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Fiduciary Commentary

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State Based Retirement Plans

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Numerous studies have illustrated the grim savings statistics of America's workforce. Among them, Boston College's Center for Retirement Research has found that American workers are $6.6 trillion short of what they need to retire comfortably. Findings from the Bureau of Labor Statistics reveal that only 53% of American workers participate in any type of retirement plan at work. Of those offered workplace retirement benefits, there was shown to be a significant divide in the availability of employer provided retirement benefits among workers at different level of earnings. Employer retirement benefits were only available to 31% of private industry workers in the lowest wage category (10th percentile) versus 66% of the total private industry workforce. This leaves a large population of workers lacking an effective vehicle to accumulate retirement savings.

Why are so many without a workplace retirement plan? The current system of voluntary private industry retirement plans is complex, and many businesses (especially small employers) do not have the resources to manage one of the current plan alternatives. This leaves over 40 million workers without access to a work-based retirement plan, the majority of which work for small firms.

In an effort to address this challenge and expand the number of workers eligible for workplace savings plans, the Obama administration has proposed a national IRA initiative: the *myRA* program. This federal program permits savers to contribute post-tax (Roth) money into a portable, government-backed account. To date, the *myRA* initiative has not gained significant traction.

States, in an effort to address this coverage gap, have begun to step in with their own proposals. A few have passed laws requiring businesses of a certain size to save a small percentage of their employees' compensation into savings programs in the absence of a current workplace offering. Currently, three states have passed state-run retirement plan legislation, and more than half of the other states across the country are considering their own alternatives.

Regulatory Oversight?

An impediment to states' progress in this area is the possibility that the plans may be subject to ERISA. If so, they would require fiduciary-level oversight and extensive recordkeeping. State plan's payroll deduction feature is an area of concern to regulators, and the DOL has expressed unease about allowing them to proceed without ERISA's employee protections. States view ERISA oversight as a significant deterrent to the success due to the managerial responsibilities required of employers. Their concern is so intense that many states have inserted language in their legislation that would terminate their arrangements if they were found to be subject to ERISA's rules.

Phyllis C. Borzi, head of the Employee Benefits Security Administration, said the DOL is seeking to make it easier for states. "States want greater certainty into what they can do," Borzi said. The DOL has been tasked to issue new regulatory guidance to facilitate states in designing plans, and to provide clarity on their status with ERISA. The DOLs first task will likely be to issue a safe harbor for state plans to avoid ERISA.

Plan Features

State retirement plan initiatives began gaining momentum in 2012. Now, half the states are evaluating plan alternatives, and more are conducting legal and financial feasibility studies of their options. Some plan roll-outs are slated as early as 2017. Many plans taking shape include varied design alternatives, (including voluntary and mandatory participation by the employer), yet all IRA-based programs allow participants to opt out of participation. Examples include:

- California's Secure Choice Retirement Savings Trust Act would require that businesses without a plan and having five or more employees automatically enroll workers in a traditional IRA-based savings plan at 3% of pay. The program would be professionally managed by the California Public Employees' Retirement System or other management organization. Employers would not have fiduciary liability and would only be required to maintain the direct-deposit programs. The proposal provides that a benefit would be guaranteed through underwriting by private insurers.
- Washington's plan provides employers with fewer than 100 employees with the Small Business Retirement Marketplace. The program provides a digital portal to find private sector plans such as an IRA and the federal *myRA* program. Employer participation is voluntary and businesses can match employee deferrals up to 3% of what savers contribute.
- Connecticut's proposal would automatically enroll employees into an IRA at a default contribution rate for businesses with 5 or more employees. The plan would work more like a defined benefit plan than an IRA where upon retirement, savings would be paid out as a lifetime annuity with an option to take a lump-sum cash payout. There would be an annual guaranteed rate of return with survivor benefits, backed by private insurers.
- The Illinois Secure Choice Savings Program proposal would require all businesses without an existing plan and less than 25 employees to automatically enroll employees in Roth IRAs. The default contribution rate would be 3% into a state-run investment pool.

A critical factor is whether state-run retirement arrangements can meet their intended goals – to produce higher savings rates – without over burdening small businesses in the process. In 2013, the GAO studied how automatically enrolling individuals without employer retirement plans into IRAs would influence their retirement savings. In this study, 3% of a worker's salary was contributed to an IRA; this resulted in approximately 36% of households producing an increase in savings, with a median boost of approximately $1,046 in annual retirement income. The study concluded that automatic IRAs would just modestly increase retirement income, but the households that would benefit the most were the lowest-earning quartile of savers, with a rise in their projected monthly household income of 66%.

Additionally, there are concerns that state plans could compete with traditional private sector plans such as 401(k)s and other defined contribution plans. If state initiatives find success, the plans could be an attractive alternative to employers who would otherwise sponsor a traditional private sector plan. States, to further expand their offerings, could also grow the number of organizations that would be eligible to adopt state plans to employers with larger number of employees, creating more competition to the private sector. Concerning to some in the industry, this potential competition will only gain traction if it is filling a void not being met by the marketplace.

Conclusion

Encouraging workplace retirement programs is a worthwhile policy goal. While there is no single proposal that will resolve these challenges, state-backed plans have the potential to bolster the retirement security of the most difficult-to-reach segment of our workforce. The sheer number of small business employees that would be affected could have a significant impact on this demographics' savings. These plans would likely find success by utilizing plan design elements that we know are effective - namely automatic enrollment and default investments - and making them more accessible to the smallest employers.

State-backed IRA programs continue to gain attention and may quickly become a prominent feature of the retirement plan landscape. The legal and logistical issues that need to be resolved appear to be forthcoming with DOL guidance. If the states receive the clarification they seek - that their plans are not subject to ERISA, the momentum behind them will surely increase with more states initiating their own state-based retirement solutions.

House Derails Fiduciary Rule

In October, the House passed a controversial bill that would prevent the DOL from moving forward with its mandate to redefine fiduciary standards for retirement accounts. The House voted in a 245-186 decision, to require input from the SEC before the DOL finalizes its rule. The legislation's opponents contended that this vote undermined the agency's efforts to protect the retirement security of American savers. The White House has threatened to veto the bill.

IRS Announces 2016 Cost-of-Living Adjustments

On October 21, 2015 the IRS announced this year's retirement-related cost of living adjustments. There were no changes made to any of the figures below:

2016 Pension Plan Limitations	2015	2016	Change
401(k) / 403(b) Salary Deferral Limit	$ 18,000	$ 18,000	No Change
Age 50 Catch-up Contribution Limit for 401(k), 403(b), and 457 Plans	$ 6,000	$ 6,000	No Change
Maximum Compensation Limit	$ 265,000	$ 265,000	No Change
Social Security Taxable Wage Base	$ 118,000	$ 118,500	No Change
Individual Retirement Accounts			
· IRAs for individuals age 49 and below	$ 5,500	$ 5,500	No Change
· IRAs for individuals age 50 and above	$ 6,500	$ 6,500	No Change
Highly Compensated Employees			
· Compensation in Excess of:	$ 120,000	$ 120,000	No Change
Top Heavy/Key Employees			
· Officer having greater annual compensation from the employer greater than:	$ 170,000	$ 170,000	No Change
415 Limits			
· Defined benefit plan dollar limit:	$ 210,000	$ 210,000	No Change
· Defined contribution plan dollar limit:	$ 53,000	$ 53,000	No Change