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What 10 State Auto IRAs Mean

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The author discusses state-based automated workplace savings programs and how, when fully implemented, current authorized programs will have the ability to provide workplace retirement access for about 19 million workers – or about one-third of the 57 million workers who are estimated to be uncovered by a workplace savings plan today.

Not long ago, the words "State Auto IRA" were an oddity, perhaps something to be alarmed about. These days the programs are becoming much more common. It is likely that by the end of 2024, at least 10 states will be operating automated individual retirement account ("Auto IRA") programs. Those states are home to about 19 million American workers who otherwise do not have access to retirement savings in the workplace, where the paycheck is earned.

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States with Auto IRA Programs Authorized and Live, or in Implementation

Auto IRA State	Before Auto IRA: Uncovered Workforce	Program Live or Anticipated
Oregon	759,474	2017
California	6,676,205	2018
Illinois	2,195,023	2018
Connecticut	639,116	2022
Maryland	1,096,394	2022
Colorado	1,122,953	2023
Maine	236,997	2023
Virginia	1,491,537	2023
New Jersey	1,556,081	2023-4
New York	3,230,441	2023-4
In Auto IRA states	19,004,221	34%
National Uncovered	56,626,884	

If these programs are new to you – or if you looked away from the space for a few minutes during the pandemic – this article will bring you current.

EXPANSION OF COVERAGE

The concept of automated workplace savings into retirement accounts is not new. For several decades experts have studied the workplace savings gap and proposed a range of ways to close it. The sticking point? If you want retirement savings to occur in the workplace, you need payroll deduction. To get payroll deduction, you probably have to create an employer requirement – a mandate – of some sort.

Proposed at the federal level under multiple administrations, the idea of an employer requirement to facilitate retirement savings got stuck. The idea stayed stuck until states began legislating, in about 2008. Initial state legislation focused on establishing retirement security task forces to study readiness and retirement savings gaps and implications. By 2015 the first three states – California, Illinois and Oregon – had passed legislation authorizing state Auto IRA programs and requiring employers who do not otherwise offer workplace retirement plans to facilitate savings into these programs. These programs went live in 2017 and 2018.

Rolling forward to 2022, the United States now has 10 programs authorized from coast to coast. Auto IRA states include California, Colorado, Connecticut, Illinois, Maine, Maryland, New Jersey, New York, Oregon and Virginia. When fully implemented, these programs have the ability to provide workplace retirement access for about 19

State Facilitated Retirement Savings
May 2022

Live · Enabled · Legislation or Study - Recent · Active · Not Active

Source: Massena Associates – May 2022

million workers – or about a third of the 57 million workers who are estimated to be uncovered today.

So, what is happening in states that have not enabled Auto IRA savings programs – are they sitting on the sidelines? It is fair to say they are not. In the past decade, all but four states have proposed some form of retirement savings legislation. Despite the disruptions of the pandemic, 16 states introduced retirement savings coverage bills in 2021 and 2022. Two of those bills became law. One, Hawaii, is now on the governor's desk awaiting signature. Three bills are still pending and possible for the 2022 legislative season.

Experience to date has been that one or two bills pass into law each year.

PROGRAM USAGE EXPERIENCE

It is one thing to stand up a program, and yet another to declare success.

To consider where we are, this article will take a closer look at the three programs that have been live the longest: Oregon, Illinois and California. It is worth noting that each state has a phased program rollout period, generally starting with larger employers and working down to smaller. Employers can join ahead of deadline, and many do.

	Employer Registration Deadlines, by Size						
	2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Oregon	100+	50+, 20+	10+, 5+			remainder	
Illinois		500+	100+, 25+			16+	5+
California				>100	>50	5+	

The states' early activity related to program rollout is highly focused on communication, awareness, and education. Initial engagement and notification centers around employers, employer associations, and key service providers such as certified public accountants and payroll companies.

PROGRAM PARTICIPATION

As of March 2022, across the three programs, about 461,000 savers had accumulated over $445 million in retirement assets. It is worth pausing for just a moment to appreciate those figures. Nearly half a million new savers, and nearly half a billion dollars saved in just a few years' time. It is estimated that more than 90 percent of California's covered employers are part of June 2022's Wave 3, and it is expected that by the fall of 2022, we will begin to see a significant increase in funded accounts and larger monthly cash flows into the program.

Program growth in each state has been at the same time very steady, and slower than originally forecast. Admittedly the first forecasts included some flawed assumptions: that employers would take action on time, every time. In real life, many employers take action early, many on time, and many over time following multiple engagements with and encouragement from the state program. California is the first state to activate its employer penalty clause, for employers of the first wave who have not yet taken appropriate action. Oregon and Illinois have similar activity under way.

We suspect, but do not have the data to prove, that the growth curve associated with state Auto IRAs looks a great deal like the growth

	Rate of Change			Year End		
State Auto IRA Programs[1]	**YTD**	**12/31/2020**	**3/31/2022**	**12/31/2021**	**12/31/2020**	**12/31/2019**
Total Assets	9%	2.6x	**$ 445,875,977**	$ 407,904,516	$ 160,100,055	$ 54,823,423
Funded Accounts	7%	1.7x	**460,902**	429,663	263,764	108,945
Average Account Balance	2%	1.5x	**$ 967**	$ 949	$ 607	503
Employers Registered to Facilitate	32%	1.7x	**61,613**	46,636	28,999	19,498
Employers Have Added Employees	27%	1.7x	**43,441**	34,254	22,076	13,350
Employers Started Payroll[2]	21%	1.6x	**20,403**	16,889	11,439	5,134
Effective Opt Out Rate[2,3]	-2%	-2 points	**32%**	33%	34%	35%
Effective Participation Rate[2,3]	1%	+2 points	**68%**	67%	66%	65%

[1] *OregonSaves, Illinois Secure Choice, and CalSavers*

[2] *Hybrid data as of publication - 10/31/2021 (Oregon), 3/31/2022 (California and Ilinois)*

[3] *Computed as a simple average of the 3 programs' effective opt out and participation rates.*

Source: Massena Associates, April 2022

curve of new 401(k) plans when they were first gaining adoption in the early- to mid-1980s.

An important part of program growth is the experience of and with savers. It is striking how similar the experience has been across the three state programs. Retention rates across the three programs, and for each individually, are hovering around 68 percent. Conversely, about a third of eligible workers are formally opting out of the savings opportunity when it is presented.

This may seem high compared to traditional 401(k) metrics where the use of automatic enrollment generally leads to retention rates of 90 percent or higher. Why would the opt outs be so much higher in the Auto IRA space? This deserves further analysis, but there are three reasons that come to mind, in likely order of impact.

One, median earnings for the workforce covered by Auto IRAs is much lower than that of workers covered by other types of retirement plans. It varies by state, but tends to fall in the $29,000 to $36,000 range. By contrast in 2020[1] the average compensation of a full time worker in the United States was nearly three times higher, at about $87,500. Some of the workers covered by Auto IRA programs genuinely cannot afford to save at the moment, and they say so as they opt out.

Two, Auto IRAs are new and for almost all workers the idea is being presented to them for the first time. The concept of saving for retirement at work is not new, which probably keeps opt out rates from falling further. But in the types of jobs that they fill, many of these workers have not had the opportunity before; the program is both new to them and to the employer making them aware of it. It is our opinion that as familiarity grows, the opt-outs related to program newness will decline.

Three, and it is hard to assess the impact of this one, auto-enroll 401(k) plans typically come with some form of a match that is well promoted that likely keeps in-plan employees that might otherwise opt to hold off on saving for retirement. Auto IRAs do not have this sort of spiff. All funds contributed and saved come directly from the paychecks of the individuals doing the saving. Note: one state is looking closely at the mechanics behind providing a $500 incentive and match for savers in its Auto IRA program.

RATES OF CONTRIBUTION AND WITHDRAWAL

Another area of similarity is the levels of savings. Across the three programs average savings rates vary – from 5.1 percent in California to 5.6 percent in Illinois and 6.3 percent in Oregon (see chart on prior page for data dates and additional information). Each of the programs

started with an automatic savings rate of five percent that could be adjusted up or down by savers in one percent increments. They all now have auto-escalation features that apply to savers who have been in the program six months or more. For these savers, savings rates increase by one percent each January unless the saver opts out of the increase. The programs in Oregon and Illinois cap escalation at 10 percent. California currently caps automatic escalation at eight percent.

These savings rates are translating to current average monthly savings of between $130 and $170. The $445 million accumulated has so far been saved at a rate of about $50 to $60 per paycheck.

The programs are not immune to withdrawals and cash-outs. Oregon's program data shows that about 25 percent of all funds ever contributed have been withdrawn. The OregonSaves staff have commented in board meetings that they see a spike in withdrawals when quarterly statements go out. California's cumulative withdrawal rate is lower, at about 12.6 percent, possibly reflecting the newness of the program relative to Oregon, or possibly for other reasons.

The level of withdrawals will be worth gaining a better understanding of in the future:

- Are these instances of genuine need for short term emergencies;
- Would programs benefit from segregated accounts called "Emergency" and "Retirement";
- Are these instances of non-urgent spending; should there be active encouragement not to withdraw retirement savings;
- Do withdrawal patterns change as account balances change – e.g., is there a behavioral element where savers are less likely to dip into larger accounts because those balances are harder to replace; and
- Keep in mind that half of the experience of the longest program, OregonSaves, has occurred during the COVID-19 pandemic and related disruptions in employment and family life.

ATTITUDES TOWARD STATE AUTO IRA PROGRAMS

It is not an exaggeration to say that early on, state Auto IRA programs were met with heavy skepticism and concern. Opposition to the programs included a laundry list of arguments, including that the programs would compete with private sector providers and

products, that programs would be too unwieldy for employers and employees to use, that programs would be too costly for states and providers to operate, and that programs would be subject to or preempted by the Employee Retirement Income Security Act of 1974 ("ERISA").

In 2022 vestiges of those concerns still exist, but actual experience is showing results that are quite different. In live states, Auto IRA programs are becoming a normal part of the retirement savings landscape. Increasingly, residents in the state have personal or family-linked savings experience with the programs and they view them as an important and useful retirement savings option.

Retirement plan advisors have discovered that rather than losing business, they are gaining new customers. It turns out that the state's deadlines for employers to take action are serving as a catalyst. Employers who have thought about offering a plan but have not quite gotten there are motivated by impending deadlines to complete the work and establish plans. The Pew Charitable Trusts has a multi-year study of Form 5500 data[2] showing that in states with Auto IRA deadlines active, new plan formation has risen significantly.

Employers have also reported no-to-low levels of out of pocket expenditure and, given that participation is a requirement if they do not take other action, reasonable levels of satisfaction. The Aspen Institute's report on Expanding Worker Access to Automatic Enrollment into Retirement Savings[3] quotes another survey by Pew Charitable Trusts this way: "nearly three quarters of participating employers report being satisfied with or neutral about the program. What is more, employers who are actually funding accounts through payroll contributions expressed higher satisfaction than ones who have recently signed up – a possible sign that working with OregonSaves is a positive experience."

Program providers have worked, and are working to make the programs minimally invasive for employers, while keeping them simple, easy to use, and valuable for employees. As programs begin to shift from rollout to early operating maturity, it will be interesting to see how program features change. Changes could include richer toolsets that look like those of top 401(k) plans today. Or, given that these programs rely heavily on automated features to create results, they might lean into nudge technologies that encourage savers to contribute more, withdraw less, and meet specific goal-related milestones.

Another slow change taking place is that the institutional retirement servicing community is beginning to pay more attention to the state programs. To date, only a handful of institutions have taken on program servicing, either as program administrators or as investment managers. However, as the number of states with programs grows, as assets grow, and as time passes, these programs start to look like

a part of the market that has durability and that might belong in a strategic business plan. We do not expect to see a lot of providers jumping in quickly, but we are seeing more providers quietly express interest and begin the process of educating themselves about this new market.

Legal challenges to date have been resolved, most recently with the decision[4] by the U.S. Supreme Court in February 2022 not to review the 2021 ruling by the U.S. Court of Appeals for the Ninth Circuit[5] in favor of the CalSavers Retirement Savings Program. The Ninth Circuit ruling stated: "We hold that the preemption challenge fails. CalSavers is not an ERISA plan because it is established and maintained by the State, not employers; it does not require employers to operate their own ERISA plans; and it does not have an impermissible reference to or connection with ERISA. Nor does CalSavers interfere with ERISA's core purposes. Accordingly, ERISA does not preempt the California law."

Finally, legislators at the national level are well aware of the state programs and the progression of coverage and experience. Proposals like the retirement segment of the Build Back Better Act[6] accommodate the state programs while hewing to the early interests of congressional leaders of extending coverage much more consistently to workers across the country.

PROGRAM CHALLENGES, AND WHAT WILL BE THE NEXT FRONTIER?

Lest it seem as if we are painting only a rosy picture, programs and providers have plenty to focus on in the near term to ensure programs are healthy and achieving intended outcomes.

Achieving Breakeven and Bringing Down All-In Costs

To date, most states have used a program funding model that provides start-up funds on a loaned basis – often using loans from a state's General Fund. The expectation is that fees charged to program participants will, as programs grow, allow the program to break even, pay back early expenses, and operate on a self-sustaining basis. After that, programs will be in a position to reduce expenses to participating savers. Under current approaches where states are contributing very little in the way of permanent startup funds, and based on current provider pricing structures, most state programs are unlikely to break even at the state level before they reach the five to seven year mark. Those that get out of the gate more slowly could take longer.

Providers typically need to break even much sooner and have had a tendency to approach this market with caution.

Multi-State Collaboration

Not all states are large enough to afford to establish a standalone program. Smaller states working on legislation are aware of this and most have clauses enabling them to collaborate on a program with other states. Two states are actively working on this now: Colorado and New Mexico are operating under a Memorandum of Cooperation within which they aim to form a single program led by Colorado that can serve multiple states. Existing programs have also expressed interest in having states join them. Providers have also considered how to offer multi-state platforms and services. To date, though, none are live. It is recognized that not only must the system architecture be multi-tenant, but there are interesting details to be determined related to program branding, pricing across and within states, and the characteristics of the overall product offering.

New Features: Emergency Savings, Lifetime Income, Nudges and More

The first states to establish Auto IRAs have, understandably, been very focused on getting a first generation capability out to market and in use. Now that a template has been somewhat set, states are starting to consider next generation issues. States are beginning to think about whether retirement-adjacent emergency savings accounts should be an explicit part of their programs, rather than an implicit capability of a retirement-oriented Roth account. Additionally, account balances will be small for a while, but several states have prioritized innovation for lifetime income, including working on concepts such as using accumulated assets as a "bridge" to Social Security. Other concepts under consideration include how to make annuitized retirement income payments an embedded part of the way the program operates.

Saver engagement is still fairly straightforward across the programs – via email, real mail, and apps. As program economics begin to shift away from employer acquisition toward participant asset retention and growth, programs are likely to begin spending on innovation that allows them to connect with savers intelligently: right message, right medium, right timing.

All of this requires state programs to balance the priorities and activities of "now" that drive current day improvements against the

creative thinking that keeps the programs moving forward toward where their customers, and the market, will be "soon."

WHAT DOES IT ALL MEAN

State Auto IRA programs are showing encouraging early results, and they appear to be settling in to a natural role in the retirement savings ecosystem. States are able to aggregate small employers in ways that other entities are not able to do. As they do this, Auto IRA programs are, in a way, serving as a training ground for employers. At the same time facilitating employers are building a track record: how many of my workers are saving, and how much retirement savings do we submit every year. This makes these employers good future customers for the private sector and the traditional retirement savings vehicles available in the current system.

The demand for, and use of, workplace retirement savings options by an increasingly large chunk of the previously-uncovered workforce is likely to keep the federal government motivated toward a 50-state solution.

Does this negate or in any way diminish the existing retirement savings system in the United States? We think it does not. In fact, we think this is an important new part of the system that, because of its existence, will make the rest of the system more robust and more complete.

NOTES

1. *https://www.statista.com/statistics/243846/total-compensation-per-employee-in-the-us/.*

2. *https://www.pewtrusts.org/en/research-and-analysis/articles/2021/06/17/availability-of-state-auto-iras-appears-to-complement-private-market-for-retirement-plans.*

3. *https://www.aspeninstitute.org/wp-content/uploads/2021/11/Expanding-Worker-Access-to-Automatic-Enrollment-into-Retirement-Savings-April-27-Session-1-1.pdf.*

4. *https://www.treasurer.ca.gov/news/releases/2022/5.pdf.*

5. *https://www.supremecourt.gov/DocketPDF/21/21-558/196136/20211012165725191_HJTA%20v.%20CalSavers%20Appendix.pdf.*

6. *https://www.congress.gov/bill/117th-congress/house-bill/5376.*

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