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Facts and Fallacy about State-Facilitated Retirement Savings Plans

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Over 25 states are considering the creation of state-facilitated retirement savings plans for small business employees, and seven are already implementing them. These plans use private sector providers to manage investments and provide other services. State-facilitated retirement savings plans are likely to cause the greatest increase in several decades in the number of workers saving for retirement. By combining state facilitation with private providers, these plans allow small businesses to offer simple, low cost retirement savings plans to their employees, enabling more workers to provide for themselves rather than rely on taxpayer-paid services. They also will provide business opportunities for more private sector providers.

Unfortunately, state plans are now under attack. Most of what opponents have said about state-facilitated retirement savings plans, however, is simply wrong. Some of the misinformation is due to a lack of understanding of the subject, but the rest is intentional scaremongering designed to confuse the issue. Many attacks either have nothing to do with the plans that are being created or do not apply to the population they are intended to serve.

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Such fallacies in the criticisms of state-facilitated plans are discussed below; first, however, here are some facts that opponents would like to ignore:

Fact: **State-facilitated plans would save taxpayers money.** A new study by Segal Consulting estimates that in the first ten years after state-facilitated retirement savings plans were established, total state spending on Medicaid would be $5 billion lower.[1] Over time, "the potential savings on state Medicaid expenditures increases exponentially."[2] A study of Utah found that the savings over 15 years for five

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essential government support programs would amount to $3.7 billion in that state alone.[3] Allowing workers to save today for their own retirement is far better than requiring taxpayers to pay the budgetary consequences of an increasing number of Americans who are unprepared for retirement.

Fact: **Fifty-five (55) million Americans work for employers that do not offer any form of retirement savings or pension plan.**[4] That is almost half of private sector workers age 18 to 64. These workers may face retirement with little more than Social Security benefits and are more likely to need to resort to taxpayer-financed services. The average Social Security retirement benefit is about $16,000 a year, and while it is essential to retirement security, that amount alone is insufficient for a comfortable retirement.

Fact: **Today, small business retirement plans cost much more than those available to larger employers.** A Pew study found that total costs for a small business plan can be four times higher than those available to a larger employer.[5] Seventy-one (71) percent of small business owners surveyed by Pew said that a retirement plan is too expensive to set up.[6]

Fact: **State-facilitated plans are a huge opportunity for the private sector.** Half of small businesses required to join a state-facilitated retirement savings plan would start their own private retirement plan instead.[7] Financial advisors are starting to recognize this potential business opportunity.[8]

Fact vs. Fallacy: Why State-Facilitated Retirement Savings Plans Are the Right Answer

There has been a lot of wrong and confusing information about the state-facilitated programs. Here are the facts—listed alongside those fallacies to show how they dispel them:

Fact: **State-facilitated retirement savings plan assets would be the personal property of the individual saver, and their money can only be used to benefit the individual saver.** Investments would be managed by outside private sector fund managers – the same ones that currently handle private sector 401(k) and similar plans. There will be no connection between state-facilitated programs and public pensions for government employees. There is precedent for states taking action to promote personal financial responsibility. When college savings plans, known as 529 plans, were created in the 1990s, less than $2.5 billion had been saved for college in these programs. Today, individuals have put away more than $253.2 billion for college in 529 plans.[9]

> ***Fallacy:*** State-facilitated plans are designed to bail out public employees' pension plans.
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> "But these same irresponsible politicians have figured out a way to bail out their government worker pension systems: forcibly enlist the general public into the underwater systems, taking their money, making them dependent on government, and compelling voters to care about rescuing those retirement systems." *(Federalist[10])* "...state-based private pension plans could be used to shore-up dwindling public-sector pension systems." *(Heritage[11])*

Fact: **States have been given a tremendous amount of flexibility to establish a number of different types of plans, including those with voluntary participation and ERISA protections. A large majority (86 percent) of small business owners support an Automatic Individual Retirement Account (IRA) plan.**[12] The federal government has actually removed barriers preventing states from innovating and creating plans that work best for them. States now have the choice of establishing a wide range of plan design options, including either an IRA plan or a 401(k)-like Multiple Employer plan (MEP). They have the freedom to choose whichever type of plan best meets their specific needs. If states choose an Automatic IRA, namely a payroll deduction IRA combined with automatic enrollment, employers must be required to participate or to offer another type of retirement plan to receive an exemption from the Employee Retirement Income Security Act (ERISA), the law governing employee benefits. If the state chooses a MEP, it cannot require employer participation, and if it chooses an IRA with ERISA coverage, it does not need to require participation. Employers always retain the freedom to establish another type of retirement plan instead of the state-facilitated model.

> ***Fallacy:*** State-facilitated plans must require companies to offer a retirement plan.
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> "In order to qualify for an exemption from ERISA's rules and regulations, state-based retirement plans must include a mandate on employers to offer a retirement plan." *(Heritage)*

Fact: **State-facilitated plans will use the same types of accounts as other retirement savings plans.** States have the choice of basing state-sponsored plans on either the IRA or Multiple Employer Plans (MEPs). State-facilitated MEPs could accept contributions from employers if the employer chooses to make them. If the state-facilitated plan uses an IRA, the Internal Revenue Service (IRS) requires that IRA contributions come only from the account owner. As a result, employers are prohibited from making contributions to any IRA. That applies to all existing IRAs as well as those that would be part of state-facilitated plans. Employers that want to make contributions can always open a 401(k) plan instead of participating in the state-facilitated plan.

> ***Fallacy:*** State-facilitated plans would prohibit employer contributions.
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> "Yet, the DOL's rule would prohibit employers from contributing to state-based plans." *(Heritage)* "Under state auto-IRA programs, employer contributions are prohibited…" *(Chamber of Commerce)*

Fact: **Eighty-four (84) percent of small business owners would like a retirement plan that offers a reduced level of legal liability.**[13] State-facilitated plans that are based on an IRA remove fiduciary responsibility from employers. The state would have consumer protections that are equivalent to those provided under ERISA. Interestingly, the Heritage Foundation has proposed a small business retirement plan with reduced ERISA responsibilities and burden.[14] If an employer wants the responsibilities, it can sponsor a 401(k) or similar plan instead of participating in the state-sponsored plan. Of course, the state-facilitated plan only applies to employers that offer no retirement plan at all, and thus their employees currently have no ERISA protection at all.

> ***Fallacy:*** State-facilitated plans would deny workers important ERISA protections.
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> "If federal protections like ERISA and the fiduciary rule are so important, why does the Obama Administration want to shift a significant portion of Americans' retirement savings into plans that lack all these protections?" *(Heritage)* "States successfully avoided being subject to the strong legal protections in federal law for workers' retirement plans, leaving workers with an uncertain legal environment from state to state." *(Chamber of Commerce[15])*

Fact: **Savers in a state-facilitated plan have control over both participation and their money.** They always have the option to stop saving, save more, or save less. Savers also have the ability to access their money if they need to, subject to the same type of restrictions in other retirement accounts. States are allowed to encourage savers near retirement to choose an appropriate retirement income vehicle, but none to date have actually done so.

> ***Fallacy:*** Savers will be unable to access or control their money.
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> "DOL…specifically allowed states to create plans that would lock employees in without any access to or control over their contributions." *(Heritage)*

Fact: **The IRA contribution levels in state-facilitated plans are appropriate for their target population.** In California, research shows that employees without access to a retirement plan have a median income of $23,000.[16] They would have to contribute almost one-fourth of their pre-tax income to reach the IRA contribution cap of $5,500. If savers in a state-facilitated plan contributed an initial 3 percent of pay, a participant would have to earn about $183,000 to exceed the IRA contribution limit. If a small business owner wants to contribute more than the IRA limit, he or she can open a 401(k) or similar plan. But as these employees currently have no retirement plan, the contribution limit is meaningless to them.

> ***Fallacy:*** State-facilitated plans would reduce the amount that employees could save.
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> "Under state auto-IRA programs,...the amount employees can personally contribute is about one-third of what is allowed in a 401(k)." *(Chamber of Commerce)*

Fact: **Almost 90 percent of employers would keep their current retirement plan if there was a state-facilitated retirement savings plan.**[17] The reason is simple. Those employers understand their current plan and know that they would lose employees if they moved to a plan with smaller benefits. Their most important managers would be especially likely to leave. Additionally, states have included provisions in their legislation designed to prevent employers from dropping an existing retirement plan and moving their employees to the state-facilitated plan.

> ***Fallacy:*** Employers will drop their current plan in favor of the state-facilitated plans.
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> "Under new state-based retirement plans, many employees who like their employment-based 401(k) may not be able to keep it. That is because private-sector retirement plans will be hard-pressed to compete with government-run plans..." *(Heritage)* "If a state mandates auto-IRAs, some employers will decide to avoid taking on the work of offering their own plans and let the state take it on instead, resulting in the loss of significant retirement savings opportunities for their workers." *(Chamber of Commerce)*

Fact: **State-facilitated retirement savings plans will use private sector investments that are managed by private sector providers.** States will not directly manage investments for private sector employees. These state-facilitated plans will be defined contribution plans, not defined benefit plans. States today already manage similar programs, whether they be state voluntary deferred compensation programs (457(b) programs) or college 529 savings programs. For these programs, states partner with many different financial services firms and have a history of successfully managing these programs.

> ***Fallacy:*** State-facilitated plans will mismanage workers' savings.
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> "Many states have dramatically mismanaged their public employee retirement systems, and it is not clear that they will do a better job when they control the assets of millions of private-sector savers." *(Chamber of Commerce)*

Fact: **State-facilitated retirement savings plans will use the same types of investments found in 401(k) plans and the investments will be selected for the exclusive benefit of the saver.** These plans are defined contribution plans, and they include investments like target date funds that are managed by private sector providers. These programs are required by law to be designed and maintained exclusively in the best interest of participants.

> ***Fallacy:*** State-facilitated plan investments will be politically motivated.
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> "Some state pension funds restrict investments to favor state initiatives, and some states engage in politically motivated investment and divestment schemes rather than investing in the economic interest of the savers." *(Chamber of Commerce)*

Fact: **Employers have no trouble dealing with individual state requirements for income tax and unemployment tax.** Most employers already do so by using either outside payroll processors or payroll software. This is no different. Further, if employers already offer a plan, state-facilitated plans have no impact on them whatsoever.

> ***Fallacy:*** Each state-facilitated plan will have different requirements, which will be a burden on employers.

> "Each state will have different rules for its program and all employers will have to track them to ensure compliance—different standards for eligibility, notices, and similar matters will affect nearly all employers whether they currently offer a plan or not." *(Chamber of Commerce)*

Fact: **State-facilitated plans only apply to companies that do not offer a retirement plan.** As a result, the employees of those companies are not likely to be saving now for their retirement. Any level of retirement saving resulting from a state-facilitated plan will be an improvement. If a company wants to help its employees to save more, it can sponsor a 401(k) or similar plan instead of using the state-facilitated plan. Employers always retain the right to offer the retirement plan of their choosing, including acquiring a plan directly from a financial service provider.

> ***Fallacy:*** Because employers are not sponsoring the plans, employees won't save as much.
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> "Unengaged employers lead to lower retirement savings rates: Employers encourage workers to contribute to the employers' plans, where average worker contributions well exceed the common 3% default contribution for state auto-IRAs." *(Chamber of Commerce)*

Conclusion

There has been a great deal of misinformation about state-facilitated plans, but the facts are simple. These public-private partnerships would save taxpayers billions of dollars, would be responsibly managed for the benefit of savers only, and meet the needs of employers. State-facilitated plans could contribute to the biggest increase in several decades in the number of Americans saving for their retirement and building financial security.

States are once again leading the way, as they have with college savings and the ABLE savings program, to create savings opportunities for employees without workplace retirement plans, especially for low and moderate income families. The federal government recently removed regulatory barriers that give states the freedom to choose what type of retirement savings programs will work best to help these underserved populations save for their retirement. These state initiatives are not about government dictating how people should save, but identifying easier and more effective ways to help more Americans build retirement savings. Retirement security is a bipartisan problem deserving bipartisan cooperation to address.

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13 Ibid. Page 10.

14 David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," The Heritage Foundation, Testimony before The Committee on Small Business, United States House of Representatives, March 4, 2015. Found at: http://cf.heritage.org/research/testimony/2015/building-an-opportunity-economy-the-state-of-small-business-and-entrepreneurship.

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