Structuring State Retirement Saving Plans:

A Guide to Policy Design and Management Issues

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I. Introduction

Many American workers do not have access to employer-sponsored payroll deduction plans for retirement saving. Groups with low rates of access include younger workers, members of minority groups, and those with low-to-moderate incomes.[1] Small business employees are especially at risk. Only about 14 percent of businesses with 100 or fewer employees offer their employees a retirement plan, leaving between 51 and 71 percent of the roughly 42 million people who work for a small business without access to an employer-administered plan (Government Accountability Office 2013).

Lack of access makes it difficult to build retirement wealth. A study by the Employee Benefit Research Institute (2014) shows that 62 percent of employees with access to an employer-sponsored plan held more than $25,000 in saving balances and 22 percent had $100,000 or more. In contrast, among those without access to a plan, 94 percent held less than $25,000 and only three percent hold $100,000 or more. Although workers without an employer-based plan can contribute to Individual Retirement Accounts (IRAs), very few do.[2] But employees at all income levels tend to participate at high rates in plans that are structured to provide guidance about the decisions they should make (Wu and Rutledge 2014).

With these considerations in mind, many experts and policy makers have advocated for increased retirement plan coverage. While a national approach would be desirable, there has been little legislative progress to date. States, however, are acting. Three states have already created state-sponsored retirement saving plans for small business employees, and 25 are in some stage of considering such a move (Pension Rights Center 2015).

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[1] John and Koenig (2014) estimate that 55 million U.S. wage and salary workers between the ages of 18 and 64 lack the ability to save for retirement through an employer-sponsored payroll deduction plan.

[2] Among such workers with wages between $30,000 and $50,000 only about one out of 20 contributes regularly to an IRA (Employee Benefit Research Institute 2006).

This paper highlights a variety of issues that policymakers will need to address in creating and implementing an effective state-sponsored retirement saving plan. Section II discusses policy design choices. Section III discusses management issues faced by states administering such a plan, employers and employees. Section IV is a short conclusion.

II. Plan Design

State-sponsored plans can be either defined contribution plans or defined benefit plans, although to date, defined contributions are prevalent. A third option, market place models, could be used with either type of plan and would provide a way to connect firms and providers. Each option presents certain advantages and disadvantages. The optimal choice for a specific state will depend on its own political, historical, or economic factors. Because most workers hold a number of jobs during their working life, a key issue is that a state-sponsored plan be compatible with those offered through private sector employers.

A. Defined Contribution Retirement Savings Plans

1. Types of Plans

States have mainly explored two types of plans – Automatic IRAs and Multiple Employer Plans (MEPs) – though sometimes they are called by different names.

Under an Automatic IRA, employers would automatically enroll workers into a payroll deduction IRA (Iwry and John 2009). Employees would have complete control and could choose to opt-out, save more or less than the default amount, or choose their investment option. Their contributions would be placed into one of only a few investment options, with those who do not choose otherwise contributing to a target date fund or similar investment. Savers would receive regular statements.

The Automatic IRA is a simple, easy-to-understand, low-cost retirement savings plan for small businesses and aims to replicate the benefits of automatic enrollment seen in 401(k) plans (Madrian and Shea 2001). While it was designed as a federal retirement savings initiative with bipartisan support and has been included in every Obama Administration budget, the Automatic IRA is equally suitable for state-sponsored retirement savings plans. Because it is not an Employee Retirement Income Security Act (ERISA) plan, and because all investment options would be specified by the state, employers would face minimal if any regulatory burdens. The Automatic IRA would likely boost retirement plan participation substantially, but its effect on retirement saving balances depends on how old employees are when they start to save and how much they contribute (VanDerhei 2015).

Under a Multiple Employer Plan (MEP), several small businesses join together to offer a common type of account to each employer's workforce. In the state context, states would create a MEP for its small businesses. As ERISA-regulated plans, MEPs can be 401(k) plans or accounts with features similar to 401(k)s, including allowing for employer contributions. But MEPs are simpler: the common plan structure reduces the compliance burden and places most fiduciary responsibilities on the plan administrator. Currently, the Department of Labor requires all employers participating in a MEP to have a common bond such as being in the same industry, but a regulatory change or pending federal legislation could enable MEPs under less restrictive circumstances. If states are allowed to offer MEPs, it is uncertain if they could also require a small business to offer their employees such a plan, as ERISA appears to prohibit states from requiring employers to offer an ERISA plan.

In addition to the Automatic IRA and the MEP, some states are considering other defined contribution accounts ranging from the IRA SIMPLE to the new federal MyRA to more complex models containing features that are closer to the 401(k). Because the IRA SIMPLE is covered by

ERISA, states cannot require an employer to offer it, but they can include the accounts as an option in a voluntary marketplace model. The MyRA, which is essentially a Roth IRA, is explicitly outside of ERISA, but has a maximum size of $15,000 and can only be invested in government bonds. This makes it suitable as a starter account, but it would need to be supplemented with another type of account so that funds can be transferred once the balance limit is reached.

2. Tax Treatment

Traditionally, retirement savings plans have exempted contributions and accruals from taxation and taxed withdrawals as income. This treatment provides an immediate deduction for contributions, a benefit that is visible on the payroll stub. However, the deduction is worth less to those who have less income and thus face a lower marginal tax rate. In addition, a withdrawal before age 59 ½ imposes income tax and in many cases an additional ten percent penalty. The penalty is waived in case of hardship and, in the case of an IRA, if the money is used for certain purposes. When savers change employers, traditional retirement account balances can be moved to a traditional 401(k) or a traditional IRA.

Roth IRAs and 401(k)s embody an alternative tax treatment, where the contribution is made from after-tax income and accrual and withdrawals (after age 59 1/2) are not taxed. Because Roth contributions are made with income that has already been taxed, payroll stubs do not show any tax benefit. But savers may withdraw all or part of their contributions at any time without having to pay any additional tax. This feature makes them more suitable for lower-income savers, who are less likely to benefit from a traditional tax treatment and may have a greater need to withdraw money to meet financial emergencies. The Roth tax treatment is available to IRA savers at all income levels and 401(k) savers with income below $116,000 for single taxpayers and $183,000 for those who are married and filing jointly.[3] At higher income levels, the benefit phases out. Roth accounts have more limited rollover options.[4]

3. Automatic Enrollment

In a traditional retirement saving plan, workers are not enrolled unless they specifically sign up. In automatic enrollment plans, in contrast, workers are automatically enrolled unless they opt-out. Automatic enrollment harnesses savers' tendencies towards not taking an action and makes it work to their retirement saving advantage. Automatic enrollment has been shown to raise participation rates among eligible workers of all ages, genders, racial and ethnic groups and income levels (Madrian and Shea 2001). While savers always have complete control and can always choose to opt-out, automatic enrollment provides guidance that many savers find valuable.[5] If a state-sponsored plan uses automatic enrollment, employers merely have to offer automatic payroll deduction, sign the workers up for the plan, distribute information to employees, and collect forms from those who wish to opt-out.[6] Each pay period, as the employer sends deductions for income taxes, state taxes, and payroll taxes to their respective destinations, it would also deduct an amount for retirement saving contribution and send that amount to the account administrator.

States that choose to require automatic enrollment are likely to see higher participation

[3] These are 2015 income levels. The IRS adjusts the amount annually for inflation.

[4] Roth IRAs may roll into another Roth IRA, and a Roth 401(k) can roll into another Roth 401(k) or a Roth IRA, but Roth IRAs are currently not allowed to roll into a Roth 401(k). IRA SIMPLE plans cannot accept Roth contributions.

[5] In one poll, over 98 percent of savers who were automatically enrolled were glad that their employer used this mechanism, as were over 80 percent of those who chose not to participate (Retirement Made Simpler 2007).

[6] Schmitt and Xanthopoulos (2007) found that 97 percent of employers with ten or more employees used either an outside payroll processor or payroll processing software. Using either service sharply reduces the burden of complying with a required offering. Thus, a plan that restricted the coverage requirement to those firms would likely impose small administrative burdens.

levels. However, the ERISA treatment of automatic enrollment into an IRA is a grey area, as discussed below. Forthcoming regulatory guidance from the Department of Labor may resolve this question. An alternative currently considered by some states would require an active enrollment decision. Under this mechanism, employees must indicate in writing whether they choose to participate or not. While this does not produce the same participation rates as automatic enrollment, it has produced better results than a traditional opt-in approach in a 401(k) setting (Carroll et al. 2009).

4. Contribution Levels

Most state-sponsored plans under consideration include a default contribution level, and plans with automatic enrollment must specify a default contribution level. Many retirement saving plans, including some planned state-sponsored plans, follow the lead of federal legislation and use a contribution level of three percent of earnings. This level, however, is not high enough to create retirement balances sufficient to replace much pre-retirement earnings, especially if workers begin contributions when they are older.[7] Thus, a higher initial contribution level such as five percent or six percent may be preferable. In automatic enrollment plans, participation rates are not particularly sensitive to the initial contribution level (Chandler and Mottola 2014). Lower-income savers are less likely to opt-out of default levels, even if those levels are not economically advantageous to them (Beshears, Choi, Laibson and Madrian 2013). Initial contribution levels should be set with those employees in mind.

Automatic escalation, in which the share of earnings contributed rises over time, is popular with employees. Typically, the contribution rate would rise each time an employee

[7] VanDerhei (2015) shows the effect of increasing the default contribution rate from three percent of earnings to six percent. In his simulations, an Automatic IRA resulted in a 10.6 percent reduction in retirement savings shortfalls for savers aged between 35 and 39 with a three percent contribution rate, growing to a 17.9 percent reduction if the contribution rate increased to six percent.

received a raise. Workers are often willing to commit to increased contribution amounts in the future when this feature is added to the plan (Thaler and Benartzi 2004). Employers, however, have raised concerns that dealing with each employee's contribution level individually is more complex to administer. An alternative may be to phase in higher contribution levels for the entire plan gradually over time.

5. Investment Options

Most state-sponsored plans will have a small number of investment choices, with one designated as the default fund that savers will be placed in unless they choose another. The probability that workers participate in a plan declines as the number of investment choices rises (Iyengar, Jiang, and Huberman 2003).

Federal law allows plan sponsors to adopt either of two methods when developing a default investment choice. Sponsors can choose a mix of investments that accounts for "the characteristics of the group of employees as a whole, rather than each individual" or the sponsor can consider each participant's age, retirement date, and life expectancy. These standards usually allow a choice of balanced funds, target date funds, and managed accounts.

Initially, states may wish to use passive index funds, as those usually perform as well as actively managed funds at a much lower average cost. However, if the experience of state-sponsored plans follows that of the federal Thrift Savings Plan (TSP), as the plans grow, purveyors of other types of assets such as real estate funds may seek to have their products added to investment options. These funds often prove to be more expensive than other investment options and carry a higher risk to savers.

Target date funds are a diversified mixture of investments designed to be the only investment choice that workers use. The mixture of investments automatically changes as the account holder ages, thus freeing the worker from having to think about investment allocation over time. A target date fund is usually invested in a high proportion of equities or other risky assets when worker is young, moving to a less risky investment mix as retirement becomes closer. Target funds are especially useful for workers who don't wish to be involved with decision-making (Chalmers and Reuter 2012).

The United Kingdom's National Employment Savings Trust (NEST) follows an alternative strategy, placing contributions in a stable value fund for the first two years after a worker joins. This protects savers from facing principal losses in the first two years and may encourage continued participation. After the two years, NEST moves the existing balance and all new contributions to the appropriate target date fund, given the worker's age. This is more complex than a standard target fund, but state-sponsored funds may wish to consider this option.

Friedman and Stein (2014b) propose yet another strategy: using a single pool of diversified investments. The pool would be professionally managed and could offer low administrative fees because of its size and simplicity. The chosen strategy would be structured to meet the specific needs of the overall population using the state-sponsored plan and would not be tailored to individual worker characteristics. Diversified pooled investments would be suitable for either a defined contribution or a hybrid pension plan.

6. Rate-of-Return Guarantees

Some states are considering guarantees that would protect individual savers from investment losses or ensure at least a certain level of return. To a large extent, interest in this type of provision comes from the high losses suffered by some retirement savers during the financial crisis that started in 2008. Supporters believe that a guarantee would protect state-sponsored plan participants at a low cost.

The benefits of a guarantee will depend on the overall share of wealth that is being guaranteed, the level of the guarantee, and the saver's risk aversion (Gale, John, and Kim 2015). The level of costs will depend mainly on what is guaranteed. A guarantee against principal losses is less expensive than a guarantee that a portfolio will earn at least a certain positive return. Including inflation protection adds more expense. Insuring "bond-like" returns backed with "equity-like" assets is quite expensive. The allocation of costs is equally important. Savers can pay for guarantees via explicitly through premium payments or implicitly through caps on how much they can earn (with returns above that amount accruing to the plan provider) or restrictions on the portfolio. Insurance companies will not bear the burden of the costs – they will pass it along to workers. Governments may show small budgetary costs, but these costs do not account for the economic resource value of the guarantee, which can be quite large, even if expected outlays are small.

7. Withdrawal Options

A state-sponsored plan could include an immediate annuity upon retirement, a longevity annuity where payments begin a number of years after retirement, or a target date fund that begins to convert retirement balances into an annuity during workers' careers (Kahn and Strakosch 2015). However, an annuity-like product that is purchased before retirement may lose value when converted back into cash for a rollover. Until annuity costs come down, conversions become less complex, and such features are commonly found in the private sector plans, it may be prudent for states to resist the temptation to require them. The market for annuities is changing rapidly, however, and a number of better lifetime income options may well emerge.

B. Defined Benefit Plans

A second model for state-sponsored plans is to offer small business employees the opportunity to join a defined benefit (DB) plan. The program could be managed by the state's public employee pension plan or a subsidiary of those plans or a private entity. A DB plan can provide workers who stay in the plan their whole careers with a predictable level of lifetime income, but it also has drawbacks.

For example, in the Secure Choice Pension (SCP) plan, small business employees would be enrolled in a hybrid defined benefit plan that converts into an annuity upon retirement (Kim 2011).[8] Contributions would be managed in a separate but parallel fund with those of the state employee pension plan, with both funds managed in the same way. This would enable the private employees to benefit from the expertise and economies of scale of the state employee plan. But using the same investment strategy may not make sense if the two work forces differ. Small business employees, for example, are likely to be more mobile than state employees. An investment strategy that stresses long-term growth may see small business employees who belong to the plan for only a few years lose out on certain market gains. Further, tying the state-sponsored plan to a state employee pension plan that may be underfunded or otherwise have political liabilities could undermine support for the small business plan. And upon retirement, a defined benefit plan with an automatic annuity provides safe lifetime income, but that retirement income option may be less suitable for savers with lower incomes and relatively high Social Security benefits because their Social Security would replace a higher proportion of their pre-retirement income. This would be even more of a problem if current low interest rates mean that savers would receive relatively little retirement income for their savings.

C. Marketplace Models

[8] Also known as a cash balance plan, a hybrid plan accepts contributions from the employee and/or employer if allowed and credits them with a pre-determined amount of investment earnings each year. If the plan earns more in a year, it could pay special higher dividends or retain that money to make up the difference in years when it earns less than the promised return.

A marketplace is a state-sponsored website that enables small businesses to find pre-screened retirement saving or pension plans. The marketplace might include a diverse array of plans, including payroll deduction IRAs, IRA SIMPLE plans, MEPs, the new federal ~~MyRA~~Myra, and perhaps even 401(k) plans and DB plans. Listed options would meet certain requirements such as low fees. Providers could pay a fee to be listed that would cover the cost of the site.

The marketplace model would not require the state to have any involvement with ERISA because a marketplace just connects employers and providers. The website itself would not be covered by ERISA, and each type of account would retain its current ERISA status. This would allow employers to choose for themselves whether to adopt an ERISA plan or another option.

A marketplace does nothing to simplify retirement saving or reduce regulatory burdens or fiduciary responsibilities of smaller employers. And, by itself, it would do little to raise coverage. Pairing a marketplace with a requirement that small businesses provide retirement plans, however, would violate ERISA, which forbids states from imposing such rules.

D. Other Policy Issues

Several policy design issues are common to all of the models described above. The first is whether coverage should be mandatory. Mandating that employers above a certain size offer coverage would boost the number of workers with retirement plans. If a state requires coverage, it is likely to reduce the number of future retirees with little retirement income other than Social Security benefits. This, in turn, will lower the future demand for taxpayer-financed state services and improve the state's long-term fiscal outlook. In addition, required coverage will increase the number of savers using the state-sponsored plan, thus allowing it to charge lower fees.

Employers would know that their competitors are offering the same benefits to their employees. Further, as knowledge of this employee benefit becomes known, higher-quality job applicants who might have otherwise gone to larger competitors may be more willing to work in smaller businesses. Similarly, employees will benefit from a required offering, both because they will have the opportunity to save and because the accounts would be portable with respect to job changes. Finally, retirement service providers and the financial services sector will benefit from a required offering because they will have a guaranteed set of customers.

About 97 percent of employers with ten or more employees use an outside payroll processor or payroll processing software (Schmitt and Xanthopoulus 2007). Using either service sharply reduces the burden of complying with a required offering. A plan that exempted smaller firms from the coverage requirement would likely impose small administrative burdens.

Nevertheless, in some states, business associations have remained neutral for a voluntary system, but have indicated strong opposition to any required coverage. Opposition also comes from groups and legislators opposed to placing government requirements on businesses. Limiting the requirement to employers above a certain size has not significantly reduced the opposition.

A second issue is consumer protection. Explicit consumer protections will help to build confidence in the state-sponsored plan and to encourage participation, especially for non-ERISA plans as the protections provided by that law would not be present. Appropriately structured state consumer protections could provide the same or greater protection as ERISA. Friedman and Stein (2014a) propose six consumer protections that parallel those in ERISA. These include creating a board of trustees charged with protecting the interests of savers and retirees, with representation from savers, retirees, employers and others, but not from providers or the financial industry. The board would work with the state entity that oversees or operates the state-sponsored plan to annually review its investment choices and other aspects of the plan to ensure that savers receive the best service at the lowest cost.

State-sponsored plans should have clear disclosures to employees and retirees and explicit standards of conduct for outside providers. Similar to the disclosures required under ERISA, these should include clear and simple explanations of the plan itself, investment choices, consumer and employer rights and responsibilities, and other aspects of the plan. Starting with the notices provided through employers to employees when they are first enrolled, clear disclosures are essential to helping employees to understand how the plan operates, their rights under the plan, and how to proceed if they feel that these rights have been breached.

A state-sponsored plan's primary contact with its participants will be through regular statements of account balances. Most existing plan statements act more as investment reports than as information on retirement readiness by focusing on investment performance with other information being either secondary or entirely missing. Instead, a state-sponsored plan's statement should focus on the amount saved and how much income can be expected if the recipient continues to save at the current rate until retirement (John 2015).

Other consumer protections should include a dispute resolution process with an independent ombudsman to resolve problems between savers and their employers or other aspects of the plan. Finally, a state-sponsored plan should have clear and explicit spousal protections. These should include having spouses as default beneficiaries if savers die before retirement and an effective administrative process to divide plan assets in the event of a divorce or legal separation. If the plan includes an annuity-like guaranteed lifetime income option, it should require married savers to choose a joint and survivors option unless the other spouse agrees to a different payout scenario.

A related issue is the link between the state-sponsored plan and ERISA. ERISA includes many important consumer protections, but also places regulatory burdens on the employer. These requirements are often cited as reasons that small businesses do not offer retirement plans to their employees.

ERISA and the extent to which it applies to state-sponsored plans is one of the most contentious issues facing these plans. ERISA definitely does not cover a payroll deduction IRA if all contributions come from the employee and participation is voluntary. The effect of adding automatic enrollment is a grey area, though. Toth (2014b) and Morse (2014) argue that automatic enrollment would not trigger ERISA, but other legal opinions differ. The question revolves around whether automatic enrollment meets the requirement that employee participation is completely voluntary. While DOL ruled in 2006 that automatic enrollment into a Health Savings Account (HSA) meets that standard (Employee Benefits Security Administration 2006), it has not yet done so in the case of a payroll deduction IRA. In response to a direct request from President Obama, the Department of Labor (DOL) has stated that it will issue clarifying rules on this issue by the end of 2015 (Perez 2015).

III. Management Issues

A. Government Responsibilities

1. Operation

An important, but understudied decision is where in the state government to place the responsible agency. Ideally, the agency would have prior experience in finance and investing, but would avoid conflict-of-interest with the financial industry.

A related issue is the extent to which services are performed in-house or contracted out. With Section 529 college savings plans, states have had overall control, but contracted specific functions to private sector providers. Thus, the state might use one or more providers to handle investments, another to handle collecting and crediting contributions, and perhaps another to handle marketing. This structure uses the minimum number of state employees to operate the plan while utilizing the expertise and participation of private sector providers. Combining contracts that only last for a certain period with a regular cycle of rebidding allows the state-sponsored plan to control costs and benefit from the latest innovations.

Contracting out specific services increases the responsibilities of the state entity using it. State employees must understand how the different pieces fit together and structure the contracts so that different providers can mesh to create the whole. They must also have enough expertise in the functions to create contract specifications that clearly state which services are needed and set clear expectations about performance standards. The contracts need a clear set of deliverables that can be regularly monitored by state employees and a set of penalties or other measures if the provider fails to meet its responsibilities.

Private operation differs from contracting out specific services in that the entire state-sponsored plan is handled by a private entity – either one company or a consortium of providers – with all decisions made by them. The state entity's function would be limited to oversight and branding. This structure is attractive to some because private professionals who know the industry rather than state employees who may not understand all the implications of a decision handle the details of the plan. By using this existing structure, it becomes clear that the state is not directly competing with the private sector. However, private operation under state oversight also carries potential risks. First, the process of selecting a single entity or consortium must be completely open to avoid indications of favoritism. And because the state is at arm's length from the day-to-day operations of the entire plan, oversight responsibilities may be more difficult. Decisions about the plan will be folded into the provider's overall corporate culture, strategy and managerial style. States will need to take special care to ensure that there is no appearance of the operator favoring its own investment products over others, structuring aspects of the plan to meet its existing corporate practices, or having an inappropriate fee structure.

Another option is to allow a state entity such as that which makes investment decisions for the state or operates the state employee retirement plan to operate the state-sponsored plan. Under this structure, the state might use existing tax collection or pension contribution structures to gather contributions, existing state or pension plan investment mechanisms to structure and handle plan investments, or existing state financial literacy experts to handle educating participants. By using existing state competencies for an expanded purpose, costs to plan participants could be lower and the plan could go into operation faster. However, if this structure is chosen, the state must be careful to avoid conflict of interest problems or the appearance that the plan is being used to benefit some other program or group. The state must also ensure that direct operation is compatible with federal laws and regulations. Another factor is that while the existing state functions may appear to be similar to those needed for the state-sponsored plan, the two may require different skills. For instance, investing excess state funds or trust funds may in practice be very different from investing for a retirement plan.

Special care should be taken if a state uses a state employee pension plan to administer the state-sponsored plan. In such a situation, the pension plan should consider whether to set up a legally separate subsidiary or entity to handle the state-sponsored plan. Such a step would help to avoid the appearance of using assets from small business employees to prop up a potentially underfunded state employee plan or using fees collected from private sector employees to pay the costs of the state employee plan. Also, investment decisions for a state employee defined benefit plan may be very different from those needed for a defined contribution plan that serves a very different workforce.

2. Start-Up Costs

Even if a state-sponsored plan is to be self-supporting from fees paid by either savers or participating service providers, there will be a certain amount of advance expense necessary to set up the program. This may include the cost of a feasibility study, legal fees, seeking providers, publicity, and the time of certain state employees. The actual costs may not necessarily be very high. In fact, the costs described are essentially the same type of costs that would have been necessary to set up a state's Section 529 college savings program or a state employee retirement savings program, and in many cases, knowledge gained from setting up and managing those programs may be directly transferable to the state-sponsored retirement savings plan. There are a number of ways to raise the money. In some states, most notably California and Connecticut, funds for feasibility studies and legal fees have come from outside contributions from non-governmental sources. Depending on the state's ethics laws and practices, nonprofits, private sector providers, or both could make these contributions. In no case has one entity funded the entire share of start-up costs or even provided funds to pay for a large proportion of them. It is preferable to have a wide number of groups participating in the funding as it demonstrates interest and discourages questions about conflict-of-interest.

The state or state entities are a second source of funding. Depending on its preferences, money could come from a direct appropriation, a direction to a state official such as the treasurer to build such costs into his or her budget, or an allocation from a fund such as the state's unclaimed property fund or a similar entity. The startup costs could be regarded as a direct expense to the state or as a loan to be repaid over time from the plan's revenues. If it is a loan, it would be best to spread the repayment over a period long enough so that the fees needed to cover it are not so high that they discourage participation or make the plan uncompetitive.

3. Regular Review

Retirement plans, fee structures, and the workforce are constantly evolving, and a regular review of the state-sponsored plan and all of its elements will be important to ensure that it continues to meet the needs of the state's small business employers and their employees. As part of the review, the state can consider innovations and ensure that the plan's costs and fees are as low as possible and that it complies with any new federal laws and regulations. It will also ensure that the state is meeting its fiduciary duties and protect it from unnecessary controversy. If possible, enacting legislation should provide for a full study of the state-sponsored plan at regular intervals of at least every five years. In addition, the legislation should require an annual review of investment and other fees charged to savers. Both reviews could be handled by either benefit consultants or other experienced financial professionals, and their results should be made public as quickly as possible.

In addition to the reviews by financial professionals, states should consider establishing a review commission composed of representatives of employers, employees, financial professionals, and others that could meet every two years or so. The commission could help to ensure that the plan continues to meet the needs of its savers and review the plan's progress in increasing coverage among small business employees. In addition, the commission could propose changes to help the plan to better accomplish its mission. However, such a commission should not replace the review by financial professionals. Rather, it should use that report as the basis for its considerations and supplement it with testimony and other resources.

In the case of a marketplace plan, the regular review should review both the products that it offers to ensure that they continue to meet its standards and the standards themselves. As with other models, it would also be useful to review the progress that it has made in increasing coverage, and if that progress were to be less than satisfactory, to recommend changes to the model and its standards.

B. The Role of the Employee

Participation in a state-sponsored plan should be as simple and easy as possible. In states with automatic enrollment, employees do not need to take action in order to participate. They will be automatically enrolled in the plan and will save a recommended amount in an appropriate investment unless they make a different decision. Employees always have complete control over their participation and saving choices, including whether to stop. When state-sponsored plans do not offer automatic enrollment, employees will need to choose whether to participate, how much to contribute, how to invest the funds, and how to withdraw the funds. This includes situations where the state uses a required decision mechanism. Inevitably, those who participate or are thinking about participating will have questions about participation, investments, and other issues both before they start to save and during their participation. As a result, plans should provide savers with either a website or a call center that they can use for inquiries.

C. The Role of the Employer

Employer responsibilities depend on the structure of the state-sponsored plan and whether participation is required or just encouraged. In either case, states can keep the employer's duties at a minimum by keeping the plan as simple as possible. If the state chooses an Automatic IRA, employer responsibilities would be limited to four simple functions: enrolling employees or handling their paperwork to opt-out, setting up the payroll deduction, forwarding contributions to the plan, and dealing with an annual open enrollment period (Cowan 2015). Not all plans will have open seasons. As discussed above, most employers use either an outside payroll provider or payroll processing software so the cost and burden of setting up the deduction and forwarding contributions would be minimal. Changing the contribution amount is no more difficult than adding or subtracting the number of tax deductions when an employee has a child, or gets married or divorced. The Illinois plan uses automatic enrollment, which may require the employer to distribute state-provided notices that explain the implications of the process before it begins. The enrollment process and open season in an automatic enrollment plan simply requires the employer to distribute materials, collect and return forms, and forward them to the plan provider. Some employees may have questions, but if the plan has a website and/or call center, the employer can refer employees there. This would be the same process for enrollment and open season (if there is one) in a non-automatic enrollment plan.

If the state chooses a marketplace model, the specific employer responsibilities will depend on which option the employer chooses. It could be minimal if the employer chooses the MyRA, or more complex if it chooses an IRA SIMPLE or even a 401k. Under this model, since the state's role is limited to pre-screening the different providers, it does not really take on any of the employer's functions or legal responsibilities. They remain the same as those associated with the retirement savings option, had it not been selected through the marketplace.

Other than arranging for a payroll deduction, the employer's most important duty is to ensure that an employee's contributions reach the plan in a timely manner. Employers with outside payroll processors need only to notify the processor of the deduction and provide routing information for the payment. Once this is done, the processor will handle the retirement contributions just like it handles FICA contributions, federal income tax withholding, and any other deductions, and forward the money to the plan manager each pay period. Employers using payroll processing software would handle retirement plan contributions in much the same way. Once the deduction is set up, contributions will be routinely forwarded each pay period. Companies doing their own payrolls without payroll processing software may find the process slightly more complex, but once the deduction is arranged, payment will become a routine part of the process. In no case will forwarding payments be any more difficult than handling income tax withholding.

States that use an Automatic IRA or similar model can simplify the employers' contributions process by establishing a single routing address that receives all payments to the plan. If the state-sponsored plan has several investment options or even several different investment managers, the central receiving location could then allocate payments to the different final location as well as record that the money was received and when. In addition, states could simplify the contributions process for very small employers that are more likely to do payroll by hand by allowing them to send payments using the same schedule that the state uses to collect state income tax withholding. This would ensure that small employers do not have to set up a different schedule just for retirement plan payments. States without an income tax could allow employers to use the schedule used for federal income tax withholding payments.

Employer contributions depend on the structure of the state-sponsored plan or the specific choices allowed under the marketplace model. It would be very difficult for a state to require an employer to contribute. If the state-sponsored plan's underlying account is a traditional or Roth IRA, employer contributions are prohibited. Both the IRA Simple and the SEP-IRA can receive contributions from the employer, and an IRA SIMPLE requires one. However, because ERISA prohibits states from requiring employers to offer an ERISA-covered plan, employers would have to choose to offer such an account. Under the IRA SIMPLE, the employer can choose matching employee contributions of up to three percent of pay or a flat contribution of two percent of pay. In addition, employers who chose a 401(k) through a marketplace would be permitted to match contributions at their discretion. Employer contributions are not required for 401(k)s except under certain types of safe harbor plans.

States can reduce the potential liability of employers by adopting a simple plan design and by assuming responsibilities that would otherwise fall to the employer (Toth 2014a). By doing so, liability can be placed where the responsibility for a decision lies and with those who are best able to handle it. In the case of a state-sponsored plan where the plan itself sets contribution amounts, chooses the fund manager, and makes other decisions about the plan structure (and the role of the employer is limited to collecting employee contributions and forwarding them), the enacting law should clearly place all liability for plan structure and similar decisions with the state entity. Employer liability should be limited to their primary roles. In marketplace plans, where the employer selects an option from a pre-screened list of providers, liability for selecting an appropriate provider should also rest with the state entity or the contractor who administers it if there is one. However, to the extent that the employer makes decisions on investments or other aspects of the chosen plan, it should be responsible for the consequences of its decisions. It would be best to have liability issues directly addressed in legislation and regulation to avoid assumptions and misunderstandings.

In addition, employers need clear disclosures stating what their responsibilities are and what standards they are expected to meet. Inevitably, employers or payroll providers working on their behalf will make a mistake such as using a wrong number, missing a deadline, etc. Fear that such an innocent error would result in a stiff penalty or other punishment has been raised in several states as a reason for small business opposition to a state-sponsored plan. For this reason, states would be best served by making it clear that that they will treat innocent and occasional errors leniently as long as a correction is made quickly after the mistake is identified. This could include working with the employer or provider to develop ways to prevent future problems, having low penalties that could be waived in many cases, and encouraging employers to self-report errors. Treating innocent errors lightly does not mean that intentional or habitual failures should receive the same treatment. Penalties should match the seriousness of the infraction. Willful failures to forward employees' contributions promptly or at all are essentially stealing from employees and should result in strong penalties to discourage such practices. It is important, however, for the state to determine if the failure is the fault of the employer or the payroll provider if there is one, and to only penalize the guilty party.

IV. Conclusion

State-sponsored retirement savings plans for private sector small business employees have a real potential to improve the retirement security of its participants and improve the state's fiscal outlook. By increasing the number of people with access to a payroll deduction plan, they can reduce the number of retirees with few financial resources other than Social Security benefits. Equally as important, a state-sponsored plan can reduce the number of future retirees who would need to depend on taxpayer financed services. State-sponsored retirement savings plans offer the best chance in the near term to increase the number of Americans with access to payroll deduction retirement savings plans. In the absence of a comprehensive federal program, they could be the most significant improvement in coverage for many decades. But there is still a great deal of work to be done before the plans reach their full potential. In order to make a difference, these plans must be carefully structured and implemented. The success of the plans in achieving their goals depends on a host of issues regarding plan design and plan management described above.

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