate and incur a possible penalty. Account balances of $15,000 or accounts in existence for 30 years, are required to be rolled over to a Roth IRA. Participants have the option to rollover to a Roth IRA at any point prior to this limit without penalty, as well.[1]

The myRA plan is designed as merely a stepping stone to get Americans started in saving for retirement and is not intended to be a long-term retirement income vehicle. Admittedly, myRA will not produce nearly enough income for retirement. Consider the following example. If available in 2012, a myRA account would have experienced a return of 1.47% (the return of the G Fund for 2012) and an inflation rate of 1.76%. The rate of inflation was higher than the return rate of the G fund, garnering a return much lower than other investment alternatives. For example, the S&P 500 index earned 15.96%.[2]

Individuals and households for whom the myRA program was designed have little to no retirement savings. Besides lacking an employer sponsored retirement plan, this could be the result of several factors. Demands of daily living expenses and living paycheck-to-paycheck may not allow for any savings. Individuals at this income level may also have never been properly informed on how to best save for retirement. At this early stage of the myRA program, there are more questions than answers. Will this program actually increase

[1] Hicken, Melanie. "What you need to know about Obama's 'myRA' retirement accounts". CNN Money. http://money.cnn.com/2014/01/29/retirement/myra-accounts/
[2] Coy, Peter. "Can Obama's myRA Retirement Plan Get Americans to Save?" Bloomberg Businessweek. http://www.businessweek.com/printer/articles/180853-can-obamas-myra-retirement-plan-get-americans-to-save

savings? If it does, will it be a rate significant enough to make a difference in the retirement lives of the targeted participants?

Let's consider the following example: Assume that a participant wants to start saving, but can't afford very much, therefore he elects to save the minimum contribution of $5 per paycheck. For an individual being paid semi-monthly, this would be a total contribution of $10 per month. If these contributions continued with no distributions being taken, the account balance would be approximately $4,900 after 30 years (assuming an average return of 2% per year) at which point the account would be required to be rolled over into a Roth IRA. While the account served its' purpose as a *starter* retirement savings account, it has not produced nearly enough money for a successful retirement. What will $4,900 really buy you in 30 years?

The educational component of myRA is also being questioned. In planning for retirement, relevant education is the single most advantageous tool a participant can receive. Properly saving for retirement is not an inherent skill, it must be taught. Participants must be educated on the amount to save, the fundamental balance of risk and return, and the utmost importance of leaving their money in a plan until retirement. This is especially necessary since participants have the ability to pull out their principal investment from myRA at any time, without penalty. They must also receive education on how to switch to a Roth IRA after the life of this account, as well as how to smooth consumption in retirement to safeguard from outliving their savings. It is essential that myRA participants understand that this is a small stepping stone on the path to a successful retirement, not the solution.

A concern of the myRA plan is that it may prompt novice savers to set aside money for retirement; however, it can result in an even lower current standard of living for the hopes of a better future. American workers do need to save for retirement, but myRA is not necessarily a practical first step. Patrick McGonigle, a Financial Advisor at CJM Wealth Advisers, Ltd. in Fairfax, Virginia recommends that these individuals focus on saving before retirement investing. "I first recommend that they have an emergency fund equal to 6 months of expenses in a bank account. Once this goal is met, only then should they open a retirement account."[3]

The details of myRA are still being heavily questioned by many retirement plan experts. The primary argument is that better retirement investment vehicles already exist. Instead of developing new retirement savings alternatives, time may be better spent enhancing the options available in the market place today and attempting to make current plans more accessible to employers and participants alike.

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[3] Carosa, Christopher. "Ten Reasons Retirement Experts Want You to Say "No" to MyRA". Fiduciary News. http://fiduciarynews.com/2014/02/ten-reasons-retirement-experts-want-you-to-say-no-to-myra/