www.thebell.org

Blueprint for Opportunity

No. 26

Implementation Memo

TO: Governor-elect Ritter
Treasurer-elect Kennedy
Members of the 66th Colorado General Assembly

FROM: The Bell Policy Center – Rich Jones, Director of Policy & Research

DATE: December 13, 2006

RE: Implementing Bell's Blueprint recommendation No. 26 to create Colorado Voluntary Pension Accounts

In the 2006 Blueprint for Opportunity, the Bell Policy Center recommends:

Create Colorado voluntary pension accounts

The legislature should create Colorado Voluntary Pension Accounts to provide access to retirement plans for all Coloradans. These plans would reduce the cost and complexity of offering pension plans for small employers and would be portable, allowing workers to contribute to same account for each job they hold in Colorado. *(See Blueprint, page 35)*

This memorandum briefly discusses the issues surrounding this proposal, describes steps for implementing it, outlines some of the factors to consider and lists sources for additional information and resources.

If you are interested in pursuing this issue further, we are prepared to work with you. Please contact Rich Jones, director of policy and research, at (303) 297-0456 or jones@thebell.org.

Overview of the issue

Most Colorado families will have to supplement their Social Security benefits if they want to maintain a reasonable standard of living in retirement. Many will rely on personal savings and benefits earned through employer-sponsored retirement plans.

However, 1.4 million Colorado workers, almost three out of five, are not covered by retirement plans at work.[1] To a large extent, a worker's access to a job-based retirement plan depends on the size of the employer's business. Those working for small businesses are less likely to have access to retirement plans.

Surveys show that small businesses do not provide retirement plans because of the cost, complexity and time it takes to administer them. The economic climate and whether a firm's profits are likely to increase also play a role in plan sponsorship.[2] Some retirement savings products on the market provide tax incentives for employers and employees. Even with these tax incentives, many employers don't offer retirement plans.

Moreover, many workers chose not to participate in plans even when they are offered. Research shows that many workers fail to save through existing products such as 401(k) and Individual Retirement Accounts (IRA) because employers have not made it easy enough to do so. Automatically enrolling workers in 401(k) plans and allowing workers to fund IRAs through payroll deductions are examples of changes that make it easier for workers to save for retirement.

There are several reasons the market has not worked to cover more workers, particularly low- to moderate-income workers in small businesses.

- Tax incentives for retirement savings tend to be more valuable for those in higher income brackets, and offer limited benefits for low- and moderate-income workers.
- Small businesses face a higher cost per employee to offer retirement plans.
- The financial services industry tends to be less interested in small accounts that do not grow rapidly, so they may not aggressively market products to small businesses that employ low- to moderate-income workers.[3]

The state can act to make it easier for workers to save for retirement, for businesses to offer retirement plans and for financial services firms to create and market retirement savings products to small businesses. Mark Iwry, a senior fellow in economics with the Brookings Institution, proposes grouping state actions into two tiers.

In the first tier, the state can advertise to employers and workers that IRAs can be funded through payroll deductions. It can also select through competitive bidding one or several low-cost, simple IRA products that employees can use to invest their retirement savings. This is similar to the 529 savings plans used to accumulate college savings.

The state government could also make it easy for employers to transmit payroll deductions for IRAs and could even require employers to offer this option if employees request it. Under this approach, employers would not add their funds to the employees' payroll deduction IRAs.

In the second tier, the state can make it easier for businesses to adopt simple, off-the-shelf retirement savings plans for their employees. The two primary plans in this area are the SIMPLE-IRA and the prototype 401(k) plan. Employers who want to supplement their employees' retirement savings would use these plans.

Again, through a competitive bidding process, the state could contract with one or more firms to provide standard, off-the-shelf products that businesses could use to provide a retirement savings plan for their employees. By standardizing the plan and limiting options, the state can encourage financial services firms to provide competitively priced products for businesses that currently do not provide retirement plans. The state could help market these plans and make it easier for businesses to support and administer the plans.

Several states, including Maryland, Michigan, New Hampshire, Pennsylvania, Vermont and Washington, are considering legislation to create various forms of voluntary pension accounts. In addition, Mr. Iwry of the Brookings Institution has developed model legislation states can use to implement his concepts of voluntary pension accounts.[4]

Implementation steps

The legislature could introduce and pass legislation similar to that proposed in other states, or pass a variation of Brookings' model bill, to create voluntary pension accounts in Colorado.

The governor, treasurer and/or state legislature could also create a special commission to fully study the options for creating pension accounts and expanding pension savings in Colorado. Commission members should have experience in creating and administering pension plans. The commission should conclude its work in time to present recommendations for consideration during the 2008 legislative session.

Factors to consider

It is important that Coloradans accumulate enough assets to have financially secure retirements. There is a need to increase the amount that most workers are saving for retirement. Providing greater access to work-based retirement plans is a good way to accomplish this. Proposals to create voluntary retirement plans are an intriguing way to increase access to work-based retirement savings.

However, no state has yet enacted legislation in this area. In addition, this is a fairly complex policy area that requires strict compliance with federal law and interaction with the private sector. The legislature would benefit by engaging in a thorough hearing on the issues involved and proposed alternatives to deal with them.

Some critics object to any state intervention in the market. But since current market-based approaches have resulted in less than half of Colorado workers having access to work-based retirement plans, we believe intervention is needed to encourage the market to function more effectively. Allowing multiple providers to competitively bid on products and making the accounts voluntary may diffuse some arguments against state intervention.

Washington State has the most experience with legislation to create voluntary pension accounts. Its proposal for voluntary pension accounts received broad-based support in public opinion polls, focus groups and interviews with small business owners.[5]

Information and resources

"A Strategy for Using State-Assisted Saving to Expand Private Pension Coverage," Supplemental written testimony before the Subcommittee on Long-Term Growth and Debt Reduction of the U.S. Senate Committee on Finance, J. Mark Iwry, The Brookings Institution, June 20, 2006.

Draft Model State Statute, J. Mark Iwry, Brookings Institution, 2006.
www.thebell.org/Blueprint2006/M26-model-bill.pdf

"Washington Voluntary Accounts: Creating Universal Access to Retirement Security," Equal Opportunity Institute, December 2003.

Washington Voluntary Pension Accounts, House Bill 1570, 2005-06.
http://apps.leg.wa.gov/billinfo/summary.aspx?year=2005&bill=1570

Maryland Voluntary Employee Accounts Program, House Bill 1414, 2006.
http://mlis.state.md.us/2006rs/billfile/hb1414.htm

Michigan Senate Bill 1329, 2006.

Vermont Voluntary Retirement Savings Program, Office of the State Treasurer, Montpelier, Vt., June 2006.
www.vermonttreasurer.gov/documents/highlights/RSI_Proposal_Brief.pdf

Mark Iwry
Nonresident Senior Fellow, The Brookings Institution, Washington, D.C.
miwry@retirementsecurityproject.org

John Burbank, Executive Director
Economic Opportunity Institute, Seattle, Wash.
john@eoionline.org

Jeb Spaulding
Vermont State Treasurer, Montpelier, Vt.
jeb.spaulding@state.vt.us

End notes

1 Economic Policy Institute analysis of data from the U.S. Census Bureau, Current Population Survey, March Supplement, 1979-2005.

2 Jack VanDerhei, "Findings from the 2003 Small Employer Retirement Survey (SERS)," Employee Benefit Research Institute, EBRI Notes, No. 9, September 2003.

3 J. Mark Iwry, "A Strategy for Using State-Assisted Saving to Expand Private Pension Coverage," Supplemental written testimony before the Subcommittee on Long-Term Growth and Debt Reduction of the U.S. Senate Committee on Finance, The Brookings Institution, June 20, 2006.

4 Ibid.

5 "Washington Voluntary Accounts and Public Opinion," and "EOI Interviews Small Businesses about Voluntary Pension Accounts," Economic Opportunity Institute, Seattle, Wash.
www.eoionline.org