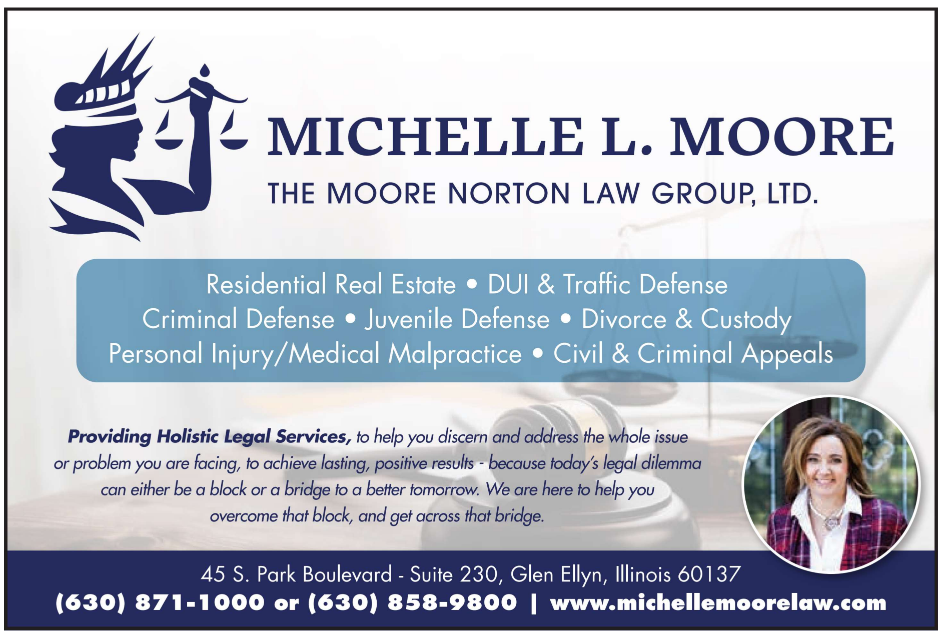

The "State" of Retirement Plans

BY ERIK FORD

Saving and investing for our retirement should be a priority for all of us. Unfortunately for too many, reality falls short of necessity, and as a society we have not saved sufficiently for our collective golden years. Increasingly, states are implementing retirement plans for private businesses to address the perceived lack of retirement preparedness. The plans are mandated for employers not offering plans of their own on various schedules and are subject to various penalties, depending on the state. At this point, more than half of the states have implemented or are in the process of implementing such mandates.

Illinois was the first state to have a state-mandated plan signed into law. The mandate began in 2018 for companies with 500 or more employees. Since few employers of that size do not offer their own 401(k) or similar plan, the impact of the mandate was small at first. Since then, the mandate has gradually included smaller employers to the point where employers with 16 or more employees will be included as of Nov. 1, 2022, and the mandate will drop to employers of five or more on Nov. 1, 2023. Many of these smaller employers have plans already, but many do not, and not knowing this mandate includes them may subject them to fines until they comply. New employers are not subject to the mandate until they have been in business for two years.

While the intent of these state-sponsored programs is good, as with many other state programs, the execution may not meet expectations or well serve employees or employers.

Let's take the Illinois program as an example. It has, of course, given a catchy name, Secure Choice. The contribution method is via after-tax only (i.e., like a Roth IRA), pointedly protecting the state's income tax collection. The plan is an auto-enrollment plan, meaning employees are automatically enrolled but can opt out. That is not a bad feature, and it is increasingly being added as a feature to 401(k) plans to encourage participation. However, it is typically an auto-enrollment for pre-tax contributions. The default auto-enroll contribution rate in Secure Choice is 5%, and it automatically escalates by 1% a year up to 10%. Again, employees can set their own levels or opt out completely. The annual limit for contributions is $6,000 ($7,000 for those over 50), so the Illinois plan does not offer a savings opportunity any better than a traditional or Roth IRA and far less than allowed in an employer-sponsored 401(k) plan. Further employer contributions are not allowed, which is one of the most attractive features of a traditional 401(k) plan.

Secure Choice will offer only three investment funds plus a target date option, all chosen by a state-assembled board. Additionally, there is an 0.75% administrative fee applied to employee accounts. At least there is no cost to the employers other than additional administrative work. It is easy to find fault with a mandated state service that provides limited choices, a high administrative fee, no personal advice and is overseen by state officials. What this should lead to is an increase in the implementation of actual 401(k) plans for those employers who may not offer one up to now. We have always considered a well-designed 401(k) plan to be the best employee benefit an employer can offer after a health care plan. Given that, the question of leaving that in the hands of the state can be debated. If you are an employer who may be affected, providing a more robust plan tailored to the specific needs of your employees will serve them much better than a state-mandated program that is intended for all but serves no one well. If you are an employee in a company that may fall under the mandate, you may want to encourage your employer to consider implementing a true 401(k).

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