State-run Retirement Programs: Insights for Success

October 2020

Overview

This AKF Retirement Market Report provides an overview of the initiatives underway in the design and implementation of retirement programs administered by State or local entities for the benefit of businesses and their employees ("State-run Retirement Programs" or "SRRPs"). We expect that as State legislation and SRRP implementation progress, new considerations will evolve. Following a summary of the current state of the market, our observations and future considerations include:

- Across the thirteen public entities that have authorized or implemented an SRRP, most have done so through a payroll-deduct Auto-IRA, notwithstanding other benefits offered by Multiple Employer Plans and Marketplace models.
- Within the Auto-IRA model, most legislatures have made employer participation mandatory, including penalties for non-compliance or incentives for compliance. Participation levels in purely voluntary Programs are more difficult to predict.
- Investment option menus thus far are simple and straightforward, geared toward asset accumulation, and in several cases, initial capital preservation. This approach is intended to avoid overwhelming participants and may include a default investment when none is selected. Moving forward, SRRP governing entities could consider additional options tailored toward decumulation.
- SRRPs offer the benefit of providing a "bridge" between the start of retirement and activation of Social Security payments, thereby allowing participants to optimize a larger Social Security annuity payout. Educating participants about the power of deferral and providing an investment or administrative mechanism to help facilitate it, may serve as an important catalyst to increase participation in State-run Retirement Programs.
- Engaging payroll providers will be key to simplifying employer participation and ultimately enhancing the success of these Programs.
- Collaboration across States might enable SRRPs to reach economies of scale faster, similar to State ABLE partnerships and alliances.

As legislatures and public entities consider optimal Program design and implementation, they will begin to help their otherwise unserved citizens achieve retirement readiness.

Method

Data for this AKF Market Report has been compiled from available disclosure documents and Program websites as of August 11, 2020.

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

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

Findings and Observations

Over the course of the last five years, three Program models have emerged across State initiatives: Auto-IRA, Multiple Employer Plan ("MEP"), and Marketplace; within the Auto-IRA model, employer participation is either mandated ("Mandatory Auto-IRA") or voluntary ("Voluntary Auto-IRA"). The following chart details the most important characteristics of each model:

	Auto-IRA	Multiple Employer Plan	Marketplace[1]
ERISA Applicability[2]	State is not subject to ERISA	ERISA rules apply to the MEP	State is not subject to ERISA
Employer Role	Mandatory Auto-IRA: Unless exempt, employers must register Voluntary Auto-IRA: Employers choose whether to register	Employers choose whether to join the MEP	Employers can choose from employer-based ERISA plans offered in the Marketplace
Employer Liability	Employer is not a fiduciary Mandatory Auto-IRA: Employers can be fined for noncompliance or, in some States, forego incentives for participation	Employers retain some fiduciary and administrative responsibilities SECURE Act eliminates "one bad apple" liability that previously applied to MEPs	In choosing an employer-based ERISA plan, employers retain some fiduciary and administrative responsibilities
Employee Options	Employees may opt out	Employees may opt out	Employees may opt out
Contribution Limits[3]	$6,000	$19,500	As set by plan
Expected Employee Contributions	Typically set by Board or in statute as percent of payroll Default minimum is often 3-5%	Minimums are set by MEP Board can have discretion (available Program default minimum is 6%)	Minimums are set by plans
Auto-escalation	Often set in statute (10% is highest cap across available Programs)	Board has administrative discretion (available Program cap is 12%, increasing to 15% January 1, 2021)	None, voluntary
Employer Contributions	Not Allowed	Employers can make matching contributions	Employers can make matching contributions
Employer Resource Commitment	Minimum	Moderate	Moderate

[1] Includes employer-based 401(K) (ERISA) and individual-based plans. This chart focuses solely on employer-based plans
[2] Employee Retirement Income Security Act of 1974
[3] Contribution limits are set by the existing federal limits for IRAs and 401(k)s. For employees who are 50+, Auto-IRA limit is $7,000 and MEP limit is $26,000. In employer-match plans, maximum combined contribution is $57,000 for 2020

Observation 1: Auto-IRA Model Trending

As the SRRP market has developed, we observe that States have tended to adopt the Auto-IRA model. Three of five launched Programs — California, Illinois and Oregon — offer an Auto-IRA model. Additionally, the majority of SRRPs in development (seven of nine) plan to utilize the Auto-IRA model, as shown below:

	Auto-IRA	Multiple Employer Plan	Marketplace
Launched	**California Illinois Oregon**	**Massachusetts**	**Washington**
Under Development	**City of Seattle Colorado Connecticut Maryland New Jersey New York[4] New Mexico[5]**	**Vermont**	**New Mexico[5]**

We believe the Auto-IRA model's simplicity is attractive to both the State as an administrator and to the employer as well. An Auto-IRA is relatively easy to establish and administer on an on-going basis, which appears to be an important consideration in choosing the Auto-IRA structure over the MEP, notwithstanding the ability to accumulate more assets per account in a MEP. From the employer's perspective, the Auto-IRA also requires the least effort of the three models. The employer is not subject to filing requirements (e.g., a Form 5500) and is not a fiduciary to or for its employees. In fact, the Auto-IRA model untethers the employer and employee altogether, with the employee owning the account and being responsible for the investment decisions.

In terms of the MEP structure as implemented in Massachusetts, the model offers several noteworthy employee and employer advantages, including materially higher contribution limits and the potential for employer matches. The Massachusetts Program also offers employees the option of professional account management to customize investment portfolios based upon individual risk tolerances along with the tools necessary to manage asset decumulation in retirement. Finally, from the employer perspective, the structure reduces some administrative and fiduciary responsibilities required under ERISA. For example, the State files a single Form 5500 on behalf of all participating employers, but employers are still responsible for timely contributions and reporting.

With respect to the Marketplace, depending on Plans included, the structure would offer some of the benefits and advantages outlined above. At a high level, we note that the model was authorized by the State of New Jersey in 2016, but no actions were ever taken to implement it. At this time, we view the Auto-IRA authorized by the New Jersey legislature in 2019 to have superseded the Marketplace legislation. We also note that in 2020, Auto-IRA legislation was introduced in the State of Washington. This suggests that an additional SRRP would offer more choices than the Marketplace alone and thus ultimately increase employer participation in the retirement space. We are encouraged that the New Mexico authorized legislation includes both a Marketplace and a Voluntary Auto-IRA but suspect that ultimately the State will implement one or the other but not both.

[4] New York Program is a Voluntary Auto-IRA; legislation is pending to convert to a Mandatory Auto-IRA
[5] New Mexico Program is authorized as a hybrid structure, incorporating both a Voluntary Auto-IRA and a Marketplace

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

As a final point, we note that for an employee, retirement funding via payroll deduction – whether in an Auto-IRA, MEP or Marketplace – will have the largest impact on behavior, positioning for success employees who might not otherwise save for retirement.

Observation 2: States Encourage Participation through Mandatory Auto-IRAs

As States consider the potential for an SRRP and draft authorizing legislation, employee participation becomes a critical component in the success of the ultimate Program. An employee's exposure to or awareness of an SRRP likely depends on whether the *employer's* participation is mandated by statute or is voluntary in the first place. In the case of a Program with an employer mandate, an employer that is not otherwise exempt (i.e., an employer that does not offer its own retirement program, or an employer that has more than the base number of employees identified by the Program) must provide employee information to the Program or be subject to penalties or forego certain incentives. An employee can always opt-out, but exposure to and awareness of the Program are key to their continued participation.

Active Auto-IRA Programs in California, Illinois and Oregon have all adopted mandatory employer participation. This model encourages a Program to have the broadest reach across the State, and consequently, enables a Program to more easily achieve economies of scale and sustainability. Similarly, Programs under development in Colorado, Connecticut, Maryland and New Jersey follow the mandated nature of employer participation.[6] It is interesting to note that even in New York, legislation has been introduced to amend the voluntary nature of the Auto-IRA to one that mandates employer participation.

The benefit of broad reach is contingent upon enforcement — how will States ensure that every eligible employer adopts the Program? This question is the primary challenge with the mandatory model and entails a variety of considerations. For example, to enforce mandatory participation, a State must have access to reliable employer information, the source for which could be the entity responsible for business registrations (e.g., a secretary of state, revenue department or tax agency). Another consideration is whether to establish sanctions for non-compliance along with the severity of such sanctions. Alternatively, a State may consider establishing an incentive for participation, such as a fee waiver for the employer. In assessing these considerations, the State ultimately should structure enforcement so that it meaningfully encourages and impacts participation.

Observation 3: Simple Investment Choices Geared to Building Assets

State initiatives have thus far emphasized the importance of straightforward investments, so as not to overload an investor with choice. As shown in the chart on the top of the next page, we observe a degree of uniformity in investment menus, including target date funds ("TDFs") and two to four additional individual options, mostly offered by well established, low-cost investment managers.

[6] As drafted, the City of Seattle Program will be mandatory but the City has not yet taken steps toward implementation

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

	California	Illinois	Oregon	Mass[7]	Washington		
					Aspire	Finhabits	Saturna
TDF Provider[8]	SSGA	BlackRock	SSGA	SSGA	BlackRock	Vanguard	Vanguard
Equity	Global Equity Fund Sustainable Balanced Fund	Growth Fund	Growth Fund	Growth Fund	Vanguard Balanced Fund		Saturna Funds (7) Vanguard Funds (7)
Fixed Income	Core Bond Fund	Conservative Fund	Not Offered	Inflation Fund Income Fund		Income Fund	Saturna Funds (4) Vanguard Funds (3)
Short Term	Money Market Fund	Capital Preservation	Capital Preservation	Capital Preservation			Vanguard Funds (2)
Default Provision	*$1K to Money Market and then to TDF*	*90-Day Holding in Money Market Fund and then to TDF*	*$1K to Capital Preservation and then to TDF*	*Applicable TDF*			
Total Options[9]	5	4	3	5	2	2	24

As indicated in the table above, if an investor does not choose an initial investment option, preselected "default" options are in place in California, Illinois, Massachusetts and Oregon. For available Auto-IRA Programs, contributions will first "default" into a liquid money market or capital preservation fund. After a certain asset limit ($1,000 in both California and Oregon) or time limit (90 days after initial contribution in Illinois) is reached, contributions will transfer into the appropriate TDF for the investor.

One final observation regarding the current investment line-ups is the apparent emphasis on the accumulation of assets whereby investment options are designed and expected to help an employee achieve a comfortable retirement. From our view, strategies for the decumulation or spend-down of retirement funds appear to be absent from SRRPs today. How does a Program educate participants about investments in retirement? When does a retirement-phase investment approach come into play and what is that strategy? We believe these questions raise important considerations for Boards along with their administrators and investment managers to address in the future.

[7] This chart does not include the additional managed account and customized options offered by Empower Retirement Advisor Services, which options would allow participants to develop efficient portfolios based on individual risk tolerances
[8] Only specifying TDF investment managers. For other investment options, Oregon and Finhabits only offer SSGA and Vanguard Funds, respectively; all other Programs include additional investment managers
[9] TDFs are considered one Option regardless of how many TDF Portfolios are available

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

Future Considerations

As the landscape for State-run Retirement Programs continues to evolve, State administrators may be presented with or otherwise seek new opportunities to promote growth and reduce participant costs. We note several key considerations for the industry as it matures.

Consideration 1: Promote Decumulation to Maximize Lifetime Income

While much attention has traditionally been paid to the asset accumulation phase of retirement programs, we believe it is also important to optimize retirement income drawdown strategies during the decumulation phase. Program administrators and investment managers should consider their participants' other potential income streams, especially lifetime income options, when structuring decumulation investments to close the gap between actual and required retirement income. In particular, we believe that SRRPs can and should be used to enable participants to maximize their Social Security benefits.

A retirement program is often thought of as a complement to the steady flow of Social Security payments that begin upon retirement. We view assets in a State-run Retirement Program to be a critical component when participants contemplate a comfortable retirement. Full Retirement Age ("FRA") is gradually rising, and, for individuals born in 1960 or later, it is age 67. This increase in FRA will require that individuals plan accordingly to maximize their Social Security benefits.

Deploying assets accumulated in a State-run Retirement Program as a "bridge" to Social Security is a strategy that participants might consider when planning the best age to claim their benefits. The chart below illustrates the increase in the monthly benefit amount based upon the age and year a participant begins to claim Social Security, assuming the participant's current earnings are $30,000 and the participant turns 62 (the earliest one may claim Social Security) in 2020. Based on the example shown below, by postponing the collection of Social Security until age 70, the monthly benefit would be approximately 90% higher than it would have been at age 62, thereby assuring a significant increase in a lifetime income stream.

Retirement age	Monthly benefit amount[10]
62 and 1 month in 2020	$787
66 and 8 months in 2025	$1,151
70 in 2028	$1,499

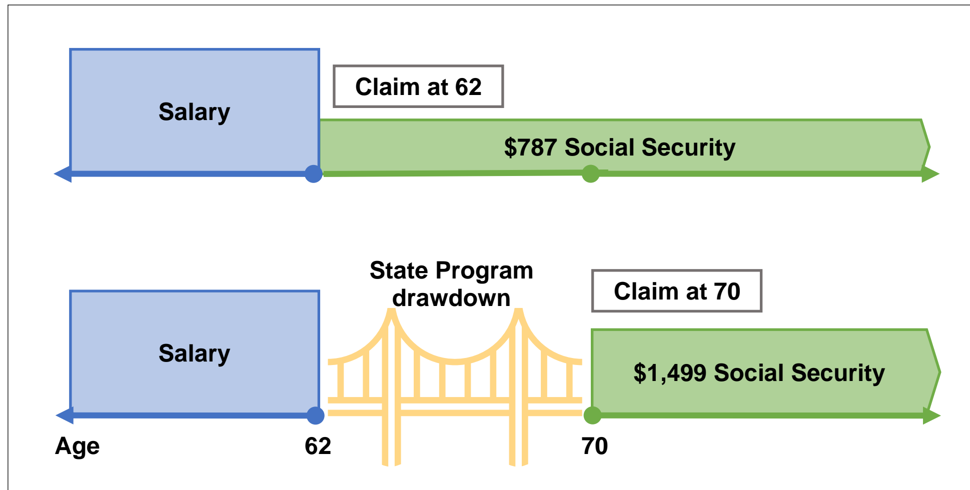
According to a 2019 study done by the Center for Retirement Benefits at Boston College, only 5% of men and 7% of women defer claiming Social Security benefits until age 70, and 35% of men and 40% of women claim benefits at age 62.[11] By claiming these benefits early, individuals forego the increased guaranteed income and cost-of-living adjustments that would otherwise be available by deferring Social Security benefits until age 70.

[10] Source: Social Security Quick Calculator. Assumes no future increases in prices or earnings. Benefit indicated in year-2020 dollars

[11] Source: Center for Retirement Research at Boston College, "How Best to Annuitize Defined Contribution Assets?" October 2019

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

By postponing collection until age 70 the participant *almost doubles* his or her monthly Social Security payment *for the rest of his or her life*, thus helping to mitigate longevity risk in retirement. In the interim period from age 62 until age 70, the participant draws down his or her SRRP assets, using the assets to “bridge” the gap between retirement and the year in which he or she can claim maximum Social Security payment, as shown by the following illustration:



This combination of faster SRRP drawdown and a larger guaranteed, inflation-protected stream of income is an alternative to the more common combination of target date investment decumulation plus lower Social Security benefits and has the added benefit of reducing market risk in retirement. As an aside, the increased Social Security benefit will also increase a spousal benefit.

Although SRRPs are relatively young, we believe that participation can be a critical factor in enabling individuals to plan to delay the receipt of Social Security to achieve the best possible outcome over the long run. Understanding the concept of deferring Social Security payments can serve as a catalyst to increase participation in these Programs and can be achieved either through creative administration of investments or by offering investment options that will provide sufficient cash flow in the years before drawing upon Social Security.

As we have noted, the importance of lifetime income has become a critical component of planning for retirement. Given this emphasis on income replacement and the expected demographic of participants in a State-run Retirement Program, options such as managed payouts or, if possible, cost-effective annuities, could be a compelling investment option alternative for participants.

Consideration 2: Engage Payroll Providers in Administration and Outreach

In evaluating possible distribution channels, States should consider engaging payroll providers as part of an outreach strategy. In addition to employer accounting systems, we view payroll providers as an essential element of State-run Retirement Programs. Many employers outsource payroll, while others use applications such as QuickBooks to manage administrative functions. For employers that previously did not provide a retirement option but now adopt an SRRP, simplifying enrollment and minimizing the cost or involvement in the day-to-day operation of the Program is critical. For this reason, we believe the integration of these payroll providers, accounting systems and a Program’s recordkeeping is critical to a Program’s overall success.

We have observed a variety of payroll integration levels in the SRRP marketplace. The two most comprehensive forms of payroll integration are automated. Depending upon the level of integration, participant contribution information can flow from the payroll provider to the Program's administrator or to and from the payroll provider and the administrator. Without automated integration, it is also possible for the payroll provider or the employer to use a template available from the administrator to upload information, although this often will take more time than an automatic upload from the payroll provider.

The role of the payroll provider in simplifying the enrollment process and in communicating with employees cannot be undervalued. Payroll providers have ongoing contact with employers, can be instrumental in encouraging participation, and look after the Program on an ongoing basis. They provide easy, automatic access to quality data regarding the Program's target audience. We believe that as SRRPs roll out in more States, the importance of engaging payroll providers will continue to be a key factor in their success.

Consideration 3: Leverage State Coalitions for Economy of Scale

Historically, administering qualified retirement programs has been too costly and too time-consuming for some businesses. While the need for such benefits is substantial, small businesses simply do not possess the scale necessary to offer retirement benefits affordably, and other larger employers may be affected by issues related to high turnover and large percentages of part-time employees.

State-run Retirement Programs aim to eliminate these obstacles: no fees are charged to employers, required employer administrative activities are minimal, and fees charged to employees are lowered through the participation of many businesses across each State. Even so, as the Georgetown Center for Retirement Initiatives outlined in its May 2019 Policy Report, the issue of achieving scale remains critical, most considerably for small States without an eligible population large enough to sustain affordable fee structures.[12] State initiatives can be expensive to start up and run, and the difficulty in predicting future growth only adds to the risk — and challenge — of creating a new, affordable Program.

The same challenge of achieving scale affected States' efforts to implement the Stephen Beck Jr. Achieving a Better Life Experience ("ABLE") Act. In response to this concern, States formed coalitions to ensure the viability of a uniform ABLE structure, whether through partnerships or multi-State alliances. In these collaborations, two or more States pool assets and accounts often into one underlying ABLE trust. Despite stringent limitations on ABLE participation,[13] four cooperative business models have achieved success, as shown in the chart on the top of the next page:

[12] Source: Georgetown University Center for Retirement Initiatives. "Achieving Economies of Scale in State-Facilitated Retirement Savings Programs: The Case for Multi-State Collaboration (Policy Report 19-01, May 2019)".

[13] Among other limitations, Section 529A of the Internal Revenue Code limits the amount that can be contributed in a single year to a single account per participant

	ABLE Alliance	Ohio STABLE	Oregon Partners	Nebraska Partners
States	Alaska Arkansas Colorado Delaware District of Columbia ***Illinois*** Indiana Iowa Kansas Minnesota Mississippi Montana Nevada New Jersey North Carolina Pennsylvania Rhode Island	Arizona Georgia Kentucky Missouri New Hampshire New Mexico ***Ohio*** Oklahoma South Carolina Vermont West Virginia Wyoming	Maryland ***Oregon*** (2 Plans) Washington	Alabama ***Nebraska***
Assets[14]	**$102.0 million**	**$116.2 million**	**$48.4 million**	**$14.0 million**
Accounts[14]	**13,799**	**17,146**	**7,086**	**1,959**

Blue *indicates lead entity for the collaborative structure*

Together, these collaborative models with approximately $280.6 million in assets across almost 40,000 accounts nationwide represent 60% of ABLE assets and 56% of ABLE accounts nationwide.[14, 15] The ABLE Plans in these partnerships benefit from increased assets under management, which we believe has resulted in lower account fees overall than might have been the case for States with small populations.

While we have not seen alliances or coalitions form yet in the State-run Retirement industry, the ABLE models may be appealing to States with smaller employer and employee bases. Notably, Illinois and Oregon have statutory authority to allow other States to join their respective Programs.[16,17] Other States have expressed interest in partnerships including Wyoming, through its Task Force on Retirement Income Security,[18] and Washington, through legislation that ultimately did not pass.[19] As more States begin to consider the viability of creating SRRPs, we expect the coalition model to become more widely considered.

[14] Source: ISS Market Intelligence as of June 30, 2020
[15] As a result of size or other specific factors, nine States offer ABLE Plans on a "stand-alone" basis, including California, Florida, Louisiana, Massachusetts, Michigan, New York, Tennessee, Texas and Virginia. According to ISS Market Intelligence, these Plans collectively have $188,858,398 in assets and 30,883 in accounts as of June 30, 2020
[16] Illinois General Assembly Senate Bill 1787: https://www.ilga.gov/legislation/BillStatus.asp?DocNum=1787&GAID=15&DocTypeID=SB&LegId=119274&SessionID=108&GA=101
[17] Oregon Legislative Assembly Senate Bill 166. https://olis.leg.state.or.us/liz/2019R1/Measures/Overview/SB166
[18] Task Force on Retirement Income Security. "Report to the Committee on Labor, Health & Social Services". https://retirement.state.wy.us/-/media/Files/Misc/Report----Task-Force-on-Retirement-Income-Security.ashx
[19] Washington Senate Bill 5740. https://app.leg.wa.gov/billsummary?BillNumber=5740&Initiative=false&Year=2019
Washington House Bill 2516. https://app.leg.wa.gov/billsummary?BillNumber=2516&Year=2019&Initiative=false

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169

Find Out More

While SRRPs might still be in their early stages, AKF's analysis of the progress made by early-adopter States has yielded considerable insights for success. We would be delighted to share our findings in more detail with you. For more information, please contact:

Andrea Feirstein
AKF Consulting Group
(646) 218-9864 office
(917) 865-2169 cell
andrea@akfconsulting.com

About AKF Consulting Group

AKF Consulting Group is the leading Municipal Advisor to public sector administrators of consumer facing, State-run investment programs, including 529, ABLE and State-run Retirement Programs, counting 43 public entities across 35 States as current or past clients. Specifically, AKF Consulting assists in structuring and advising upon all program design, implementation and operations, including governance, administration, investments, marketing and performance evaluations. We proudly include the States of California, Connecticut, Illinois and Maryland as State-run Retirement Program clients. For more information, please visit www.akfconsulting.com.

AKF Legal Disclosure

Pursuant to Municipal Securities Rulemaking Board ("MSRB") Rule G-42, on Duties of Non-Solicitor Municipal Advisors, Municipal Advisors are required to make certain written disclosures to clients and potential clients which include, among other things, Conflicts of Interest and Legal or Disciplinary events of AKF and its associated persons.

Conflicts of Interest

AKF represents that in connection with the issuance of municipal fund securities, AKF receives compensation from its client issuers for services rendered on an hourly, retainer or fixed fee basis. Consistent with the requirements of MSRB Rule G-42, AKF hereby discloses that such forms of compensation may present a potential conflict of interest regarding AKF's ability to provide unbiased advice regarding a municipal fund security transaction. This potential conflict of interest will not impair AKF's ability to render unbiased and competent advice or to fulfill its fiduciary duty.

Legal or Disciplinary Events

AKF does not have any legal events or disciplinary history on its Form MA and Form MA-I, which includes information about any criminal actions, regulatory actions, investigations, terminations, judgments, liens, civil judicial actions, customer complaints, arbitrations and civil litigation. You may electronically access AKF's most recent Form MA and each most recent Form MA-I filed with the Securities and Exchange Commission at the following website: www.sec.gov/edgar/searchedgar/companysearch.html. If any material legal or regulatory action is brought against AKF, AKF will provide complete and detailed disclosure to its clients, thereby allowing each client to evaluate AKF, its management and personnel.

757 Third Avenue ▪ New York, NY 10017 ▪ O: (646) 218-9864 ▪ C: (917) 865-2169