State-Run Auto-IRAs Are Spreading While Critics Note Shortcomings

Stephen Miller

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In California, a new state-run workplace retirement savings program, CalSavers, will open July 1 with an estimated 250,000 to 300,000 employers participating. Like other state-run retirement programs spreading across the U.S., CalSavers features an automatic payroll deduction into an individual retirement account (IRA) for the 7.5 million California workers with no employer-provided retirement plan.

For businesses with five or more employees, the program is mandatory. They must offer employees CalSavers or a qualified retirement plan chosen by the employer to avoid a penalty of $750 per employee.

Connecticut, Illinois, Maryland, New Jersey and Oregon, plus the city of Seattle, have similar state-run automatic IRA programs, so-called auto-IRAs, that are currently open or are being put in place. Other states are taking different approaches to promoting private-sector plans, such as Washington state's program to create an online marketplace similar to the Affordable Care Act's marketplace for health care plans but for state-approved 401(k)s and IRAs. In Washington state, however, there have also been legislative efforts to move to an auto-IRA program.

The various state-run auto-IRAs have similar features that were pioneered by Illinois' Secure Choice program, which was rolled out last November, explained Angela Antonelli, executive director of the Georgetown University Center for Retirement Initiatives, which tracks state initiatives.

"Small businesses want to provide their workers with a way to save," Antonelli said May 20 at the International Foundation of Employee Benefit Plans (IFEBP) Washington Legislative Update in Washington, D.C. She listed some of the common features of state-run auto-IRAs:

- Workers are automatically enrolled in the program unless they opt out.
- Employer contributions aren't allowed because that practice would trigger compliance requirements under the Employee Retirement Income Security Act.
- Employee default contributions are between 3 percent and 5 percent.

- Investment menus are easy to understand with limited options.
- Fees are reasonable.
- Boards are established to oversee the programs.
- Many programs default savings into a Roth IRA instead of a traditional IRA because accessing the funds, if needed, is easier for workers with the Roth accounts.

State-based programs "begin to finally address a serious problem—the retirement plan coverage gap," Antonelli said. They can "create new savers now who can start early, save longer and save more."

In addition, she added, these initiatives "encourage more businesses to set up their own plans," since the alternative is having to participate in the state program.

Criticisms of State-Run Auto-IRAs

Not everyone favors these programs, however, and some fear that state-run options can dissuade small employers from adopting their own plans.

"IRAs are not 401(k)s, so a lot of folks would like to see the employer contribute," which they can't do under a state-run auto-IRA program, a benefits manager pointed out at the IFEBP symposium during a Q&A session.

"At first blush, many employers—especially employers that currently offer 401(k) or pension plans to their employees—may quickly dismiss these laws as not applicable," Arthur T. Phillips, special counsel with law firm Foley & Lardner, wrote recently in the *National Law Journal*. "However, as employers add small employee groups, resulting from multistate expansion through organic growth or acquisitions, they should be aware of state-run retirement plan mandates to ensure compliance and avoid the accumulation of penalties."

Aaron Yelowitz, an economics professor at the University of Kentucky and a senior fellow with the libertarian Cato Institute in Washington. D.C., noted other shortcomings of the state-run auto-IRAs. In an online post discussing Oregon's program, which launched in 2017, he wrote that OregonSaves initially defaults worker contributions into a conservative capital preservation fund that "has offered a paltry nominal return of 1.52 percent (essentially an inflation-adjusted return of 0 percent)."

OregonSaves also charges an annual administrative fee of 1 percent of assets regardless of investment choices, further diminishing this return.

"Financial-planning websites consistently emphasize paying off revolving high-interest debt before saving for retirement (unless a company offers a match rate), yet auto-IRAs fail to take these investment lessons into account," Yelowitz noted. He recently co-authored a study, "How Will State-Run Auto-IRAs Affect Workers?" for the *Journal of Retirement*.

"At an 18 percent interest rate, an unpaid $5,500 credit card debt would mushroom to $28,800 in 10 years. The same amount of money directed toward OregonSaves might accumulate to $12,900 under rosy assumptions about investment returns," Yelowitz argued. "Ultimately, our study shows a significant number of workers are in situations like this, and auto-IRAs would do more harm than good for them."

In a 2017 commentary, the U.S. Chamber of Commerce stated that, although well-intentioned, states considering mandating auto-IRAs "are likely to hurt the very workers they think they are helping. The reason is simple—state auto-IRAs are a poor substitute for employer-provided plans."

Instead, "the time and effort devoted to these state programs could most profitably be used to improve the employer-provided system to expand coverage," according to the chamber. For example, government policies could help small businesses band to form a multiple-employer plan (MEP), "greatly simplifying the regulatory compliance and reducing the expense of offering a plan," it noted.

A provision to help small business form MEPs is included in the SECURE Act, which the U.S. House of Representatives passed last month.