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Mandated State- and City-Run Retirement Plans for Private-Sector Workers

-Serious Economic Flaws-

State- or city-run retirement programs for private-sector workers are destined to fail to attain scale and economic viability because (1) the pool of possible participants is smaller than estimated; (2) participation rates will be low; (3) contribution amounts will be small; and (4) set-up and administrative costs will be high. As a result, program participants, program sponsors, taxpayers, or all three, will find there is a steep price tag for these programs.

1. The pool of possible participants is smaller than estimated.

- **Estimates of the coverage gap overstate the number of workers without access to workplace retirement plans.** Whereas these state-run plans are starting from scratch, building scale to share fixed costs will be important, and if the pool of potential participants is smaller than estimated, reaching scale in the plan will be more difficult.

  Sources: Current Population Survey (59 percent of private-sector workers without coverage) versus National Compensation Survey (34 percent of private-sector workers without coverage)

2. Participation rates will be low for several reasons.

- **The workforce composition of employers without retirement plans differs from employers with retirement plans, which will make it difficult to attract workers to participate in the program.** Workers without workplace retirement plan coverage tend to be younger (and likely focused on other savings goals, e.g. home, education, family); lower-income (nationwide, 57 percent earn $27,000 or less); and not strongly connected to their employers (nationwide, 39 percent are part-time or part-year). As such, many of these workers will not have the ability to divert a portion of their wages to a retirement savings program.

  Source: Current Population Survey

- **Automatic enrollment experience in private-sector retirement plans occurs in a different environment than the state-run plans will create, thus opt-out rates could be higher, which would mean that participation rates in the state-run plans would come up short.** Private-sector 401(k) plans have extensive educational efforts to promote saving for retirement; about 9/10 401(k) plan participants are in plans with employer contributions (which provides a financial incentive to contribute); about 9/10 401(k) plan participants have access to 401(k) plan loans (which provides peace of mind in thinking about a potential future emergency); and 401(k) plans offer wide arrays of investment choices.

  Sources: BrightScope and Investment Company Institute (https://www.ici.org/pdf/ppr_16_dcplan_profile_401k.pdf)

- **A diverse array of investments, including lower-cost investments, available through private-sector IRAs will provide attractive alternatives to the state-run program.** IRAs are available at a wide variety of financial services providers, ranging from full-service brokerages and independent financial advisers to discount brokerages and mutual fund companies directly. Private-sector IRA investors are able to obtain lower-cost fund investing and, indeed have concentrated their assets in lower-cost funds.
  Source: Investment Company Institute, Letter to California State Treasurer (https://www.ici.org/pdf/16_ici_ca_state_retirement.pdf)

3. Contribution amounts will be small.

- **The wage composition of uncovered workers skews toward lower-incomes, which indicates that many of these workers may not have the financial resources to make significant contributions.** Additionally, even if lower-income workers were to contribute at the same rate as higher-income workers, the dollar amounts contributed would be smaller as they are from a smaller income base. Survey results from California's feasibility study indicate contribution amounts will be low. Small contributions lead to small account balances, which impedes building scale to absorb program costs.

4. Set-up and administrative costs will be high relative to assets, and there are several factors that will impact the costs of these programs and several years before they will be self-sustaining.

- **Recovering the fixed costs of setting up the program and ongoing administrative costs will be difficult with small accounts.** A fixed dollar amount is a higher percentage of a small account, and these programs will have small accounts. In addition, as ICI highlighted in our letter to the California State Treasurer, the number of workers per employer impacts the cost of the program.

- **Small changes in feasibility study assumptions can dramatically impact the predicted economic sustainability of the program.** For example, analysis of the proposed Oregon Retirement Savings Plan finds that lower contribution rates significantly increase the length of time before the plan becomes financially self-sustaining: an assumed contribution rate of 3 percent rather than 5 percent (escalating to 10 percent) increases the time for the plan to break even and repay costs to 17 years, versus 9 years.
  Source: Boston College Center for Retirement Research (http://crr.bc.edu/wp-content/uploads/2016/12/IB_16-19.pdf)

- **Another automatic enrollment program already faces these challenges.** The NEST (National Employment Savings Trust) in the United Kingdom had an average account of about £275 (in March 2016) and costs were equal to 12.5 percent of plan assets.
  Source: NEST (https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-Corp-ARA_2015_2016,PDF.pdf)

- **Costs of the US state-run programs will be higher if participants are afforded the same protections as workers in private-sector plans, and these participants should be equally protected.** Applicability of ERISA and the federal securities laws to state plans and the investments offered under those plans is important to protect plan participants, but will add regulatory costs to the programs.