PENNSYLVANIA INDIVIDUAL RETIREMENT ACCOUNTS: PROVIDING A SECURE RETIREMENT FOR PRIVATE SECTOR WORKERS

As Pennsylvania's State Treasurer, Joe Torsella will champion the establishment of a new Pennsylvania Individual Retirement Account (PA-IRA) Program to create a portable retirement savings option for private-sector employees currently lacking an employer-provided plan. By creating a new, simple and affordable retirement plan option for businesses and employees across the state, Pennsylvania can promote increased saving among workers, while also ensuring that small businesses across the state are able to offer competitive benefits.

Many Americans are concerned about their retirement security, and for good reason. The majority of American adults do not participate in a retirement savings plan through their employer.[1] As a result, nearly half of U.S. households age 55 or older have no retirement savings and few resources outside of Social Security to serve as their income in retirement. Many of these workers are employed by small businesses unable to provide a 401(k) or other options. In addition, a significant number of workers without an employer-provided retirement plan are low-income earners who live paycheck to paycheck and face added challenges in saving enough for retirement.

All of this adds up to a crisis that will only deepen as more baby-boomers retire. With states across the country – including two states bordering Pennsylvania – taking steps to solve this problem, Pennsylvania state government can and should do the same. While financial industry experts recommend that workers by their 40s have 2-3 times their annual salary set aside in retirement savings, even those Pennsylvanians in defined-contribution plans have an average balance of only 70% of their annual income. **What's worse, 44 percent of working Pennsylvanians – over two million private sector workers -- currently do not have access to any retirement plan**, according to the AARP.[2] Research shows that workers with access to retirement plan options through their employer are far more likely to save for retirement than those without access. By creating a state-wide program to reach those without an employer-provided option, we can improve the retirement prospects of hard-working Pennsylvanians, while also helping small businesses and improving the long-term fiscal health of the state.

As in other states with well-designed retirement savings programs, in the PA-IRA Program, businesses would not have to administer the program for their employees, be required to make

[1] The PEW Charitable Trusts, "How States Are Working to Address the Retirement Savings Challenge," June 1, 2016.
[2] David John and Gary Koenig, "Fact Sheet; Pennsylvania," AARP Public Policy Institute, August 2015.

contributions, or serve as a fiduciary for the accounts. Through a simple automatic payroll deduction, employees would be able to contribute their own funds to a portable retirement fund managed by the state. Modeled on successful state-level plans across the country, a PA-IRA Program would put more control over their retirement futures in the hands of working Pennsylvanians.

> ***Joe Torsella on Pennsylvania IRAs:***
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> *"Portable individual retirement savings plans are a simple tool for workers to create economic security through their own efforts, with their own earnings. This policy is a no-brainer that has been gaining momentum in states across the country. We need to empower working Pennsylvanians to build their own long-term economic security.*
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> *"The failure to save enough—or save at all—is a struggle for all working families; however, there are real risks down the road if individuals do not have access to retirement savings accounts. If Pennsylvania sets up the means for accessible and automatic savings, we can help mitigate those risks."*

THE CHALLENGE OF RETIREMENT SAVING WITHOUT ACCESS

In the past, many private-sector employers provided pensions and other defined benefit programs to their employees for retirement. That model has been shifting to defined contribution programs like 401(k) plans. However, many small businesses have been priced out of offering the benefit due to high administrative and set-up costs. Moreover, younger and lower-income workers often have no access to employer retirement plans due to the more temporary nature of their employment status. According to the U.S. Bureau of Labor Statistics, only 40 percent of private sector workers with wages in the lowest quarter of earners even have access to retirement programs through their employers or unions.[3]

As a result, 44 percent of private-sector working Pennsylvanians today do not have access to a retirement plan through their employer, according to the AARP.[4] The retirement savings gap disproportionately impacts both minority families and women. Additionally, women lag behind men with access and savings.[5] According to the Economic Policy Institute, Hispanics lag significantly behind black, white, and Asian workers in retirement savings. Data shows that only 26% of Hispanic families had savings in a retirement plan or an Individual Retirement Account (IRA), compared to 41% of black families, 65% of white families, and 58% of Asian families.[6] With less than 10 percent of all workers contributing to a plan outside of those provided by employers, access to a plan through work is crucial to promoting retirement savings.[7]

[3] The PEW Charitable Trusts, "How States Are Working to Address the Retirement Savings Challenge," June 1, 2016.
[4] David John and Gary Koenig, "Fact Sheet; Pennsylvania," AARP Public Policy Institute, August 2015.
[5] Financial Services Roundtable, "The Unique Retirement Savings Challenges of Women, Minorities, and Millenials," accessed August 11, 2016.
[6] Monique Morrissey, "The State of American Retirement: How 401(k)s have failed most American workers," Economic Policy Institute. March 3, 2016.
[7] The PEW Charitable Trusts, "How States Are Working to Address the Retirement Savings Challenge," June 1, 2016.

Personal finance experts recommend that, by their 40s, workers already have two to three times their annual earnings set aside as retirement savings. However, according to a 2014 Employee Benefit Research Institute study, only 6 percent of those without access to retirement programs through their employer had over $25,000 saved, and only 3 percent had $100,000 or more. For many in Pennsylvania and across the U.S., that means Social Security benefits will be their primary or possibly their only resource to draw on in retirement, which is inadequate in many cases.[8]

The promising news, and the impetus behind the PA-IRA Program, is that when employees are given the opportunity to enroll in a retirement savings plan through their work, participation levels are much higher across all income levels.[9] Additionally, across all income levels, participation increases greatly when employees are automatically enrolled (with opt-out rather than opt-in provisions) compared to plans without automatic enrollment. Studies have found that participation rates can reach as high as 95 percent under automatic enrollment.[10]

The market costs are prohibitive for many private sector employers to offer retirement to their employees.[11] In a 2013 survey of small businesses with and without retirement plans conducted by the Main Street Alliance & American Sustainable Business Council, 63 percent cited the cost required to provide a plan—even without the added cost of an employer match—as the largest barrier. Another survey, conducted in 2014 by the Small Business Majority in Illinois, found that of the 70 percent of small businesses that do not offer plans, 27 percent cited a lack of administrative capacity and 14 percent cited cost as reasons for not doing so.[12]

ADDRESSING THE CHALLENGE OF RETIREMENT SECURITY – STATE-BY-STATE

With the retirement crisis looming across the country, many states and the Federal government have started programs to encourage or require employers and individuals to save and have access to the ability to save.

***California Secure Retirement Savings Trust* –** Signed into law on September 28, 2012, the program will eventually require that all businesses with five or more employees enroll their employees in a new type of savings plan, if they do not already offer a plan to employees, and established the California Secure Choice Retirement Savings Investment Board, chaired by the California State Treasurer, to oversee an investment trust for workers' accounts. California Secure Choice accounts differ from standard IRAs by being a pooled investment vehicle for contributing individuals.

[8] Remarks by California Senate Pro-Tem Kevin de León, October 2, 2015.
[9] Report to the Chairman, Special Committee on Aging, U.S. Senate, "Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges," Government Accountability Office, October 2009, p. 9.
[10] Id.
[11] The PEW Charitable Trusts, "How States Are Working to Address the Retirement Savings Challenge," June 1, 2016.
[12] Main Street Alliance & American Sustainable Business Council, "Poll Report: Small Business Owners' Views on Retirement Security," June 2013.

Eligible employees are automatically enrolled in the plan and contribute about three percent of their wages through payroll deduction, although they can opt out of the plan. Employers have no fiduciary liability involving the fund, and are only required to set up the payroll deduction on behalf of their employees.[13] If an employer, with 5 or more employees, does not offer an employer-sponsored retirement plan, then these employers will be required to offer an employer sponsored retirement plan, or enable employees to make an automatic payroll contribution to their Secure Choice account.[14] The law is awaiting final enabling legislation.[15]

***Illinois Secure Choice Savings Program* –** Signed into law on January 4, 2015, the Illinois program was the first to require that private-sector employers offer their workers a retirement savings plan. Set to be implemented by June 1, 2017, the Illinois program requires employers with 25 or more workers who do not already offer their employees a retirement plan to automatically enroll their workers in a state-run payroll-deduction Roth Individual Retirement Account (Roth IRA).[16] By securing the tax treatment of a Roth IRA, contributions under the program are made after-tax, but no income tax is charged upon withdrawal of the funds after retirement.[17]

Employees eligible for the program are automatically enrolled at a contribution rate of three percent of pay, but are free to change their contribution level or opt-out of automatic deductions. Their contributions are invested in a life-cycle fund that gradually becomes more conservatively invested as they approach their target retirement date. Money going into the Secure Choice Program will be pooled in a protected fund, separate from the state's budget and pension funds, administered by the Illinois State Treasurer's office. These funds may not be used for any other purpose. No taxpayer dollars will be invested in the program.[18]

Connecticut Secure Retirement Plan – In 2015 Connecticut created a board co-chaired by the Connecticut Comptroller and Treasurer that developed and successfully passed legislation requiring employers with 5 or more employees that have been in business for at least one year to automatically enroll their employees into a Roth-IRA. Beginning on January 1, 2017, employees working for covered employers are required to be auto-enrolled into the new Exchange. Employees can select among a range of age-appropriate target funds for their contributions, and the funds will be offered by a variety of vendors. No employer contributions into the accounts are permitted. Connecticut is also currently conducting a study of the interest in establishing a non-Roth IRA investment option, and may conduct a study of the feasibility of offering a multi-

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[13] Pension Rights Center, "State-based retirement plans for the private sector." Available at: http://www.pensionrights.org/issues/legislation/state-based-retirement-plans-private-sector

[14] Office of the State Treasurer, "California Secure Choice: Making Workplace Retirement Savings Possible for 7.5 Million Californians."

[15] As of August 17, 2016. The legislation is to be voted on during the week of August 22, 2016.

[16] This model, according to an opinion by the Department of Labor fits under a safe harbor for individual retirement accounts. "For example, the Labor Department has long provided a safe harbor in which an IRA program funded by payroll deductions is not an ERISA plan if the following conditions are met: (1) The employer does not make any contributions. (2) Employee participation is "completely voluntary." (3) Employer involvement is minimal and limited to providing information about the program to employees without endorsing the program. (4) The employer is not paid for offering the program." From The PEW Charitable Trusts, "How States Are Working to Address The Retirement Savings Challenge," June 1, 2016.

[17] Id.

[18] Pension Rights Center, "State-based retirement plans for the private sector." Available at: http://www.pensionrights.org/issues/legislation/state-based-retirement-plans-private-sector

employer, or 401k plan, or other tax-deferred vehicle.[19] The Comptroller and Treasurer will continue to be board members of the newly created authority.

Massachusetts – The state set-up a voluntary defined contribution program for small nonprofit organizations with a maximum of 20 workers in 2012. The state treasurer administers the ERISA-covered defined contribution plan. The state treasurer can contract with individuals or companies to help design, administer, and provide investment options. The legislation also created a "not-for-profit defined contribution committee" to help the treasurer develop general program policy and to provide technical advice.[20]

Oregon – Oregon passed legislation in 2015 to create the Oregon Retirement Savings Board, chaired by the state treasurer. The program creates portable and individual accounts. Employers would not be required to contribute, and employees could opt out. The funds would be invested by a third-party firm and would not go through the state treasury. The law requires businesses that don't offer a retirement plan to automatically enroll employees in the state program and deduct a portion of their wages for it.[21]

Maryland – Maryland finalized its IRA program in 2016. The legislation establishes the Maryland Small Business Retirement Savings Board to oversee the program. Members of the board include the state treasurer; the state secretary of labor, licensing and regulation; three members appointed by the governor; three appointed by the president of the Senate; and three appointed by the speaker of the House of Delegates. Additionally, the law authorized the creation of a state-run IRA, which will be administered by a private company with oversight from the Board. As such, most of the details surrounding the IRA's fees, investment options, and distributions remain undetermined at this point. The program is only for workers not enrolled or covered by an ERISA or any other federal authorized or enabled retirement savings plan at work. The law enables employers to automatically enroll their employees in the state-run IRA program by using some type of payroll deduction system or service. The law does not require any employer to allow its employees to participate, nor does it require any contributions or funding from the employer. Employees may voluntarily opt out of the program. If an employer offers the automatic deduction, the state will waive an annual business report filing fee of $300 for a business entity that complies with the new legislation.[22]

Washington – In 2015, Washington created the state's Small Business Retirement Marketplace, which will be designed and managed through the state Department of Commerce. It is a voluntary program between the private suppliers of financial programs and private-sector employers. Employers with fewer than 100 workers, as well as the self-employed and sole proprietors, will be eligible, though participation will be voluntary for both employers and workers. The director will promote the program through a website and electronic marketing materials. The marketplace also must offer the federal myRA, a new savings program for workers without a plan at their workplace.[23]

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[19] Id.
[20] Id.
[21] Tracy Loew. Oregon Legislature approves state-run retirement plan. *Statesman Journal*. June 16, 2015
[22] James Hopkins. New Law Takes Aim at Retirement Savings; Is The Levee Breaking? *Forbes.* July 6, 2016. Retrieved from:
[23] Overview from the Georgetown University Center for Retirement Initiatives, available at: http://cri.georgetown.edu/states/washington/

New Jersey – In 2015, New Jersey passed a bill similar to the Illinois' Secure Choice Retirement Savings Program that would have established the New Jersey Secure Choice Savings Program. The program would have required a mandatory payroll deduction IRA for private sector workers at employers with twenty-five or more employees that do not offer a retirement plan. Governor Chris Christie issued a conditional veto of the bill and replaced the proposed state-run retirement plan with a voluntary small business retirement marketplace modeled after Washington State. The marketplace would connect small businesses and its employees with existing investment vehicles. The Assembly and Senate approved the Governor's plan in January 2016.[24]

Federal myRA Program - After President Barack Obama directed the Treasury Department to create the myRA option to help Americans start saving for retirement, the agency announced a program to offer Roth IRAs invested in a risk-free Treasury security to workers whose employers do not sponsor plans. The myRA program is voluntary for employers and employees. The accounts can have maximum balances of $15,000 and cannot be maintained for more than 30 years. When either of these limits is reached, savings will be transferred to a private sector Roth IRA, which has no maximum balance. On Nov. 4, 2015, the Treasury began offering myRAs on a nationwide basis.

JOE TORSELLA'S PLAN

As Treasurer, Joe Torsella will champion the development of Pennsylvania's own version of the innovative retirement plans now offered in states from California to Illinois to Massachusetts.

By providing individuals with a convenient and universally accessible retirement option, Pennsylvania can take an important step toward increasing the savings workers will have at retirement. A Pennsylvania IRA Program would be a commonsense solution to help solve the retirement savings problem. Left unaddressed, the burden will fall not only on citizens unable to afford a respectable retirement, but also on the long-term financial health of the state. Not acting to address the problem now risks added costs and consequences down the road, as a result of retirees without sufficient savings.

Under Joe's plan, the primary benefactors and beneficiaries of the PA-IRA Program will be the employees themselves. Small business owners and operators throughout the state also stand to benefit. The program would enable them to offer a competitive retirement option to their employees by lowering the burden that has previously limited their ability to do so. This would allow Pennsylvania's businesses to continue to attract top talent.

Joe would convene stakeholders and Pennsylvania leaders across the spectrum to develop a Pennsylvania model, based on best practices and the most recent experience in other states, and leverage the considerable experience of the Treasury Department to help create and manage the program. Possible models range from a universal, automatic option – such as the Illinois and

[24] Overview from the Georgetown University Center for Retirement Initiatives, available at: http://cri.georgetown.edu/states/new-jersey-2/

California models – to the looser "exchange" models, such as Washington, Maryland and New Jersey.

Any successful program, however, should include several key elements:

- **Automatic Deductions:** Automatic deductions with an employee opt-out, rather than opt-in programs, have been shown to dramatically increase participation.
- **Low-fee:** Study after study shows that investors benefit from simpler, low-fee investment options.
- **Minimal Burden on Business:** No fiduciary or contribution burden on employers: under a PA-IRA, employers should bear no fiduciary responsibility for employee accounts, should not be liable for employee investment decisions, and should not be required to make or match any contributions to the accounts themselves.
- **Portability:** PA-IRAs should follow workers from job to job, throughout their lives.
- **Restricted to Retirement:** PA-IRA balances could only be used in retirement, when the contributor would have access to their savings, comprised of the money they contributed and the investment interest and dividend earnings on the account.
- **Broad Access:** The best program will be the one that provides the widest access to the approximately 2 million Pennsylvanians currently without workplace savings accounts.

THE BENEFIT

Though PA-IRA automatic deduction contributions would represent a small share of a contributing worker's current income, but over the course of a career, these contributions would add up and make a big difference in retirement.

The Social Security Administration's average monthly benefit in 2016 is $1,341.[25] For retirees who hope to maintain their standard of living, the income from Social Security may be insufficient and will need to be supplemented from other sources. By contributing just $1,200 every year into a retirement account, and assuming a conservative rate of return, after 40 years, workers should nearly double their income when combining their personal savings with Social Security.

Accounts set up for workers under the PA-IRA Program would encourage millions to save more and prepare for their own secure retirements. The program would represent no additional burden to either the employers or employees who opt out of participating, but could make a huge difference for those who opt in. As more workers retire and live longer, ensuring that they are financially prepared for the years ahead is more than just good for Pennsylvania's workers and small businesses – it's good for Pennsylvania.

[25] Social Security Administration, "What young workers should know about Social Security and saving," January, 2009.