AKF CONSULTING

AKF Market Report

State-run Retirement Programs: Momentum Increases as Programs Grow

October 2022

Overview

This AKF State-run Retirement Program ("SRRP") Market Report provides an update on trends and developments we have observed over the past year, as well as considerations for States seeking to launch or otherwise grow their SRRP. The lack of retirement preparedness has become more pronounced in recent years, often highlighted by industry reports and the media. In response, States are stepping up to address the looming retirement crisis by providing opportunities for individuals to save for the future. Although only available since 2017, these Program have amassed approximately $520 million in assets across more than 585,000 accounts nationwide.[1]

Trends and Observations

- Auto-IRA assets and accounts have grown in 2022, spurred by employer registration deadlines and impending enforcement actions
- States continue to embrace Auto-IRAs through new program launches, implementations and authorizations
- Recently launched Auto-IRAs offer new investment selections but overall investment line-ups remain simple across SRRP programs
- The hybrid fee structure is a trend visible in new and existing programs alike

Considerations for States

- A new wave of litigation highlights the importance of prudent governance practices for program fiduciaries
- Colorado makes headway on State partnerships, offering smaller states an efficient pathway to program launch
- New retirement products, including Pooled Employer Plans, may compete with SRRPs in the future
- Financial wellness could mean fewer opt-outs and more people on the path to a secure retirement

Method

Data for this AKF Market Report has been compiled from available disclosure documents and Program websites as of October 11, 2022. Colorado's Program information will be available upon full Program launch.

[1] Source: Georgetown University Center for Retirement Initiatives ("GU-CRI"). Includes California, Illinois and Oregon as of September 30, 2022; Connecticut as of October 18, 2022; and Massachusetts and Washington as of June 30, 2022

AKF Consulting Group gratefully acknowledges the resources provided by the Georgetown University Center for Retirement Initiatives. Please see www.cri.georgetown.edu for extensive information related to the development and status of the SRRP industry.

Findings and Observations

Since our 2021 SRRP Market Report, we have seen the progression of several State initiatives, including Mandatory Auto-IRA Program authorizations in Delaware and Hawaii, Plan launches in Maryland and Connecticut, and a pilot launch in Colorado. The following chart summarizes available SRRP models and authorized Programs:

	Auto-IRA		Multiple Employer Plan	Marketplace
	Mandatory	Voluntary		
Employers	Must facilitate employee enrollment	May choose to participate		
Employees	May opt-out of Auto-IRAs or choose not to participate in MEP or Marketplace			
Contribution Limits[2]	$6,000 – 2022 $6,500 -- 2023		$20,500 – 2022 $22,500 -- 2023	Set by plan
Employer Match	Not permitted		Permitted	Permitted
Key Design Features	Defaults in Launched Programs: 5% Contributions (3% in CT) 1% Annual Auto-Escalation (none in CT) 10% Maximum Escalation (8% in CA; none in CT) Roth IRA primary Traditional IRA may be available for rollovers		Defaults: Set by plan Employer qualified plans	Defaults: Set by plan 401(k) and IRAs offered
Launched	California Colorado Connecticut Illinois Oregon Maryland	--	Massachusetts	Washington
Under Development	Delaware Hawaii Maine New Jersey New York City[3] New York State City of Seattle Virginia	New Mexico	Vermont	New Mexico

In terms of Programs under development, we note that Virginia has engaged both a Program Administrator and Investment Manager; Maine has hired an Executive Director and New Jersey has a search underway; the New York and Delaware Boards have begun meeting, with New York moving into the planning phase with the engagement of independent consultants (Delaware is expected to issue an RFP for these engagements and proceed with an Executive Director search before year-end). These developments are described in more detail in Observation 2 below.

[2] Employees age 50+ can add $1,000 to Auto-IRA limits in 2022 and 2023; the MEP add-on for those age 50+ is $6,500 in 2022 and $7,500 in 2023

[3] Expectation is that New York City Auto-IRA will merge with the New York State Program

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Observation 1: Impressive Growth as Early Auto-IRA Programs Take Hold

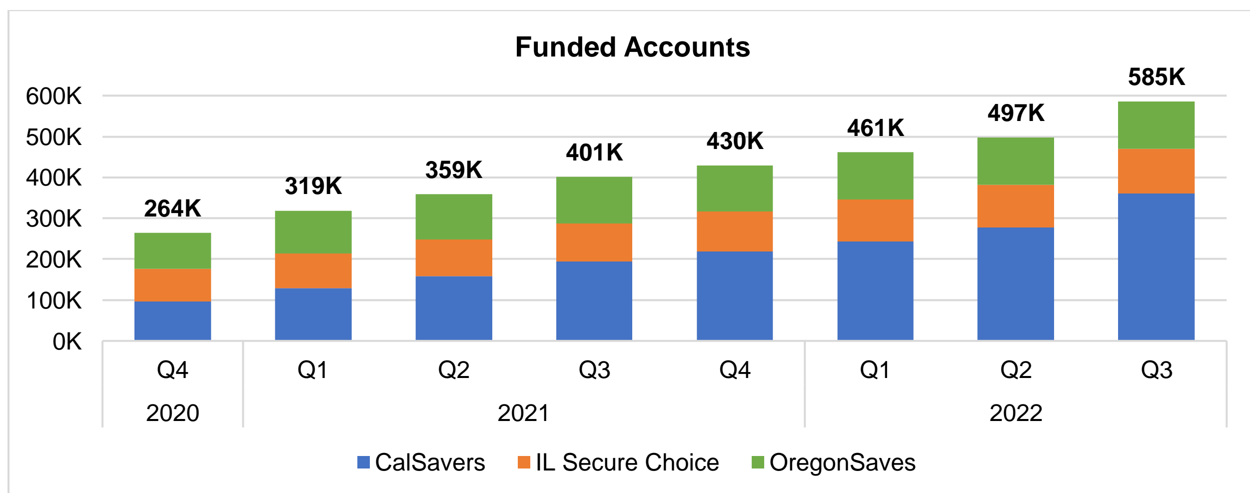
Retirement studies consistently show that individuals are more likely to save at the workplace than on their own. Participation in the first generation of Programs in California, Illinois and Oregon powerfully demonstrates that employee auto-enrollment enhances participation. To that end, the following chart shows generally that approximately 70% of employees remain enrolled in the Auto-IRA and that the majority contribute at the designated default contribution rate:

	California	Illinois	Oregon
Opt-out Rate	**37.4%**	**31.9%**	**24.8%**[4]
Avg. Contribution Rate	**5.07%**	**5.53%**	**6.1%**
Avg. Monthly Contribution	**$166**	**$144**	**$159**
Avg. Funded Account Balance	**$756**	**$768**	**$1,282**

Source: GU-CRI as of September 30, 2022

Over the last two years, we have seen the impact of mandatory employer participation on enrollment and asset growth. Based on information in Performance Data and Trends compiled by the Georgetown Center for Retirement Initiatives, during the rolling two-year period ending September 31, 2022, we find that the number of funded accounts across California, Illinois and Oregon doubled while assets more than tripled.[5]

The chart below illustrates the growth of Auto-IRA funded accounts in first-generation Programs since December 31, 2020 (2020 Q4), with California driving the numbers overall. These results reflect the sheer magnitude of the State but also may be attributable to the onset of California's employer mandate deadlines. The final employer registration deadline, encompassing all eligible businesses, was on June 30, 2022, and compliance enforcement is now underway.

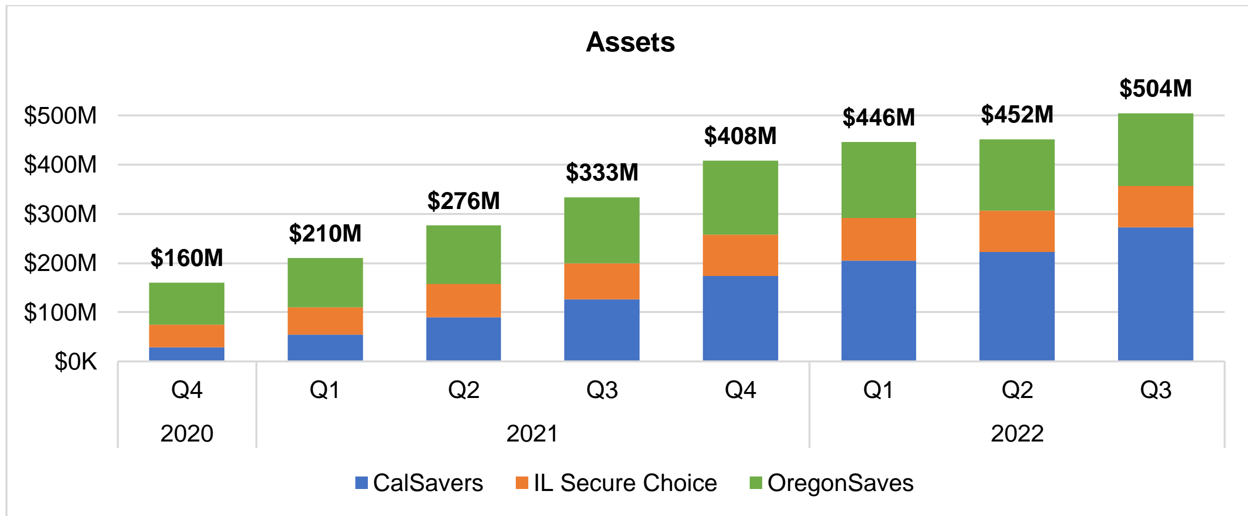


Source: GU-CRI as of September 30, 2022

[4] Oregon reports an Opt-out Action Rate, which is defined as the percentage of savers who opt in the first 30 days of enrollment. California and Illinois each use an Effective Opt-out Rate that includes all program enrolled accounts without any contributions. The difference in measurement periods results in comparatively higher Opt-out Rates for California and Illinois

[5] See GU-CRI: https://cri.georgetown.edu/states/state-data/current-year/#annual-data

The following chart shows asset growth over the same two-year period, including market performance. We note two points. First, continued asset growth through the first year of the pandemic, particularly in Illinois and Oregon, is likely the result of auto escalation. And second, the slight increase in assets between 2022 Q1 and Q2 indicates that contributions (either from existing accounts or through new enrollments) continued despite market volatility.



Source: GU-CRI as of September 30, 2022

We expect to see the number of accounts increase with the passage of State legislation that expands the pool of eligible employers. In September 2022, the CalSavers statute was amended (SB1126) to apply the mandate to employers with one to four employees, excluding sole proprietors. Effective January 1, 2023, this will open the door to an estimated 300,000 new employers that must offer a qualified plan or facilitate employee enrollment in CalSavers. Similarly, Illinois passed legislation (HB117) in July 2021 to expand eligible employers to those with five to 24 employees, with enrollment dates spread across two additional waves. As a result, an estimated 66,000 new employers will be eligible to participate in the Illinois Secure Choice Program.

In the fall of 2021, California began enforcement actions against non-compliant employers in its first wave (employers with at least 100 employees). Enforcement actions against non-compliant second wave employers (50 to 99 employees) began as of July 1, 2022. The California penalty for non-compliance is $250 per employee upon first notice. After 90 days of non-compliance, another $500 per employee will be charged.

Illinois is gearing up for enforcement and expects to mail notices of proposed assessment to select non-compliant employers with 25 or more employees in February 2023. Upon receiving the notice, employers will have a 120-day grace period in which to comply. The penalty for non-compliance in Illinois is $250 per employee in the first year and $500 per employee in each subsequent year.

Observation 2: Auto-IRAs Continue to Dominate the Market

SRRPs continued to pick up speed in 2022, with States authorizing Auto-IRAs as the primary retirement vehicle. We have already seen three Program launches in 2022, significant movement on at least five implementations, and several new Program authorizations. The following chart summarizes these developments overall:

2022 Launches	Implementation Underway
Connecticut *Pilot: November 1, 2021* *Launch: April 1, 2022* **Maryland** *Pilot: June 6, 2022* *Launch: September 16, 2022* **Colorado** *Pilot: October 17, 2022*	**Virginia** *Vestwell and BlackRock named* *Projected Launch: July 2023* **New York** *Consulting team named* *Projected Launch: FY 2024* **Maine** *Hired Executive Director* **New Jersey** *Executive Director search underway* **Delaware** *Board meetings begin October 2022*

As shown in the chart above, five States are moving ahead with Program development. Furthest along, Virginia has selected both a Program Administrator and Investment Manager and has set its investment line-up. The Virginia statute provides for a launch by July 1, 2023, but given its progress thus far, we would not be surprised by an earlier 2023 launch. New York State has engaged consultants to proceed with the design of its Program, with the Board targeting release of an RFP for Program services by 2023 Q2. Finally, the Maine, New Jersey and Delaware Boards are meeting regularly; Maine has hired an Executive Director and New Jersey's search is underway (Delaware will follow shortly). We hope to see progress on at least two other State Programs by in early 2023.

In 2022, Hawaii joined the list of States to authorize a mandatory Auto-IRA. The statute incorporates the Auto-IRA provisions we have come to expect, including auto enrollment, an opt-out provision, default contributions and auto escalation – all in connection with a Roth IRA. These features, coupled with the cost effectiveness and ease of adoption for the employer, should make the Auto-IRA the model of choice for States going forward.

While New Mexico does not yet have a projected launch date, we note that it has taken significant steps to solicit interest in its Marketplace program. It also has actively engaged with Colorado on the development of a partnership structure, which would accommodate its Auto-IRA Program once the legislature authorizes it as mandatory (as opposed to its current voluntary character).

Overall, we are encouraged by the commitment we see from all the States included above. And we are looking forward to additional legislative action in States including Pennsylvania, Missouri and Mississippi, among others.

Observation 3: Investment Line-ups Remain Simple

In our 2020 Market Report, we noted the uniformity of investment options across all SRRPs, including the Massachusetts Multiple Employer Plan and the Washington Marketplace. With the 2022 Auto-IRA launches in Colorado, Connecticut and Maryland this trend continues, as shown in the following chart. Details on Colorado's Program will be available upon full Program launch.

	California	Connecticut	Illinois	Maryland	Oregon
TDF Provider	SSGA	Customized (Fidelity, Schwab Vanguard)	BlackRock	BlackRock	SSGA
Equity	Global Equity ESG	Growth Moderate Growth	Growth	Global Growth Stock	S&P 500 Index
Balanced		Conservative Growth Balanced	–	--	–
Fixed Income	Core Bond	Income Income and Growth	Conservative	Bond Index	–
Short Term	Money Market	Money Market	Capital Preservation	Capital Preservation	Capital Preservation
Pre-TDF Default	30 Days Money Market	60 Days Money Market	90 Days Money Market	$1,000 Emergency Savings	90 Days Capital Preservation
Total Options	5	8	4	4	3

Today, we note three points regarding investments:

- BlackRock and SSGA continue to be the dominant managers of the underlying Target Date Funds ("TDFs"). With the exception of Connecticut, each Auto-IRA Program includes off-the-shelf BlackRock or SSGA TDFs, all at underlying fund costs of approximately 0.09% (9 basis points).
- Connecticut alone offers a customized TDF structure, which incorporates underlying funds managed by Fidelity, Schwab and Vanguard. Lockwood Advisors serves as the Investment Advisor responsible for the TDF customization.
  - The customized portfolios result in underlying investment costs of approximately 0.035% (3.5 basis points), while the cost of customization is included in the overall administration fees paid by participants.
- Connecticut alone also offers multiple "static" or "target-risk" investment options, which are created across multiple underlying funds (as opposed to single underlying funds generally in the other Programs).

On a final note, in our 2021 Market Report, we identified the trend for Programs to use time-based investments for initial payroll deposits defaulting to TDFs. This was particularly noteworthy last year as California and Oregon each had just converted from an asset-based structure (e.g., requiring $1,000 in deposits before converting to the applicable TDF portfolio) to 30- and 90-day holding periods, respectively.

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As shown in the chart above, in the default scenario, Maryland departs from the time-based investment by using a $1,000 emergency savings fund. The underlying investment for the emergency savings fund is a guaranteed investment contract issued by Lincoln Financial with a minimum 1% return. As always, a participant may skip this initial stage by affirmatively choosing an investment option, but at least in Maryland the minimum earnings rate exceeds the money market rates that prevailed when California and Oregon both used a similar structure.

Observation 4: The Hybrid Fee Structure Takes Hold

In our 2021 Market Report, we noted the emergence of a hybrid fee structure, incorporating both dollar- and asset-based fees. Today, that trend has solidified with the Auto-IRA launches in Connecticut and Maryland. As shown by the chart below, the administrative fees accruing to the Connecticut State Administrator are also hybrid, and the dollar-based fees in Maryland and Oregon are departures from the early asset-based fees for State Administrators in California and Illinois. Details on Colorado's Program will be available upon full Program launch.

		California	Illinois	Oregon	Connecticut	Maryland
Asset-Based Fees	Underlying Fund	0.025 - 0.15%	0.02 - 0.15%	0.02 - 0.12%[6]	0.032 - 0.10%	0.025 - 0.67%[7]
	Program Manager	0.75%	0.55 - 0.68%	0.15%	0.20%	0.18%
	State	0.05%	0.05%	–	0.02%	--
	Total	0.825 - 0.95%	0.75%[8]	0.17 - 0.27%	0.252 - 0.32%	0.205 – 0.85%
Dollar-Based Fees	Program Manager	–	–	$14	$24	$24
	State	–	–	$4	$2	$6
	Total	–	–	$18	$26	$30

On a final note, on October 3, 2022, the CalSavers Board authorized its Executive Director to negotiate possible changes to its pure asset-based fee structure. While the Auto-IRA market has experienced significant growth, until a critical mass of assets is achieved, dollar-based fees will be more important for private sector program administrators. Moreover, as account values grow, dollar-based fees will become more cost effective for participants.

[6] Subject to confirmation by the State
[7] Represents Global Growth Stock at 0.67%
[8] Fees capped by statute

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Future Considerations

As the landscape for SRRPs continues to evolve, we note four considerations for State Administrators.

Consideration 1: New Wave of Litigation Highlights Governance Risks

This summer, we began seeing a number of ERISA lawsuits against prominent employers that use low-cost target date funds in their retirement plans. Rather than focusing on fees, as litigation has typically done in years past, these new suits instead alleged that the employers (and their retirement plan Boards) violated fiduciary duties by performing incomplete evaluations of the TDFs during fund selection and thereafter by failing to diligently monitor these funds.

While these particular lawsuits impact plans governed by ERISA (which does not apply to State Auto-IRA programs), the core issue is really about governance, due diligence and processes – topics that touch all SRRPs. For example: does the SRRP Board engage in regular performance monitoring and reporting? Does it fully and critically assess its investments annually? What does the Board look at and compare against when undertaking these assessments? Does the Board have documented governance processes? Is the Board trained on its duties, including all of the aforementioned tasks?

This litigation highlights the critical importance of regular Board training, especially for Boards of start-up programs. Boards should understand what being a fiduciary means and what good governance entails. Demonstrated adherence to strict, thorough processes and policies is important for program fiduciaries, and will often be the best possible defense against litigation.

Consideration 2: Partnerships Are Imminent

In our 2020 Market Report, we discussed the concept of leveraging a consortium of States with respect to SRRPs. The Colorado Board essentially authorized the first partnership structure by adopting the Interstate Adherence Agreement ("IAA") on September 27, 2022. The State worked with New Mexico to draft this structure overall, which will include execution of the IAA by Colorado and each Partner State as well as a separate Agreement between each Partner State and the Colorado Program Administrator. This advancement in partnership possibilities is particularly relevant for smaller States considering options for Program design and launch. Partnership structures are a means for small States to offer cost-effective retirement savings solutions. Given the success we have seen in the ABLE industry, we are confident that the partnership model will take hold in the SRRP industry as well.

Consideration 3: Will New Retirement Products Emerge to Challenge SSRPs?

To date, SSRPs predominantly have been established as Auto-IRAs using Roth IRAs as the default account structure. Low costs, easy access to funds, and minimal administrative requirements make Auto-IRAs appealing to small business owners and lessen the sting of a mandatory compliance obligation. The Massachusetts multiple employer plan ("MEP") and the Washington Marketplace offer appealing options as well but at higher engagement levels for employers.

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The SECURE Act created a new type of MEP: the pooled employer plan ("PEP"). A PEP allows unrelated small businesses to band together to achieve economies of scale under one retirement plan, which must be governed by a pooled plan provider ("PPP"). These plans can provide small employers with the same features as an employer sponsored 401(k) plan but at a significantly lower cost.

Like the traditional 401(k) plan, PEPs would permit a matching employer contribution, higher deferral limits and a more robust selection of investments. In a PEP, the PPP will assume administrative responsibilities, including IRS tax filings and any DOL amendments or updates. These features could make a 401(k) more appealing to small business owners, and if so, the number of employers opting to enroll in an SRRP might decrease. Since PEPs are still new it remains to be seen how many employers would make this choice, but the possibility is worth acknowledging and reinforces the importance of designing and offering competitive SRRPs.

Consideration 4: Financial Wellness Could Mean Fewer Opt-outs

Financial wellness has become an important component of many workplace benefit programs. What financial wellness translates to for employees depends upon the employees themselves: what is financial wellness and do employees think that they are financially "well"? In an economic environment increasingly defined by high inflation and rising interest rates, what constitutes financial wellness?

Answers may vary, but one thing is certain: for the vast majority of Americans, complete financial wellness requires a retirement savings plan. The challenge for States is to ensure that employees both hear and *believe* this message. The right information, delivered in the right way, can lead participants to remain enrolled in a Program rather than choosing to opt out. The key concepts to impart are (i) the importance of starting to save early, regardless of how small the savings may be, and (ii) the power of tax benefits. If this is an individual's first exposure to any financial planning, the road to wellness may require more than just education about retirement savings.

The path from employee to retiree is not always clear: there can be obstacles, roadblocks, and unknowns along the way. A financial wellness program can help educate employees so that uncertainty does not result in opting out. Small steps in the right direction can move employees closer to financial wellness.

Find Out More

We hope this analysis of the evolving SRRP market and progress made by early-adopter States is insightful for State Administrators and decision makers nationwide. We would be delighted to explore the implications of these developments in more detail with you. For more information, please contact:

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