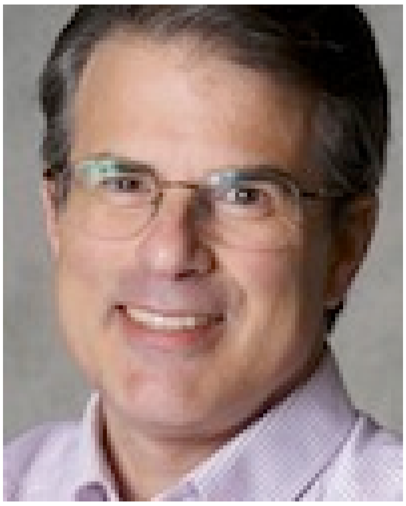
Real and Fake News on State Auto-IRAs

By Kerry Pechter *Fri, May 5, 2017*

Opponents of state-mandated auto-IRAs say the plans will unintentionally rob small business employees of the opportunity eventually to participate in 401(k)s. But that's really a phantom opportunity for many. It's time to try something new.



Senate Republicans voted Wednesday to reverse a ruling by the Obama Department of Labor that would have helped states like California and Oregon proceed with plans to require employers without retirement plans to let their workers be auto-enrolled into state-sponsored Roth IRAs so they could save for retirement through payroll deduction.

In other words, the Senate's majority voted (on House Joint Resolution 66) to make it harder for states to sponsor such plans. This week's vote book-ended a similar vote (on H.J. 67) in April that applied to municipal versions of so-called "auto-IRA" plans that cities such as New York and Philadelphia hoped to establish.

Hypocrisy aficionados noted that Republicans, traditional champions of state's rights and less federal regulation, voted solidly against state's rights and against relief from federal regulation. And industry groups that supposedly favor workplace savings urged the Senate to thwart plans that, incidentally, low-income and minority union members in solidly Democratic states wanted.

The votes won't necessarily stop the states from executing their plans. At the Pension Research Council's conference on *Saving and Retirement in an Uncertain Financial Environment* today, David John of AARP said, "Five states are continuing with their plans. A number of other states are continuing their efforts. This is not the end."

This week's vote was, at least for some, a slight surprise. After the vote on the city exemption last month, an auto-IRA advocate at a Washington non-profit told me that some headway had been made in educating Republican senators about the auto-IRA or "Secure Choice" plans, and that they might still be persuaded to vote for these plans at the state level.

Republicans who had voted to reverse the municipal exemption, she said, did so in the mistaken belief that the Obama DOL had tried to force states to herd workers into IRAs where they would not be protected by the provisions of the Employee Retirement Income Security Act of 1974, or ERISA.

On the contrary, the states had reached out to the DOL and asked for a ruling that confirmed that states could sponsor and run auto-IRAs without the burden of DOL red tape. (The plans would work like 529 college savings plans; state-sponsored but run by big asset managers. State Street, for example, is set to manage the money in Oregon's plan.)

After analyzing the situation and determining that ERISA oversight wasn't necessary for these plans, the Obama DOL complied with the states' requests and issued an exemption that clarified the situation. A similar exemption for cities soon followed. The states can still set up auto-IRAs without an explicit exemption from ERISA, but some states might not for lack of legal clarity.

But press releases from the American Council of Life Insurers and the Investment Company Institute, who should be pro-savings, this week congratulated the Senate for killing the exemption. They said the vote preserved essential ERISA protections for workers.

That's a tactical mischaracterization. The Senate, the ACLI and the ICI worry that if states require small employers currently without plans to provide access to a payroll deferral IRA at work, and if a cheap, simple public option is available, then many small employers will be lost as potential clients to the advisor-sold 401(k) industry. Advisor-sold retirement plans are an important distribution channel for large asset managers.

AARP, which is consumer-driven, supports the state plans. This week it criticized the Senate votes. Charging that " H.J. Res. 66 does significant harm to a common-sense bipartisan solution that creates private investment vehicles to help middle class families save through a simple payroll deduction," AARP promised to inform its 38 million members how each Senator voted.

November's election results, of course, had doomed the exemption. From a political perspective, the state auto-IRA initiatives can't expect to find much love in Washington, D.C., these days. States where auto-IRAs have gotten traction—California, Oregon, Connecticut, Illinois, and Maryland—are "blue" states where Democrats control the legislatures. (The initiative has been proposed in other states but hasn't made nearly as much progress there.) These are states, almost by definition, where unions have influence in the legislatures. The Service Employees International Union (SEIU) in particular has supported the state auto-IRAs as a near-necessity for their members.

The state auto-IRAs aren't a perfect solution to the lack of retirement plan coverage at small businesses. The ACLI, the ICI and other retirement industry groups have argued that a federal mandatory auto-IRA would be better policy than a bunch of different state plans. Privately, some have said that state auto-IRAs will only do harm by channeling small employers and low-income employees into feeble savings plans that lack the incentives and capacity needed for long-term success.

But there's a deeper reason, and it's not a secret. A few years ago, an official at ASPPA (the American Society of Pension Professionals and Actuaries; now part of the American Retirement Association) explained to me the importance of incentives in the retirement business.

The fundamental driver of defined contribution plan coverage in the United States, in the small and micro-plan market, is the army of brokers and advisors who sells them, he said. This army is incentivized not only by fees earned from selling and servicing a plan to a small business, but also by the prospect of cultivating high net worth principals in the businesses as individual advisory clients.

More specifically, he explained that only when a broker or advisor demonstrates to small business owners that the tax benefits of sponsoring a 401(k) plan are big enough to justify the expense and labor involved, do many small business owners agree to start a plan.

According to this view, state-mandated auto-IRAs will only introduce an inferior product into the marketplace. Through a crowd-out effect, they will unintentionally rob small business employees of the opportunity eventually to participate in a 401(k). But that supposed opportunity is really a phantom opportunity for millions of low-income workers, and not a valid argument against trying something new.