

# Issue Brief

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## KEY POINTS

- The U.S. Department of Labor (DOL) estimates the number of employees without access to an employer-based retirement plan at nearly 70 million.
- Over the past several years, eight states have enacted state-based retirement initiatives in an effort to expand retirement coverage among private-sector workers, and other states are considering similar legislation.
- The Academy's AGES principles can be used to illustrate the strengths and shortcomings of retirement systems and proposals to reform them, including state-based initiatives.
- State-based retirement initiatives are a helpful step in expanding retirement coverage to workers who do not currently have access to a workplace retirement plan, though their overall effectiveness may be limited.



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1850 M Street NW, Suite 300

Washington, DC 20036

202-223-8196 | [www.actuary.org](http://www.actuary.org)

Craig Hanna, Director of Public Policy  
Ted Goldman, Senior Pension Fellow

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## State-Based Retirement Initiatives and the AGES Principles

### Introduction

Over the past several years, a number of states have enacted or proposed state-based retirement initiatives in an effort to expand retirement coverage among private-sector workers.<sup>1</sup> In a typical state-based program, any employer above a certain size would be required to offer its employees the option to enroll in the state's program if the employer does not offer its own retirement plan. Participating employers would be responsible for collecting employee contributions via payroll deduction and remitting those contributions to the plan. However, employer contributions would not be required. The responsibility for maintaining the program and selecting administration and investment service providers would remain with the state.

As of this writing, eight states have enacted legislation to implement such retirement programs for workers in those states: California, Connecticut, Illinois, Maryland, Massachusetts, New Jersey, Oregon, and Washington. In addition, Vermont has enacted legislation to establish a state-facilitated multiple employer plan, a different type of plan than those established by other states (see the "Public Policy and Regulatory Framework" section below). More than 30 other states have legislation in various stages of development or consideration or are performing feasibility studies on such programs.<sup>2</sup>

These state-based initiatives are being introduced because employer-based retirement systems are currently leaving many workers uncovered. According to an analysis by the Employee Benefit Research Institute, only 48.6 percent of all workers in 2012 worked for an employer sponsoring a retirement plan, and only 39.4 percent of all workers actually participated in such a plan. The percentages are even lower for employees working for small employers. Among workers who worked for employers with fewer than 100 employees in 2012, only 24.4 percent worked for an employer sponsoring a retirement plan, and only 19.0 percent

1 Some larger municipalities have also considered similar programs.

2 The Center for Retirement Initiatives at Georgetown University maintains a summary of [the current status of these programs by state](#).

participated in such a plan.<sup>3</sup> The U.S. Department of Labor (DOL) estimates the number of employees without access to an employer-based retirement plan at nearly 70 million.<sup>4</sup>

In addition to expanding retirement coverage among workers who might not have access to an employer-based retirement plan, state-based programs may be able to take advantage of economies of scale. Pooling together resources from employees working for many different employers may enable greater efficiency and result in lower administrative costs than a single individual or employer would be able to achieve on their own. Even greater efficiencies could potentially be achieved through a broader national program available across state lines. However, such a national program would require enactment of federal legislation and likely take longer to implement than a series of state-based initiatives.

This issue brief explores the public policy and regulatory framework that could apply to these state-based retirement initiatives. It also considers how these programs potentially align with the American Academy of Actuaries' Pension Practice Council's Retirement for the AGES<sup>5</sup> principles. The AGES principles enable an assessment of the strengths and shortcomings of retirement systems, and proposals to reform them, by focusing on the specific elements of Alignment, Governance, Efficiency, and Sustainability. The AGES principles do not address issues of availability and adequacy, which could remain a challenge for the state-based programs.

## Public Policy and Regulatory Framework

Many of the state-based initiatives that have been enacted thus far are structured as automatic individual retirement account (IRA) or Roth IRA<sup>6</sup> arrangements. From a tax perspective, such a program would be subject to the IRA rules. This would include the annual IRA contribution limits, which are generally lower than the limits that apply to employer-based defined contribution plans, as well as the tax treatment of IRA contributions, investment earnings, and distributions. Also, such a program would not be subject to the various tax qualification requirements that apply to employer-based plans, such as minimum participation requirements and nondiscrimination testing.

In August 2016, the DOL issued a final regulation that included requirements that such a state-mandated automatic IRA would need to meet in order not to be considered an employee pension benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA). The regulation limited the role of the employer in such a program, and would have enabled the employer to avoid the fiduciary and other requirements that apply to sponsors of ERISA plans. In December 2016, the DOL amended its final regulation to permit similar programs established by state subdivisions such as cities and counties. In February 2017, two joint resolutions were passed by the House of Representatives to repeal these DOL regulations. These two resolutions were passed by the Senate in March and May 2017, and the president signed them

3 [EBRI Databook on Employee Benefits](#), Chapter 6: Employment-Based Retirement Plan Participation; Employee Benefit Research Institute; updated July 2014.

4 "State retirement initiatives get guidance from US Labor Department"; Employee Benefit Security Administration news release; Nov. 16, 2015.

5 [Retirement for the AGES: Building Enduring Retirement-Income Systems](#); American Academy of Actuaries; January 2014.

6 Internal Revenue Service, "[Roth IRAs](#)," accessed Nov. 29, 2017.

Members of the Retirement System Assessment and Policy Committee include: Eric Keener, MAAA, FSA, EA, FCA—chairperson; Anne Button, MAAA, FSA, EA; Cynthia Levering, MAAA, ASA; Andrew Peterson, MAAA, FSA, EA, FCA; Andrea Sellars, MAAA, FSA; Mark Shemtob, MAAA, FSA, EA, FCA, MSPA; and Claire Wolkoff, MAAA, FSA, EA, FCA.

into law. The resolutions were in response to concerns expressed by some employers, third-party administrators, and financial services groups. Some of the concerns expressed included potential compliance burdens resulting from state-by-state differences, selection of state programs over more favorable traditional qualified pension plans, and high fees relative to small balances.

In the absence of regulations, the status of the state-based programs remains unclear. While several states have indicated that they intend to move forward with the implementation of their programs, it is possible that these programs will face legal challenges on the basis that they should be subject to ERISA or other applicable federal regulation.

The DOL separately issued an interpretive bulletin in November 2015 that would assist states in helping employers establish ERISA-covered plans. For example, a state could establish: (i) a marketplace in which an employer would be able to select from among multiple, private retirement plan providers; (ii) a prototype plan that individual employers would be able to adopt; or (iii) a multiple-employer plan in which state-based employers would be able to participate. As of this writing, the interpretive bulletin is still in effect, and Vermont has enacted legislation to establish a state-facilitated multiple-employer plan.

In addition to Internal Revenue Service (IRS) and DOL regulations, individual states may establish additional requirements that apply to such programs. Because the specific proposals establishing state-based retirement programs vary from state to state, employers who operate in multiple states and do not offer their own retirement programs may need to coordinate with multiple sets of regulatory requirements.

Ensuring consistent requirements across states could require a federally regulated program, or, alternatively, states could collectively establish a preferred “best practice” set of requirements to encourage consistency as additional programs are implemented.<sup>7</sup>

## State-Based Initiatives and the AGES Principles

The American Academy of Actuaries’ Pension Practice Council’s Retirement for the AGES initiative focuses on the need to strengthen U.S. employer-based retirement systems to improve financial security for current and future retirees. Retirement for the AGES provides a framework based on four fundamental principles that address the needs of retirement plan stakeholders:

- **Alignment** between stakeholders’ roles and their competencies
- **Governance** that defines roles, reduces conflicts of interest, manages competing needs, and properly staffs retirement system boards
- **Efficiency** in maximizing returns and minimizing costs and risks
- **Sustainability** of the system, which is achieved through appropriate cost allocation and protection from extraordinary market gyrations and inflation

The AGES principles can be used to illustrate the strengths and shortcomings of retirement systems and proposals to reform them, such as the state-based initiatives discussed in this issue brief.

<sup>7</sup> A similar approach has worked successfully in the state regulation of insurance. The National Association of Insurance Commissioners (NAIC) develops model regulations in order to encourage consistency, and individual states can choose to adopt these model regulations, with or without modification.

### **Alignment**

With regard to alignment, the state-based retirement initiatives can be consistent with the AGES principles by requiring that employers perform only those roles for which they are well-suited, such as the distribution of information on the program and withholding and transmitting employee contributions via payroll deduction. From an employee's perspective, features such as automatic enrollment can encourage employee participation. Defined contribution-based programs require robust communication and guidance to make individuals aware of how much they need to save for a secure retirement. As a result, alignment could be further improved by ensuring adequate employee education regarding savings levels and investment risk, as well as allowing employer contributions.

### **Governance**

From a governance perspective, the state-based initiatives can be structured so that a qualified board of trustees has clear, well-defined responsibilities such as selecting investment managers and other service providers, and includes representation from various stakeholders. This would align well with the AGES principles. However, the effectiveness of a governance process may not become fully clear until a particular state-based program is fully implemented. Thus, the extent to which the state-based initiatives meet the governance objectives of the AGES principles will likely emerge over time.

### **Efficiency**

As state-based programs pool together resources from many individuals working for many different employers, they offer the potential for greater efficiency and lower administrative costs than a single individual or employer would be able to achieve on their own. Professional asset management may also produce better investment results than individually managed accounts. However, some initial state support may be required to cover both start-up costs and a portion of ongoing administrative costs until the

plan reaches sufficient size to be self-supporting. In addition, like other defined contribution-based retirement programs, the employee bears investment and longevity risks, resulting in unpredictable retirement income. The opportunity to pool investment and longevity risks (such as through lifetime income options, as discussed further below) would further improve efficiency.

### **Sustainability**

The sustainability of state-based initiatives is supported by features such as mandatory coverage of employees whose employers do not offer a retirement program, automatic enrollment, and guidelines for selection of investment managers and other service providers. Limitations on the liability of both employers and the state may also increase the willingness of stakeholders to participate in the system. However, the defined contribution nature of the program limits the ability of individual employees to deal with market shocks, which ultimately impacts their retirement income. Employees could also be adversely impacted by administrative expenses if accumulated balances are small and expenses represent a large percentage of those balances. The adequacy of the retirement income provided by these programs could be strengthened by enabling and encouraging employer contributions.

In summary, these state-based initiatives can show promise in meeting the AGES principles by expanding coverage and providing access to a retirement program that can offer both good governance and cost efficiency. However, there are areas in which the alignment with the AGES principles can potentially be improved. Offering options that generate lifetime income at the stage when benefits are made available would greatly enhance the value of these initiatives. For example, workers may be better able to withstand market shocks and achieve more predictable retirement income through a degree of risk pooling or structured withdrawal programs.

The availability of such lifetime income payout options would preclude the need for individuals to manage their own savings drawdown, which they may not feel equipped to do. It remains to be seen how well the structure of these state-based initiatives will be able to accommodate such features.

## Conclusion

The American Academy of Actuaries' Pension Practice Council believes that the state-based retirement initiatives discussed in this issue brief are a helpful step in expanding retirement coverage to workers who do not currently have access to a workplace retirement plan. The ability to save for retirement via payroll deduction in an automated way, while benefiting from economies of scale and a formal governance structure, should help improve retirement security for these workers. However, the overall effectiveness of these programs may be limited by their IRA structure, which under current law does not allow for employer contributions and places lower limits on employee contributions than would apply in an employer-sponsored qualified plan.

It also remains unclear how employers who already offer retirement plans will respond to these initiatives as they are implemented. Many employers may not be well-equipped to manage the administrative, governance, and fiduciary obligations imposed on plan sponsors by ERISA and the Internal Revenue Code. The availability of a state-based retirement program that would relieve employers of these responsibilities (at least for future employees and/or contributions) could lead some employers to stop offering their own plans. Given the limitations of the state-based programs mentioned above, this may not be a desirable result.

Going forward, such concerns could potentially be addressed by the availability of broader regional or national programs with higher employer and employee contribution limits. For example, some advocates have proposed legislative changes to enable participation in a single retirement plan by multiple unrelated employers that do not share an employment-based common nexus or other organizational relationship. Such "open multiple-employer plans" could provide an opportunity for employers to offer a retirement program to improve employees' retirement security while taking on more limited responsibilities as a plan sponsor. Such plans could be sponsored by individual states, potentially in competition with similar plans offered by corporate or not-for-profit sponsors. It remains to be seen how (or whether) such concepts will develop over time, but we expect to see continued innovation as stakeholders seek solutions to America's retirement challenges.

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