Understanding State – Sponsored Automatic Enrollment IRA Plans

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Abstract

Certified Public Accounting (CPA) practitioners often face increasing complexity when attempting to give retirement plan advice to business-owner clients. The problem is exacerbated as the baby boomers age and access to retirement savings plans are uneven across states. As retirement savings throughout the country dwindle, the alarming gap in retirement plan access and participation continues to widen.

Numerous state reforms across the nation have begun to address the retirement plan savings problem. This research helps CPA practitioners to understand the magnitude of the issue, details a state-by-state summary of State-Sponsored Automatic Enrollment IRA Plans, and offers considerations that may be useful to advise clients.

The Retirement Savings Crisis

- A stark 53 to 65% of workers do not have access to employer-sponsored retirement plans and most of these people are low-income workers and minorities.
- There are 37 million older workers and spouses, of which 8.5 million will be poor or near poor in retirement. Further, 40% of older workers and their spouses will be downwardly mobile in retirement, meaning their household labor market earnings exceed 200% of the Federal Poverty Level (FPL), but their household is projected to have income below 200% of FPL in retirement. According to Fidelity, the average 401(k) balance was $121,500 in Q4 2020.
- PriceWaterhouse Coopers (PwC) industry research has found that 25% of US adults have no retirement savings and only 36% feel their retirement planning is on track. Those who are saving have a median account balance of $120,000 by age 55 to 64, which PwC estimates will yield less than $1,000 per month over a 15-year retirement, not accounting for increasing life expectancy and healthcare costs).

Adults Without Retirement Savings

Age Group	
18 to 29	42%
30 to 44	26%
45 to 59	17%
60 +	13%

Median Retirement Savings Amount

Age Group	
55 to 65	$120,000
45 to 55	$82,600
35 to 44	$37,000
Under 35	$12,300

Uneven Access to Retirement Savings Plans

Small businesses may not offer traditional retirement programs such as 401(k) plans, Simple IRAs or SEP-IRAs as they may be under the impression that the fees associated can be steep, and the administrative and fiduciary responsibilities onerous. Consequently, millions of Americans are left without a vehicle for retirement savings. Though anyone can open an Individual Retirement Account (IRA), most people will usually not do so on their own.

According to the American Association of Retired Persons (AARP), Americans are 15 times likelier to save if they can do so at work - and about 90% of workers save if they can do so through automatic payroll-deduction. Approximately 97% of privately owned establishments, employing 500 workers or more, offer retirement and health benefits but only around 50% of smaller establishments with less than 49 workers offer such plans.

State Reforms

Several states have been discussing retirement reforms in recent years, and 14 states have already enacted programs intended to help U.S. workers who would otherwise not have access to a retirement plan. The premise is that employers would either establish a retirement plan for employees or automatically enroll employees in a state-sponsored auto IRA.

These programs are structured as Roth IRAs where the contributions are after-tax and are not deductible. The plans and requirements vary between states, with some states mandating certain employers to provide access to the retirement plan while other states maintain a voluntary system. States establish boards to administer the plans and regulate the firms that are hired to invest contribute funds. The basic structure of the programs is uniform across participating states.

- The programs are of little to no cost to the employers as the employees are the sole contributors to the plan and pay all associated fees. Employees can choose their contribution rate up to the maximum annual IRA contribution limit, which is $6,000 for 2021 with an additional catch-up contribution of $1,000 for employees 50 and over.
- Employers do not have an option to contribute to the plan. There is no vesting period, loans are not allowed, and the portability of these plans allows employees to continue contributing or roll over their IRAs.
- Most states will require employers with a threshold number of employees to offer the automatic IRA in the absence of a qualified retirement plan.
- Eligible employees are typically part-time / seasonal and full-time workers 18 years old and over that are employed a certain number of days. The income cap for participation in the automatic IRA plans aligns with the IRS Roth IRA contribution limits – single tax filers earning over $140,000 and joint filers earning over $208,000 are ineligible.
- Oregon was the first state to pioneer an automatic enrollment IRA plan, known as OregonSaves. Since its debut in 2017, Oregonians have saved over $100 million. The average savings rate is $135 per month and 70% of participants automatically enrolled elect to stay in the program.
- Among the states that mandate participation in the automatic IRA plans for organizations in business at least 2 years that have over a threshold number of employees without an established retirement plan are New York, New Jersey, California, Illinois, Connecticut, Oregon, Colorado, Maryland, Virginia and Maine. Six of these states issue fines for noncompliance.
- Participation is voluntary in Massachusetts, Vermont, Washington, and New Mexico.

Considerations

Though the proliferation of automatic enrollment IRAs across states is a step forward in addressing the retirement savings crisis, it is important to evaluate whether it is a pragmatic solution.

- Given that states do not have uniform programs and there is no federal retirement savings plan, what will be required of employers who have employees in different states?
- How about employers who have employees working remotely across many states?
- From a financial perspective, plans such as 401(k) plans not only have a much higher contribution limit ($19,000 plus $6,000 for employees aged 50 and over for tax year 2021) but they are also more flexible, customizable and allow for a wider array of investment options than the rigid auto enrollment IRAs. Employees may not be getting the most out of their retirement planning without guidance from financial advisors.
- If programs like the Secure Choice Savings Plan gain widespread popularity, will employers start taking the cheap and easy way out and stop offering 401(k) plans / matching employee contributions? This could potentially be a disservice to low-income workers who would not be able to save a significant sum from their wages alone.
- Perhaps states should broaden the discussion and educate employers about simple and low-cost retirement plans that could be considered along with state-sponsored automatic IRAs. Or perhaps the notion of mandatory participation in a state-run plan will urge employers to set up alternative retirement savings options such as 401(k) plans.

Conclusion

As baby boomers are set to reach peak retirement age, the nation would be remiss not to actively undertake reforms to augment retirement savings. If most retirees will fall short of the recommended $1 million in retirement savings and will therefore live off Social Security benefits, then state and federal governments could face a massive crisis. Greater participation in more aggressive reforms addressing retirement savings is critical.

With the development of sate legislation in support of automatic enrollment retirement plan programs, CPA practitioners must be able to advise clients who do not offer retirement plans and may thus be impacted. Practitioners need to be abreast of the mechanics of the applicable automatic enrollment retirement programs to ensure their clients are compliant with state and local regulations.

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