

Making State-Based Retirement Plans Work for Private Employers

The Retirement Coverage Needle Has Not Moved in Forty Years

Since the Employee Retirement Income Security Act (ERISA) was enacted more than forty years ago, we have seen significant change in the retirement plan landscape: where traditional employer-sponsored Defined Benefit pension plans were once the dominant plan design, those plans continue to decline in both number and coverage. Today, Defined Contribution plans including 401(k), 403(b), and 457 plans, once envisioned as supplemental savings plans, are now the primary or sole retirement plan for many workers. The responsibility for managing one's retirement has shifted from the employer to the employee.

Although dramatic improvements have occurred to increase both coverage and asset sufficiency for employers that provide those plans, one striking statistic has not changed: only 47% of private employers in the U.S. sponsor a retirement plan.¹ That number has remained largely static since the passage of ERISA, and the difference between large and small employers goes beyond the provision of a plan. Consider these facts:

Access

89% of large companies offer retirement plans; however only 47% of small businesses offer some type of plan for their employees to save for retirement.²

Participation Rate

The average participation rate in the largest plan segment (plans with over \$1 billion in assets) is close to 80%. For the smallest plan segment (plans with under \$5 million in assets), participation rates dip to 74.2%.³

Savings Rates

In the largest plans, the average savings rate is 7.3% while in the smallest plans it is 5.6%.⁴

Cost

In the largest plans, the median 'all-in' fee is 0.37% whereas the median 'all-in' fee for the smallest plans is 1.27%.⁵

States are Trying to Solve the Coverage Problem

While there has been progress to increase coverage and savings sufficiency in larger employer-sponsored plans, there still remains the issue of employees without coverage in a retirement savings plan, many of whom work for small employers. As most new businesses that are created today are small businesses (defined as fewer than 100 employees), the coverage gap will likely not only persist, but may grow. Although the federal government has enacted tax incentives and plan designs intended to encourage small employers to offer retirement plans, to date those attempts to broaden coverage have not had the intended effect. The Obama Administration and various Members of Congress have also introduced Auto-IRA proposals, as well as legislation to expand the use of multiple employer plans; thus far, those proposals have not been enacted.

With little progress at the federal level, over the past few years nearly 30 states have either considered or enacted legislation that may require or encourage and facilitate all employers in their states to offer some type of retirement savings vehicle to their employees or to study how best to structure such a plan. The President's directive to the Department of Labor on July 13 to issue guidance by the end of 2015 to states regarding these state-based plans should give fresh impetus to states that are designing and/or enacting legislation regarding these plans. In order to be successful, we believe the following principles must be considered in designing these programs:

Recommended Key Guiding Principles

1. Participant and plan sponsor successes should be made easier.

We would suggest that these programs must seek to foster high participation rates, sufficient savings rates, and sound investment decisions to enable participants to retire with dignity when they have the financial means to live comfortably in retirement. Implementation and administration must not lead to undue administrative burdens for the employer or plan sponsor.

2. Participant and plan sponsor failures should be made more difficult.

We would suggest that these programs must reduce leakage, for example, by making loan repayments easier and plan-to-plan transfers more operationally efficient and seamless.

3. Superior ongoing governance.

We would suggest that the plan structure should have the ability to evolve over time, as plan assets grow, as investor needs change, and as new asset classes and product structures become available.

Important Plan Design Characteristics

1. Use of automaticity to increase participation and savings rates.

SSGA studies demonstrate that participants rely heavily on their employers for help and embrace the use of automatic features.⁶ Importantly, automaticity should extend beyond participation (auto-enrollment) and savings rate (auto-escalation) to also automate investment decisions vis-à-vis target date funds that meet the Department of Labor's Qualified Default Investment Alternative regulations, which seek to align investment risk with a participant's time horizon to retirement.

2. Simplicity and diversification of plan design.

Studies of participant behavior have indicated that participation rates decline as the number of investment options increases, which has led plan sponsors to streamline their investment menus.⁷

3. Use of institutional quality vehicles.

Institutional vehicles, including Collective Investment Trusts (CITs), rather than retail mutual funds, offer flexibility and scale in price to meet participant needs today and into the future. Achieving lower total plan costs through lower investment fees is one critical element to potentially improving retirement readiness for participants.

4. Risk management, across key risks, is critical.

When focusing on key risks affecting participants' ability to fund their retirement, we believe longevity risk stands out as absolutely critical, with inflation risk also very important. While market risk exposure should be mitigated in the years leading up to and in retirement, participant investment solutions need to balance the cost of market risk with the cost of not fully addressing longevity and inflation risks. In other words, a program that focuses on preserving capital may lead to significantly increased longevity risk and inflation risk.

Issues to be Addressed

Despite the fact that states are moving forward with consideration of these programs, there are issues and questions that must be addressed before these efforts can be deemed successful and we see broader adoption and implementation:

1. ERISA Application.

One threshold question that is under consideration by the Department of Labor is whether these state plans are covered by ERISA. Several states have made it clear that if ERISA were to apply to these plans, they would not move forward. The President's recent directive to the Department of Labor indicates that clarity and direction will be provided to the states by the end of 2015.⁸

2. State-based plans vs. Federal plans.

Although the states are moving forward, many federal policymakers believe that there may be a renewed interest in a federal, uniform solution to the coverage/access problem. MyRA, which would allow employers to auto-enroll their employees into a ROTH IRA that invests in Treasury bonds, is currently being implemented on a pilot basis. In addition, Auto-IRA proposals are being reintroduced in the current Congress. Finally, a number of bills have been introduced in Congress that would facilitate the use of multiple-employer plans (MEPs) by small employers. These plans would allow small employers to band together to offer a retirement plan to their employees, thereby reducing costs and alleviating some fiduciary liability concerns. If there is sufficient interest in a federal solution from the financial services industry and employers (particularly those with employees in several states that may be subject to different state requirements), state-based plans may lose momentum.

Conclusion

Workers in the United States face an increasingly difficult challenge to plan for, fund, and manage the retirement phase of their lives. That challenge is even more difficult for those workers who do not have access to employer-based, tax-preferred savings programs, such as Defined Contribution plans. While many ideas and solutions have circulated at the federal level for a number of years, much of what has been proposed has yet to be enacted, thereby inhibiting, although not preventing, workers' abilities to move forward with plans for retirement savings. Each day that passes only adds to the retirement challenge facing this country, and we would encourage the implementation of programs that seek to broaden the retirement savings coverage of America's workforce.

- ¹ 2014 National Compensation Survey — Bureau of Labor Statistics
- ² "Employee Benefits in the United States — March 2014," Bureau of Labor Statistics news release of 7/25/14, pg. 1
- ³ PLANSPONSOR DC Survey 2013.
- ⁴ Ibid., as of November 2013.
- ⁵ Deloitte, "Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013.
- ⁶ The Participant Winter/Spring 2012, SSGA. The survey collected data in September 2011 from an Internet panel of verified 401(k), 403(b), profit sharing and stock purchase plan participants actively contributing to their plans. The sample of 1,076 observations has a maximum sampling error of +/- 3 percentage points at a 95 percent confidence level.
- ⁷ Iyengar, S.S., and E. Kamenica. "Choice Proliferation, Simplicity Seeking and Asset Allocation." *Journal of Public Economics*, 2010.
- ⁸ President Obama's remarks at the July 13, 2015 White House Conference on Aging.

ssga.com

State Street Global Advisors One Lincoln Street, Boston, MA 02111-2900.
T: +1 617 664 7727.

Investing involves risk including the risk of loss of principal.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

The views expressed in this material are the views of the SSGA Defined Contribution group through the period ended August 30, 2015 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.