TREASURY NOTES | The Auto-IRA

September 2019

Recap: The Crisis at Hand

In the last Treasury Note, we laid out the details of Pennsylvania's retirement crisis. Too many private sector workers do not have the savings needed for retirement. This is of particular concern in Pennsylvania because the state has a much larger aging population than most. Collectively, workers' lack of retirement savings will cost the state billions of dollars in social assistance and lost tax revenue.

What the Task Force Heard

In 2017, Treasurer Torsella convened the Task Force on Private Sector Retirement Security to study the problem in depth. It was a bipartisan group of stakeholders that included the Republican and Democratic chairs of both the Pennsylvania House and Senate finance committees. The Task Force held 4 hearings across the state in which it heard from experts in retirement security research, financial service providers, Pennsylvania small business owners, and officials from other states that are implementing their own plans.

After many hours of testimony and deliberation, the Task Force ultimately reached broad consensus[1] that the state must do something to address the problem, and that the auto-IRA is the policy option that makes the most sense.

[1] While no single program design commanded universal support for every one of its details from all Retirement Task Force members, at the end of the Retirement Task Force's work there was broad and bipartisan consensus around a Pennsylvania version based on the Auto-IRA model that incorporates income stream distribution options as well as more conventional asset-allocation investment choices. The Retirement Task Force was not convened with the intention of proposing or agreeing to specific legislative solutions, and this Treasury Note does not speak for Retirement Task Force members in their individual capacities.

Summary

- Pennsylvania should establish a retirement account for workers without workplace retirement plans.
- Often called an automatic-IRA, this product simulates the best features of market-based retirement plans, like 401(k)s.
- If well-designed, this will also leverage the scale of state government to reduce costs, unwind complexity, and minimize liability for small businesses.
- The auto-IRA has enjoyed bipartisan support across the country.
- It will not require ongoing state funding or any contributions from businesses.

Background

- Treasurer Joe Torsella created a task force to study retirement security in the Commonwealth.
- Over 2 million Pennsylvania workers lack access to workplace retirement programs.
- People with access save more than those who do not.
- Reduced retirement savings means depressed tax revenues and increased public assistance expenditures.

The Pennsylvania Treasury's Task Force on Private Sector Retirement Security

- State Senator John Blake - Senate Democratic Finance Committee Chair
- Sarah Gill - AARP
- State Senator Scott Hutchinson - Senate Finance Committee Chair
- Bob Jazwinski - Pennsylvania Institute of Certified Public Accountants
- State Representative Bernie O'Neill - House Finance Committee Chair
- Kevin Shivers - National Federation of Independent Business of Pennsylvania
- Frank Snyder - Pennsylvania AFL-CIO
- State Representative Jake Wheatley - House Democratic Finance Committee Chair

The Auto-IRA: What is it?

Put simply, the auto-IRA is a means for workers to more easily save their own money. Similar to the 401(k) that many employers offer, a percentage of employee pay is deducted for investment in the employee's retirement account. Through the state-facilitated auto-IRA program, all employers who do not already offer a retirement savings plan would automatically enroll their employees in the auto-IRA. The state would partner with employers to raise awareness among the working population about the plan prior to rollout, as well as to disclose employees' right to opt-out. Just as all employers must deduct a certain percentage from employee pay for taxes and Social Security, employers would set up a new deduction that would send a portion of participating employees' pay to their new auto-IRA account. In contrast to 401(k)s, employers do not make contributions to their employees' auto-IRA accounts, as auto-IRAs are not subject to the Employee Retirement Income Security Act of 1974 (ERISA).

Within each participating worker's auto-IRA account, $1,000 would be safeguarded in a capital preservation fund. This would shield the first $1,000 a worker saves from the ups and downs of the investment markets, providing the assurance that—while retirement investing is a long-term strategy that flourishes over time thanks to compound interest—a portion of their savings will be preserved even if the market dips in the short term. The rest of workers' savings would go into a default low-cost investment vehicle, such as a target date index fund. If an employee decides they want to make changes to the default account settings they are enrolled in—for example default contribution rate or specific investment vehicle—they can always change it to fit their personal preferences and goals.

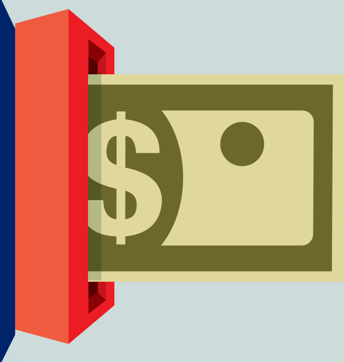
Another important feature of the auto-IRA is that it is portable. Since few people work for the same company their whole career anymore, portability allows workers to continue to save in the same plan if they switch employers, without having to worry about rolling the account over.

The auto-IRA can best be described as a public-private partnership. Through the bid process, state government selects a private investment manager and vets the investment vehicles the manager offers to program participants. While the program would require appropriations at the outset for startup costs, those costs would be repaid as the program ultimately becomes self-funding. The College and Career 529 Savings Plans provide a good example of how Pennsylvania has already successfully implemented this type of program for over two decades. And just like in the 529 Plans, the assets in the program belong entirely to the individual account owners, not the state.

Why Auto-IRA

As described in the Task Force's report, lack of access to a workplace retirement plan is a key cause of retirement insecurity.

Workers are 15 times more likely to save for retirement when they have an easy, automatic way to save.



About 77% of workers with access to a workplace plan participate, while only about 5% of workers who lack workplace access will open their own independent account. In short, when workers have an easy, automatic way to save some of their income before it even appears in their paycheck, they are much more likely to save for retirement—at least 15 times more likely, according to AARP.

The auto-enrollment aspect of the auto-IRA makes workplace saving that much easier because workers do not have to take any action to begin saving. Many workers with the best intentions to save may be overwhelmed and ultimately deterred by the time and effort it can take to research investment decisions. However, a growing body of behavioral economics research tells us that the easier it becomes for people to save through mechanisms like automatic payroll deduction, the more savings they accumulate. That means we can use auto-enrollment to harness the inertia many of us face when making financial decisions to ultimately improve people's lives.

As several small business owners stated at a Retirement Task Force hearing, employers face significant obstacles in establishing a retirement plan such as a 401(k) for their workers—particularly cost, liability, and compliance obligations related to ERISA. A state-facilitated auto-IRA program would bring the remaining employers who do not offer a retirement plan into the fold without those burdens, thereby evening out plan coverage gaps so that all Pennsylvanian workers would have workplace access to a retirement savings plan.

A Market-Oriented Solution with Bipartisan Roots

From inception, the auto-IRA has represented a bipartisan effort to address the country's lack of retirement savings. It was first proposed in a 2006 article written by David John of the Heritage Foundation and J. Mark Iwry of the Brookings Institution. Since then, it has been adopted into law by six states. California, Connecticut, Illinois, Maryland, New Jersey, and Oregon. Notably, the Maryland auto-IRA bill was signed into law by a Republican Governor in May 2016, where it passed the Senate with a unanimous vote from all 32 Democrats and 14 Republicans. This year, Oregon's standalone compliance legislation passed with bipartisan support. It was also supported by the Oregon Farm Bureau and the Oregon Association of Nurseries.

The president and CEO of the American Council of Life Insurers Susan Neely recently gave a public endorsement of a federal auto-IRA bill, stating "It is a market-based solution that can help more people save more of their own money for the good of their families' futures."

Numerous other conservative individuals have spoken in favor of the auto-IRA, including former chairman of President Reagan's Council of Economic Advisors, Martin Feldstein, Ramesh Ponnuru of the American Enterprise Institute, and journalist George Will.

> **"The Automatic IRA is a conservative, market-oriented solution to help address our retirement savings crisis. It would increase the proportion of Americans who can save for retirement at work from 50 percent to 90 percent, make it simple for small business owners to offer IRAs to their employees, and create low-cost accounts that an employee can understand and use without having to be a financial expert."**
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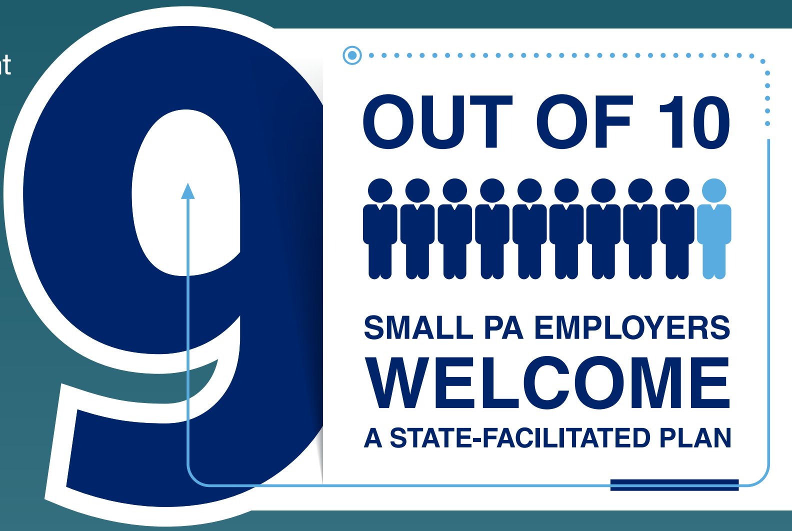
> - David C. John, Heritage Foundation, and co-author of the original auto-IRA proposal. "The Automatic IRA: A Conservative Way to Build Retirement Security." *The Daily Signal*, August 13, 2010.

Small Employers Stand to Gain

At a Retirement Task Force hearing, several small business owners testified that it is important to them to offer retirement benefits to their employees, both for competitiveness and because it's the right thing to do. However, they also noted there are many challenges involved with doing so—particularly cost, complexity, and liability risk. Results from a recent AARP survey of Pennsylvania businesses with 100 or fewer employees support these remarks. According to the survey, nearly 9 in 10 of PA small business owners agree that state lawmakers should support the creation of a state-facilitated retirement savings option. In addition, three quarters of respondents favored a ready-to-go retirement plan over having to stand one up on their own.



In contrast to most employer-sponsored plans, a state-facilitated auto-IRA involves minimal obligations for employers. Under the plan, employer obligations would be limited to simply adding an extra payroll deduction for all employees who do not opt-out, maintaining and sharing payroll deduction records with the state, and distributing information to employees. Because the auto-IRA is not subject to ERISA, employers cannot contribute to employees' accounts. They also do not have to take on any of the administrative paperwork or liability risk that comes with ERISA.

In today's tight labor market, the auto-IRA allows small businesses a step up in offering retirement benefits to potential hires without taking on the burdens of an employer-sponsored plan. This improves their competitiveness and the Commonwealth's economy.

It’s Better for Us All

The auto-IRA has the potential not only to help individuals secure their future, but to improve the fiscal standing of the Commonwealth. As stated in the last Treasury Note, if we continue with the status quo, unprepared retirees will require $14.3 billion in additional state social services over a fifteen-year period. A $40 billion decline in household spending can be expected over the same period, affecting Pennsylvania’s businesses, and ultimately contributing to a $1.4 billion decline in state tax revenue.

Because the lack of workplace access to retirement savings disproportionately affects already-underserved populations, the auto-IRA will help reduce wealth disparities. According to Pew, just 50% of Blacks, 49% of Asians, and 44% of Hispanics in PA have access to a retirement savings plan at work, compared to 58% of whites. Gender is also a factor in retirement security: 54% of women in the state have workplace access, compared to 58% of men.

There are other macro benefits to expect from auto-IRAs, too. As more and more individuals begin to save for retirement, more opportunities arise for the financial services industry to meet the needs of savers. Some participants will likely “graduate” from the menu of investment vehicles on the state-facilitated plan and look for other options as their savings grow. In addition, the increase in savers will likely spur on innovation in areas like annuities and other investment vehicles that provide lifetime income during retirement.

Off and Running Across the States

States are known as the “laboratories of democracy,” and in the past several years many have launched their own responses to the retirement crisis because of inaction by the federal government. One by one, in just a few years, states have shown that auto-IRAs are the most popular and common-sense solution to the crisis.

Three of the six states that have enacted an auto-IRA have begun implementation, and so far, the results are very promising.

Oregon was the first to implement its auto-IRA program, starting in July 2017. It is currently in the fifth wave of its rollout, registering all eligible employers with five or more employees, and plans to enroll all employers with no workplace plan by May of next year. According to the Center for Retirement Initiatives at Georgetown University, as of last month Oregon had over 7,400 employers registered and more than 70% of eligible workers (over 100,000) participating in its auto-IRA. The plan’s assets currently exceed $25.5 million, with about 45,000 funded accounts.

Illinois launched a pilot in May 2018 and began full rollout the following November. It is now in the third and final wave, registering employers with 25-99 employees. The third and final wave will begin this November, for companies with 25 or more employees. As of September 2019, the program had over 1,400 employers registered, $5.25 million assets under management, and 24,000 funded accounts.

California started a pilot in November 2018, and just officially launched in July 2019. While the first wave of employer sign-ups isn't due until June 2020, over the first two months the program already has over 120 employers registered with nearly 3,000 workers enrolled. The program has a total of 1,727 funded accounts and $383,000 assets under management.

Meanwhile, more and more states are pursuing the auto-IRA route; Connecticut, Maryland, and New Jersey have all enacted auto-IRA legislation and are preparing for implementation, and Washington State currently has an auto-IRA bill moving through its legislature.

While states have explored many other policy options, the auto-IRA is proving to be the gold standard for solutions to the retirement crisis. Pennsylvania has the unique opportunity to benefit from the first implementing states' lessons learned, while also serving as a model to the rest of the country that has yet to address the looming retirement crisis.

Best Practices for a State Auto-IRA

- ALL EMPLOYERS WITHOUT A WORKPLACE PLAN PARTICIPATE
- MINIMAL COST AND OBLIGATIONS FOR EMPLOYERS
- NO EMPLOYER CONTRIBUTIONS
- EMPLOYEES ARE AUTOMATICALLY ENROLLED AND CAN OPT-OUT
- INVESTMENT OPTIONS ARE STRAIGHTFORWARD
- ACCOUNTS ARE PORTABLE
- SELF-EMPLOYED AND GIG WORKERS CAN PARTICIPATE
- SELF-SUSTAINING AFTER START-UP PERIOD