

# State-run Retirement Programs: Operations Change and Opportunities Expand in 2021

October 2021

## 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. With approximately \$344 million in assets under management in over 400,000 accounts nationwide,<sup>1</sup> these programs have demonstrated encouraging growth in their early years. Developments across the SRRP market since our last Report include the following:

### Trends and Observations

- We still expect one pilot Auto IRA Program to launch in 2021 and foresee several SRRPs in the 2022 pipeline.
- Auto-IRA continues to be the dominant program model, but States could still surprise us by embracing Multiple Employer Plans and Pooled Employer Plans.
- New players have emerged in the service provider market, which should increase competition and lead to more robust platform technology.
- Default triggers are changing. Time, rather than asset-level, now flips the switch from initial holding vehicles to target date funds.
- Hybrid fee structures have arrived in Auto-IRAs.

### Considerations for States

- Implementation pressure grows as Congress signals an intent to mandate retirement programs.
- Financial literacy is critical for employee participation and growth.
- Partnering with payroll providers will add a valuable promotional channel and increase efficiency.

## Method

Data for this AKF Market Report has been compiled from available disclosure documents and Program websites as of October 21, 2021.

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<sup>1</sup> Source: Georgetown University Center for Retirement Initiatives (“GU-CRI”) - California and Illinois of September 30, 2021; Oregon as of August 31, 2021; and Massachusetts and Washington as of June 30, 2021.



## Findings and Observations

Since our 2020 SRRP Market Report, we have seen several State and local initiatives, including Mandatory Auto-IRA Program authorizations in Maine, New York City and Virginia. Additionally, the New York Governor just approved legislation that changes the State's Auto-IRA Program from Voluntary to Mandatory. The following chart summarizes available SRRP models and approved Programs:

	Auto-IRA		Multiple Employer Plan ("MEP")	Marketplace
	Mandatory	Voluntary		
Participation	Employers must provide employee information  Employees may opt-out	Employers choose to participate  Employees may opt-out	Employers choose to participate  Employees may opt-out	Employers choose from available Plans  Employees may opt-out
Contribution Limits <sup>2</sup>	\$6,000  No employer match allowed		\$19,500  Employers may match	As set by plan  Employer may contribute to qualified plans
Key Design Features	Defaults in Launched Programs: Contributions - 5% Auto-escalation - 1% annually Maximum escalation - 10% in Illinois and Oregon; 8% in California 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 Illinois Oregon	--	Massachusetts	Washington
Under Development	Colorado Connecticut Maine Maryland	New Jersey New York <sup>3</sup> City of Seattle Virginia	New Mexico <sup>4</sup>	Vermont  New Mexico <sup>4</sup>

Note: Blue font represents the latest authorizations

<sup>2</sup> Contribution limits reflect existing federal limits for IRAs and 401(k)s. For employees age 50+, Auto-IRA limit is \$7,000 and MEP limit is \$26,000. In employer-match plans, maximum contribution is \$64,500 for 2021.

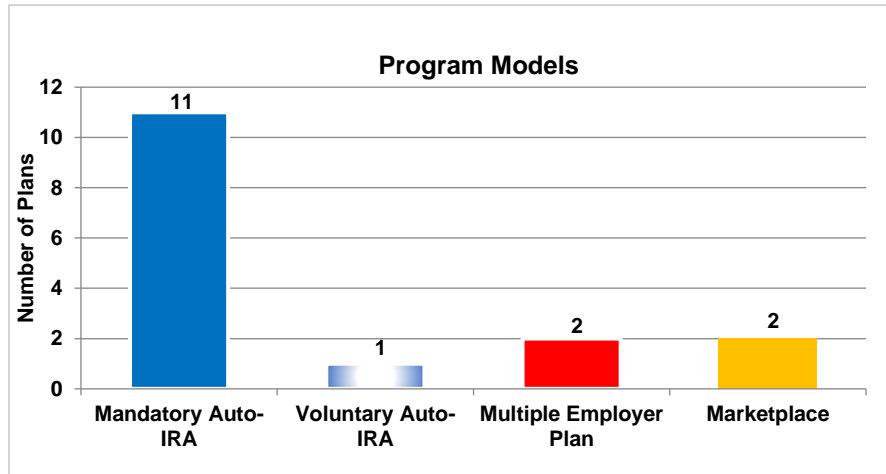
<sup>3</sup> Includes New York City, which had previously authorized its own Mandatory Auto-IRA.

<sup>4</sup> New Mexico Work and Save Program will include both Voluntary Auto-IRA and Marketplace.

By the close of this year, we expect to see Connecticut launch its pilot Auto IRA. Programs in Vermont and Maryland are expected to follow soon afterwards, with launches in early 2022.

**Observation 1: Auto-IRA Trend Continues, But Don’t Count Out MEPs and PEPs Just Yet**

In the past year, the Mandatory Auto-IRA has solidified its position as the model of choice for most available and authorized SRRPs, as shown by the table below.



With the exclusion of New Mexico, employer participation in every Auto-IRA Program under development is mandatory — employers must participate in the State Program or otherwise offer their employees a qualified retirement program. And, as indicated above, even in New York, which initially authorized a Voluntary Auto-IRA, the Program will launch as a Mandatory Auto-IRA. Interestingly, as a Mandatory Auto-IRA, the State Program it will subsume the New York City Program that was signed into law by the Mayor in May 2021.

We are not surprised that the Auto-IRA model continues to proliferate. The structure is simple and easy for both the employer and State sponsor to administer. Mandating employer participation provides the broadest exposure for new State programs concerned about viability and achieving economies of scale and achieves the all-important public policy goal of increased retirement savings.

While the Auto-IRA is the leading SRRP model today, Massachusetts offers a MEP program for not-for-profit entities that do not otherwise offer a retirement plan, and Vermont is expected to launch a MEP for small businesses in the first quarter of 2022. MEPs have been available retirement vehicles for SRRPs since first being approved by the Department of Labor (“DOL”) in 2015. Only Massachusetts has launched a MEP thus far, but other States may find elements of a MEP compelling when considering a new program. For example, MEPs have high contribution limits and allow for employer matches. Additionally, administrative services required by employers typically are less costly and less burdensome in MEPs than in comparable plans available in the small business marketplace.

Pooled Employer Plans (“PEPs”) created by the SECURE Act may present an alternative to MEPs and an opportunity for SRRPs. Unlike a MEP, which requires an association of businesses or a State nexus to be considered qualified, small businesses could directly access a 401(k) through a Pooled Plan Provider (“PPP”). Similar to MEPs, we believe that PEPs would provide small businesses a lower cost alternative to an individual plan since the PEP acts as a single plan for multiple businesses. As an aside, we note that a PEP incorporates all the Internal Revenue Service (“IRS”) and DOL filings

required by businesses offering other qualified plans. Additionally, an entity must apply to the IRS and DOL to be registered as a PPP. As of August 2021, 117 financial institutions, registered investment advisors and payroll providers applied for registration as PPPs.<sup>5</sup>

Final regulations for PEPs have yet to be released, therefore it is hard to gauge the impact they will have on SRRPs, but the structure raises some key questions. For example, are PEPs a viable alternative to MEPs and, if so, could a State choose to offer a PEP instead of a MEP? Furthermore, would a State need to qualify as a PPP or could it engage a registered PPP on its behalf? Even more important, can a State launch a PEP and market to or otherwise enroll employers from other States?

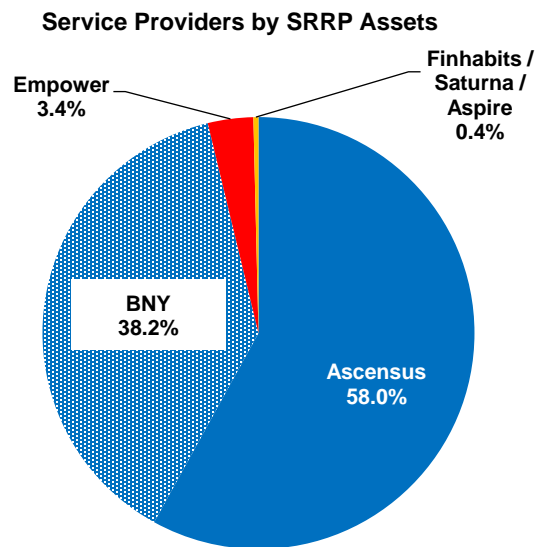
Given the newness of PEPs, these and other questions may not have answers yet. Depending on statutory interpretations and the eventual answers, it is likely we will see future State interest in all retirement vehicles as program models, including PEPs.

### Observation 2: New Program Administrators Emerge in 2021

Since our October 2020 SRRP Market Report, new service providers have been engaged as SRRP program administrators: the Washington Marketplace added Aspire Capital Advisors as a Plan Provider; Connecticut engaged BNY Mellon and its Sunday subsidiary (“BNY”) as its Auto-IRA program administrator; and Oregon announced that it would convert its program administration from Ascensus Government Savings to BNY. For Oregon, this move will bring the State’s 529, ABLE, and Auto-IRA Programs under the same administrator. Both the Oregon transition and the Connecticut pilot launch are expected to occur in November 2021.

The charts below illustrate the SRRP service provider landscape we expect to see by the end of this year.<sup>6</sup>

Service Provider	States
Ascensus	California Illinois
BNY	Oregon (expected Q4 2021) Connecticut (expected Q4 2021)
Empower	Massachusetts
Finhabits Saturna Aspire	Washington



<sup>5</sup> Most recent reporting is as of August 2021: [Pooled Plan Providers to Date by State - Retirement Learning Center \(retirementlc.com\)](https://retirementlc.com)

<sup>6</sup> Source: GU-CRI, Footnote 1



Is BNY’s engagement a harbinger of increased program administrator interest in Auto-IRAs? Looking ahead, we expect Colorado, Maine, New Mexico and Virginia to issue Requests for Proposals for program administration services over the course of 2022. The SRRP market has achieved steady growth, and as the market expands, we would expect more financial services firms — perhaps even those from the small business retirement plan market — to be attracted to these new programs.

An important service for any potential provider is integration with payroll providers. The ability to move contributions through payroll provider integration enables businesses to more easily facilitate savings programs. To this point, we believe that small business retirement plan administrators may be in an advantageous position to enter the SRRP market. These administrators often already have integrated solutions with payroll providers, which would enable business owners to easily establish and facilitate contributions to an SRRP. If these administrators are encouraged to leverage existing technology and add Auto-IRAs to their platforms, we will hopefully see a further diversifying of the provider landscape.

### **Observation 3: Default Provisions Move from Asset-Based to Time-Based**

In the past year, we have seen a decisive change to the initial funding of Auto-IRA default investment options when participants do not choose an option. Specifically, the initial “asset-based” default provisions in California and Oregon have transitioned to “time-based” default provisions, aligning with Illinois Secure Choice, as shown below:

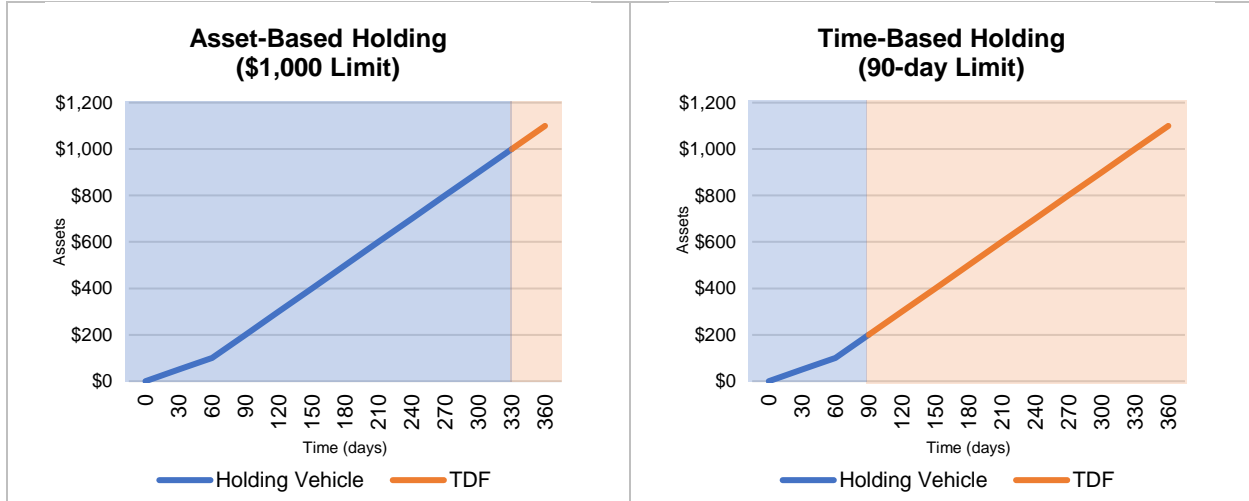
	California	Illinois	Oregon
At Launch	\$1K to Money Market and then to applicable Target Date Fund (“TDF”)	90-Day Holding in Money Market and then to TDF	\$1K to Capital Preservation and then to TDF
Now	30-Day Holding in Money Market and then to TDF <sup>7</sup>	Unchanged	90-Day Holding in Capital Preservation and then to TDF <sup>8</sup>

When the California and Oregon Programs were launched, the first \$1,000 would be deposited to a short-term investment — to preserve principal contributions and provide a cushion for emergency needs. After accumulating \$1,000, deposits would be invested in a target date fund. The *asset level* determined the first phase of default investment.

As a result of the change, initial contributions will still be deposited to a short-term investment option but only for a pre-determined number of days; thereafter, funds will be transferred to a target date fund, regardless of the amount accumulated. To illustrate this difference, the charts on the top of the next page show how the same account would be treated in an asset-based versus a time-based structure over the course of a year:

<sup>7</sup> Effective April 8, 2021

<sup>8</sup> Will be effective upon 2021 Q4 conversion



As we see it, the California and Oregon shifts to the time-based structure reflect the combined impact of an extremely low interest rate environment and relatively high asset-based program administration fees. To avoid a deeply negative impact on participant balances, administration costs either had to be waived or subsidized, which is untenable for State sponsors and their program administrators.

In contrast, a time-based holding should minimize the cost impact of low interest rates and ongoing program administration costs. Moreover, switching to a time-based structure maintains the original intention of a “holding vehicle” — a participant’s initial investments will be protected from market fluctuations, particularly during an allowable employee opt-out period.

**Observation 4: New Fee Structure Emerges in Auto-IRAs**

The Auto-IRAs in California, Illinois and Oregon all launched with a relatively uniform asset-based fee structure to cover State and program administration fees. As shown in the chart below, participants have been charged asset-based fees ranging from 0.60% to 0.90% (60 to 90 basis points). When we add the expenses of the underlying funds, total asset-based fees range from 0.75% to 1.02%.

With the entry of BNY as a program administrator, a hybrid fee structure has emerged: a combination of asset-based and dollar-based fees, which we casually refer to as “Version 2.0.” This fee structure will be implemented upon the conversion in Oregon (and presumably in the Connecticut launch) as shown in the chart on the following page:



		California	Illinois	Oregon	
				Current	Expected 2021 Q4
<b>Underlying Fund Expenses</b>		<b>0.025% - 0.15%</b>	<b>0.02% - 0.15%</b>	<b>0.02% - 0.12%</b>	<b>0.02% - 0.12%</b>
<b>Program Administration</b>	<b>Asset-based</b>	<b>0.75%</b>	<b>0.55% - 0.68%<sup>9</sup></b>	<b>0.75%</b>	<b>0.15%</b>
	<b>Dollar-based</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>\$14</b>
<b>State Administration</b>	<b>Asset-based</b>	<b>0.05%</b>	<b>0.5%</b>	<b>0.15%</b>	<b>--</b>
	<b>Dollar-based</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>\$4</b>
<b>Total</b>	<b>Asset-based</b>	<b>0.825% - 0.95%</b>	<b>0.75%<sup>x</sup></b>	<b>0.92% - 1.02%</b>	<b>0.15%</b>
	<b>Dollar-based</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>\$18</b>

Source: Program Disclosure Statements and States as of October 21, 2021

While new to Auto-IRAs, a hybrid fee structure was initially used in College Savings Plans and has since been implemented successfully by State ABLE Plans. It works especially well in new Programs because dollar-based fees provide a steady revenue stream to program administrators in the early years of a Program. Program administrators and States may have shied away from the inclusion of a dollar-based fee initially due to the potentially higher “cost” for small accounts, but this fixed dollar fee ultimately benefits investors once their accounts surpass a certain dollar amount.

Programs deliberating various fee structures must weigh potential benefits against potential detriments. Each program’s priorities will differ, but considerations may include the “headline risk” of the impact of dollar-based fees on small accounts, as well as the reliability of fee revenues to sustain young programs.

## Future Considerations

As the landscape for SRRPs continues to evolve, we note three key considerations for State administrators seeking avenues to develop their Programs and promote growth.

### **Consideration 1: Federal Initiatives Should Prompt States to Act Quickly**

We are seeing considerable legislative focus on retirement savings in 2021. Federal legislation, if passed, promises to make SRRPs more attractive and to make their implementation more urgent. Specifically, Congress seems to be signaling interest in mandatory retirement plans for most employers.

Most pertinent is the proposed federal universal savings access found in the Retirement Subtitle (B) of the Budget Reconciliation Act. The proposed legislation would require certain businesses to maintain or facilitate a workplace retirement savings plan that automatically enrolls employees in either an IRA arrangement or a 401(k)-type plan. Failure to satisfy the retirement savings plan requirement

<sup>9</sup> Fees capped by Statute



would result in a per-employee per-day tax on the employer. The proposal also includes default contributions ranging from 6% to 10% with annual escalation, and it specifies certain investment options, including a required lifetime income distribution or annuity option. As of July 2023, the proposal would apply to most employers that have been in business for more than two years and have more than five employees who earn more than \$5,000 a year — very similar demographics to those captured by SRRPs.

Importantly, the proposal includes a grandfather provision that States should pay particular attention to. Under this provision, any SRRP that is statutorily established prior to enactment of the proposed bill will automatically satisfy the mandate. We believe the incentive is clear: any State that is committed to creating a solution to the impending retirement crisis should take the steps to establish a Program *now*.

Other federal initiatives, including new retirement tax credits and additions to the SECURE Act, promise to increase the overall appeal of SRRPs. We expect these bills to increase State interest in SRRP implementation, even without a mandate from Congress.

### ***Consideration 2: Financial Literacy Should Be a Component of SRRPs***

Improving financial literacy will be a key to SRRP success. The path from employee to retiree isn't always clear; workers need a guide. According to the Employee Benefit Research Institute and Greenwald Research, workers frequently stress over not knowing *how* to invest for retirement or *how much* to save.<sup>10</sup> This uncertainty often leads to inaction. Financial education can mitigate this stress, improving participation and savings rates.

States are already recognizing this advantage; we are beginning to see financial literacy emerge in State planning and outreach. In fact, Colorado has positioned financial literacy as a key component of the Colorado Secure Savings Program, incorporating a financial planning element into the eventual Program.

We believe other States will, and should, follow suit. A variety of educational tools are already available for States to utilize, including internet-based training, in-person coaching, and even classroom sessions. Of particular interest to us are programs such as Trust Plus, a service of Neighborhood Trust Partners, a non-profit organization that focuses on financial wellness for low-income employees. This focus is necessary and important as it targets an employee demographic that would otherwise be difficult to reach.

As more States launch SRRPs, improving financial literacy will be a key to success — it imparts the benefits of establishing a savings habit early and encourages participants to keep it up over time. Financial literacy empowers people to set financial goals, calculate their financial needs in retirement, and balance financial priorities including retirement savings, healthcare, and education. We cannot think of a better outcome for the participants that SRRPs are created to serve.

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<sup>10</sup> [Employee Benefit Research Institute and Greenwald & Associates, 2020 Workplace Wellness Surveys.](#)





### ***Consideration 3: Payroll as a Distribution Channel***

In our 2020 SRRP Market Report, we discussed payroll providers as a part of an outreach strategy. We also described the variety of available integrations between payroll providers and program administrators and the potential importance of this outreach and integration.

Although there are a host of reasons why an employer may not have established a qualified retirement plan, the ongoing maintenance and cost associated with a plan is certainly a factor. We expect that integration of payroll providers into SRRP administration will become a key component in the menu of services offered by program administrators. It's an attractive step because it enables employers to easily facilitate programs and it delegates the remittance of contributions and the adjustment of contribution percentages. In fact, the incorporation of payroll systems is already an important element of 401(k) administration in the advisor and direct plan marketplaces.

With the lack of a defined distribution channel for SRRPs, payroll providers also can reinforce the advantages of retirement savings through payroll deductions — a message that can be delivered throughout the year and especially during open-enrollment periods.

We expect that engagement of payroll providers in this effort will continue to expand. As more payroll entities become integrated into SRRPs, States can use these important partners to provide program information to employers.

### **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 decisionmakers nationwide. We would be delighted to explore the implications of these important developments in more detail with you. For more information, please contact:

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## AKF Market Report

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