

State-K:
A Strategy for Using State-Assisted Saving
to Expand Private Pension Coverage

**Supplemental Written Testimony
of J. Mark Iwry**

**Before the
Subcommittee on Long-Term Growth and Debt Reduction
Of the
Committee on Finance
United States Senate**

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Mr. Chairman, Senator Kerry, and Chairman Grassley, I appreciate the opportunity to appear before you to discuss strategies for increasing pension coverage for small business employees. This written statement addresses the potential for States to play a constructive role in promoting pension coverage and retirement savings for small business employees. The statement is being submitted at the request of Committee staff who, in view of recent press

The witness is a Nonresident Senior Fellow at The Brookings Institution; Senior Adviser, The Retirement Security Project; Research Professor, Georgetown University; a practicing lawyer; former Benefits Tax Counsel, U.S. Department of the Treasury (1995-2001), and former chair, Employee Benefits Committee, D.C. Bar Section of Taxation. Of relevance to the subject of today's hearing, the witness directed the Executive Branch efforts in the 1990s to develop the SIMPLE plan for small business, the startup tax credit for small plan sponsors, and the saver's credit, as well as the Executive Branch initiatives to define, approve and promote 401(k) automatic enrollment, automatic rollover, and automatic 401(k) features generally. He also was centrally involved in developing the Universal Savings Accounts and payroll deduction IRA proposals.

The views expressed in this statement are those of the witness alone and should not be attributed to the Brookings Institution, The Retirement Security Project, Georgetown University, The Pew Charitable Trusts, any other organization, or any of the individuals acknowledged below. Nothing herein constitutes legal or tax advice and nothing herein should be construed or relied upon as such.

The material in this statement is scheduled to be published in the Tax Management Compensation Planning Journal (BNA) in July 2006 and in the NYU Review of Employee Benefits and Executive Compensation 2006 in August 2006 and is derived from the witness's address to the National Association of State Treasurers Annual Issues Conference in New York City on November 18, 2005, remarks at the Annual Meeting of the National Council of State Legislators in Chicago on December 7, 2005, statements before the Finance Committee of the Michigan State Senate on February 8, 2006 and Appropriations Committee of the Maryland House of Delegates on March 16, 2006, and statement dated April 2003 submitted to the Legislature of the State of Washington.

The witness thanks Al Lurie for valuable comments on an earlier draft of this proposal; John Barry, Bill Bortz, David Levine, Al Lurie and Stuart Lewis for valuable discussions in 2006 raising issues and suggesting improvements; and BNA Tax Management for inviting the witness to present an earlier draft to its advisory board and other invited practitioners in May 2006. Of course any shortcomings or errors would be the sole responsibility of the witness. © 2006 J. Mark Iwry, all rights reserved.

coverage (see the item appended to this statement), have asked that testimony describe the pension proposal that I have been discussing with State legislators.¹

1.01 INTRODUCTION

The core concept is simple: the private market, with the aid of more than \$100 billion in annual federal tax subsidies, has provided employer-sponsored retirement plans to about half of the U.S. work force. However, the market – under current arrangements – has not succeeded sufficiently in meeting our nation’s need for greater and more widely distributed retirement security and saving.

One approach not tried to date is to enlist the efforts of State governments, working with and through the private sector, to promote expansion of the private pension system. States could play an important but carefully limited role in helping to expand coverage, especially for small business and moderate- and lower-income workers. States could help small business employees and owners and the self-employed achieve economies of scale and reduce transaction costs by assisting them to pool their efforts in the market for retirement plans and investments. To that end, States might leverage their experience, bargaining power, and possibly the systems and the financial and administrative economies of scale associated with State sponsorship of retirement plans holding billions of dollars for millions of State and local government employees.

This proposal would not and could not introduce State regulation in a system already heavily regulated at the federal level; in general, State regulation presumably would be preempted by ERISA.² Moreover, the State would not be acting as plan sponsor but rather as facilitator. Rather than maintaining, managing or operating a plan, States would partner with providers to help make it cheaper and easier for small employers and self-employed individuals to do so. Thus, the intent would be to leverage State government resources in order that States might act as catalysts – pooling or aggregating rather than regulating -- to encourage the market to expand private pension coverage.

The remainder of this written statement seeks to demonstrate why and how States can help. Section 1.02 briefly describes the need for additional saving and private pension coverage and for improvement in our existing system. Section 1.03 outlines a framework for potential State government involvement in

¹ The principal testimony the witness is submitting to the Subcommittee today is the joint written statement with David C. John of the Heritage Foundation that describes the “automatic IRA” proposal. That proposal would involve federal legislation. By contrast, it is contemplated that the State-assisted saving proposal outlined in this supplemental written statement would require State, not federal, legislation. Interested States presumably could pursue the State-assisted saving approach as an adjunct to and in coordination with the automatic IRA.

² The Employee Retirement Income Security Act of 1974, as amended, is referred to in this statement as “ERISA”. In general, references in this statement to ERISA refer to Title I of ERISA.

promoting more and better coverage. Section 1.04 gives brief attention to a number of the key issues raised by this proposal. Section 1.05 describes some of the initial efforts to implement the proposal in several States.

1.02 THE PROBLEM

[1] The Need for Additional Saving and Private Pension Coverage

For most American households, Social Security will not be adequate to maintain a reasonable standard of living after retirement. Accordingly, a basic function of our private pension system is to supplement Social Security in helping families manage the financial risks associated with retirement. These include the risks of a drastic drop in one's standard of living on account of inadequate income replacement and savings after retirement, outliving the assets one has accumulated, high medical and long-term care costs, investment losses, inflation, and illness or disability interfering with continued ability to earn.

Yet most have not saved enough through private pensions or individual saving. Defined benefit pensions are covering a shrinking portion of the workforce, especially newly hired employees. Defined contribution (largely Section 401(k)³) plans, and individual saving have not done enough to fill the gap for most Americans. In 2001 half of all households headed by adults aged 55 to 59 had no more than \$10,000 in a 401(k) type account or IRA. Their median balance, even excluding those who had no such account at all, was only about \$50,000.⁴

At present, less than half of the workforce in the United States is covered by an employer-sponsored retirement plan. Some 71 million workers have no access to a retirement plan at the workplace. Moreover, a disproportionate share of this uncovered population comprises lower- and moderate-income workers – many of whom are more in need of additional retirement security than many of those who are covered – as well as employees of small businesses.

In addition to promoting financial security for working households, the private pension system performs a second important function: it promotes national saving, which ultimately contributes to increased national productivity and higher standards of living. Here too, the glass is at least half empty. While the pension system contributes importantly to private-sector saving, overall net personal saving as a percentage of disposable income has dropped from a rate of over 10

³ Unless otherwise specified, references in this statement to sections refer to sections of the Internal Revenue Code of 1986, as amended (the "Code").

⁴ William G. Gale, J. Mark Iwry, Peter R. Orszag, "The Automatic 401(k): A Simple Way to Strengthen Retirement Savings" (Retirement Security Project Policy Brief No. 2005-1), page 2 (available at www.retirementsecurityproject.org).

percent in the early 1980s to 1 to 2 percent in recent years and, in 2005, a rate less than zero.⁵

Moreover, in determining national saving, personal saving must be combined with public saving. Federal spending and budget deficits represent “dissaving,”⁶ and the savings attributed to pension balances accumulating in a tax-favored system are offset by the public cost of providing the tax preferences. That cost – mainly the estimated federal tax expenditure for pensions and retirement savings -- exceeds \$100 billion a year.

In addition, pension contributions and the resulting balances do not represent additional saving to the extent that they are derived from other assets that were previously saved. The mere shifting of assets from a taxable account to a tax-favored account does not add to national saving; nor does an accumulation of assets offset by an accumulation of personal debt. The evidence suggests that, in general, incentives to contribute to savings vehicles tend to induce more shifting in higher-income, wealthier households and more new saving in moderate- or lower-income households that have fewer existing financial assets.⁷ This in turn suggests that expanding pension coverage to promote more retirement saving among the majority of the population – the moderate- and lower-income households – is particularly important not only because they have the greatest vulnerability to financial risk in the long term but because it is a strategy calculated to increase national saving.

[2] Tax-Favored Vehicles for Saving Are Available

To begin with, it appears that the vehicles for saving are available. Existing tax-favored pension and retirement saving vehicles for employees include qualified defined benefit pension plans (traditional and hybrid forms), money purchase pension plans, profit sharing plans, cash or deferred arrangements (401(k) plans), SIMPLE (savings incentive match plans for employees) plans, SEPs (simplified employee pensions), and individual retirement accounts (IRAs).⁸ In

⁵ See US Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts, Table 5.1.

⁶ “National savings is the sum of public savings and private savings. All else equal, every dollar of forgone tax revenue reduces public savings by one dollar. Consequently, for national savings to increase, private savings must increase by more than one dollar in response to each dollar in lost revenue. To raise private savings, the incentives must not simply cause individuals to shift assets into the tax-preferred pensions but instead must generate *additional* contributions.” William G. Gale, J. Mark Iwry, Peter R. Orszag, “The Saver’s Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans” (Retirement Security Project, No. 2005-2), March 2005, page 8.

⁷ See, for example, Eric M. Engen and William G. Gale, “The Effects of 401(k) Plans on Household Wealth: Differences Across Earnings Groups,” Working Paper 8032 (Cambridge, Mass.: National Bureau of Economic Research, Dec. 2000).

⁸ Section 403(b) tax-sheltered annuities and Section 457 deferred compensation plans present additional alternatives for employees of nonprofit organizations and State and local governments. See Code Sections 403(b), 457.

the small business sector, where plan coverage is particularly sparse, the plans that commonly have had the most appeal to employers and employees are 401(k) plans (often with employer matching contributions and sometimes including employer profit sharing contributions) and SIMPLEs.

This array of tax-favored vehicles can be conceived of as reflecting at least an attempt at “intelligent design,” i.e., not as a random collection of options, but as a laddered hierarchy of plan forms designed to encourage coverage through a functional relationship between incentives and regulation. As a broad generalization, rewards or incentives for each plan design are calibrated to the effort it involves on behalf of workers and to its public policy benefits: more generous tax incentives are generally associated with better quality coverage.⁹

Beginning at the top of the ladder, the defined benefit pension allows the greatest amount of income to be sheltered from taxation (older, higher-income individuals can often contribute well over \$100,000 per year to defined benefit plans), assumes the greatest financial risk, and, given the stakes, is subject to the most extensive regulation. The next option, the money purchase pension, traditionally has been the “highest form” of defined contribution plan. Compared to the defined benefit (“DB”) plan, it generally affords somewhat less opportunity for tax-favored contributions while taking on less risk, but is still a “pension” plan with funding obligations, joint and survivor protections, etc., and is subject to considerable but less regulation than the DB.

The profit sharing plan (and to some degree the stock bonus plan and employee stock ownership plan) gives workers somewhat less protection from risk but still involves an employer contribution up to a substantial amount that is not conditioned on employees taking the initiative to contribute. (Until it was changed in the 2001 EGTRRA legislation, the deduction scheme reflected an effort to give employers greater incentives to sponsor a money purchase pension than the less worker-protective profit sharing plan.)

Descending further, the 401(k) plan usually offers, but does not necessarily make, an employer contribution, as the employer matching contribution is conditioned on the employee’s willingness to contribute. To make it more likely that the plan carries out its policy purpose, an employer match, like other employer and employee contributions, must meet a nondiscrimination standard. However, more than two thirds of the funds contributed to a typical 401(k) plan that has an employer match are contributed by employees, on a pre-tax basis. The 401(k) without employer match is a less powerful engine of saving, and the business owner and managers confront correspondingly lower maximum limits on their opportunity to protect current income from taxation.

⁹ See Testimony of J. Mark Iwry Before the Special Committee on Aging, United States Senate (April 12, 2005); Testimony of J. Mark Iwry Before the Committee on Education and the Workforce, Subcommittee on Employer-Employee Relations, U.S. House of Representatives (June 4, 2003).

The SIMPLE-IRA plan was designed to occupy the space between the 401(k) and the IRA, offering small employers an option that minimizes regulation and paperwork (no nondiscrimination testing, plan documents, IRS approval process, etc.) in exchange for lower contribution limits. In lieu of nondiscrimination testing, the SIMPLE requires a specified level of employer contributions (either matching or nonmatching).¹⁰

Finally, the IRA requires the sponsor to make no effort to “spread the wealth” or to cover others, requires no employer contributions, and is subject to minimal regulation, but also imposes the lowest limits on tax-favored contributions. In addition, during the 1990s, the Treasury Department sought to encourage coverage by mapping out the middle ground between the IRA and the SIMPLE plan. The payroll deduction IRA or direct deposit IRA involves the employer solely as conduit for employee contributions to IRAs, not as sponsor of a qualified or ERISA-governed plan. The employer informs employees that it is willing to offer its payroll system to enable employees to contribute to IRAs using the powerful mechanism of regular payroll deduction -- in much the same way that many employers offer direct deposit of paychecks to accounts designated by employees. The employer makes no contributions of its own and is not responsible for opening IRAs, choosing investments, monitoring contribution limits, etc.¹¹

Payroll deduction IRAs have not been widely adopted to date, but the witness, in a separate proposal (the “automatic IRA”) advanced jointly with co-author David John, has proposed that they play a much larger role in expanding coverage for employees of small employers.¹² As discussed below, payroll deduction IRAs could also be an important element of a State-related coverage strategy.

In sum, an array of saving vehicles is available. A number of them are relatively simple and not costly (although the array of options in the aggregate can at least

¹⁰ See Code Section 408(p); ERISA Sections 101(h), 403(b)(3)(B), 404(c)(2); IRS Notice 98-4 (I.R.B. 1998-2); 29 C.F.F. section 2510.3-102(b)(2).

¹¹ See IRS Announcement 99-2; Department of Labor Interpretive Bulletin 99-1 (June 18, 1999), 29 C.F.R. 2509.99-1(b). In the Conference Report to the Tax Reform Act of 1997, Congress stated that “employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction [IRA] system to help employees save for retirement by making payroll-deduction contributions to their IRAs” and encouraged the Secretary of the Treasury to “continue his efforts to publicize the availability of these payroll deduction IRAs.” H.R. Rep. No. 220, 105th Cong., 1st Sess. 775 (1997).

¹² As noted, the automatic IRA proposal is described in the joint written statement that the witness and co-author David John are submitting to the Subcommittee as testimony for this hearing. See also J. Mark Iwry and David C. John, “Pursuing Universal Retirement Security Through Automatic IRAs” (Retirement Security Project working paper, draft, Feb. 2006) (available at www.retirementsecurityproject.org and at www.heritage.org). See The New York Times, February 20, 2006 (editorial) page A18; The New York Times, March 18, 2006 (editorial) page A18; Albert Crenshaw, “Automatic IRAs—A Quick Fix for Workers Without Pensions?”, The Washington Post (Feb. 19, 2006), pp. F-1, F-8; Iwry and John, “The Other 71 Million” (op-ed), The Washington Times (March 24, 2006).

create the impression of complexity). The discussion below considers the reasons why the available vehicles are not more widely used by small employers and individuals.

[3] Why Are Coverage and Savings Inadequate?

Is there some reason why the operation of the market in this area may not be sufficient, and why further government intervention (beyond the existing tax preferences and associated regulation) may therefore be justified? It is submitted that the market by itself has been unable to achieve the public policy goals of near universal financial preparedness for retirement and adequate savings, and that there is a legitimate need for some further action, including a catalyst role for State governments. Indeed, the major federal (and corresponding State-level) tax expenditures for pensions and retirement saving reflect a recognition that there is a shortfall between the outcomes that the market would produce without government involvement and the needs and goals of public policy relating to retirement savings. These tax expenditures that subsidize retirement plan contributions through special tax preferences, as well as the extensive federal regulation under the Code and ERISA, already constitute a substantial government role in the market.

[a] Many Households Are Not Well Equipped or Inclined to Engage in the Requisite Analysis and Planning

The extensive tax subsidies for retirement saving reflect a recognition, supported by behavioral evidence, that many individuals need help saving for retirement and other long-term goals and providing for the management of long-term economic risks.¹³ The underlying premise (with which the witness agrees) is that much of the population is “myopic” when it comes to saving and risk management and therefore tends to exhibit something less than “rational” behavior in these areas. The analyses required for households to plan and provide adequately for the management of the major short- and long-term risks that confront them – mortality, longevity, disability, morbidity, unemployment, credit, market performance, interest rates, inflation, and others – do not come naturally to many individuals. For various reasons, many are unable or unwilling to confront risks that are frightening or unpleasant, to think probabilistically, to translate between present values and appropriately discounted streams of future income, or to perform financial analyses under conditions of uncertainty.

¹³ See, e.g., Brigitte Madrian and Dennis Shea, “The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior,” *Quarterly Journal of Economics* 116, no. 4 (Nov. 2001), pp. 1149-87; Richard Thaler and Shlomo Benartzi, “Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving,” *Journal of Political Economy* 112, no. 1, pt. 2, pp. S164-87; James Choi, David Laibson, Brigitte Madrian and Andrew Metrick, “For Better or Worse: Default Effects and 401(k) Savings Behavior,” in *Perspectives in the Economics of Aging*, edited by D. Wise (University of Chicago Press, 2003), pp. 81-121; Cass R. Sunstein and Richard H. Thaler, “Libertarian Paternalism is Not an Oxymoron,” *University of Chicago Law Review* 70, no. 4 (2003), pp. 1159-1202; Alicia Munnell and Annika Sunden, *Coming Up Short: The Challenge of 401(k) Plans* (Brookings, 2004).

(Arguably, these complications and stakes are greater than those entailed by most other consumer decisions.) Lack of transparency and imperfect information on the costs and benefits of alternative investments and financial products in the market also tend to hamper efforts by households to make apples-to-apples comparisons.

Most households do not appear to have overcome these handicaps by obtaining sufficient education and information regarding savings and investment or by obtaining professional advice and assistance. In addition, systematic risk management and saving requires not only some reasonable level of information, understanding and analysis, but also behavioral discipline, such as the discipline involved in deferring consumption, saving systematically, and rebalancing investment portfolios in the face of temptation to “ride” or “time” the market.¹⁴

[b] Saving Requires Making Decisions, Overcoming Inertia and Exercising Discipline

Much of the shortfall in saving and rational risk management appears to be attributable to the fact that most available institutional arrangements have not made it sufficiently easy for households to save. In theory, IRAs fill the gaps in employer plan coverage so that tax-favored retirement savings is almost universally available. In practice, however, millions of households that could save through IRAs and 401(k)s fail to do so, in part because we have not made saving through these vehicles easy enough. Those who consider saving in an IRA need to take the initiative in a number of ways: they need to decide which financial institution to select as the IRA trustee or custodian, may need (or think they need) to go to the institution and stand in line to fill out forms, need to decide how much to contribute, and need to decide how to invest. Many are daunted by the decisions; many others are affected by simple inertia and procrastination. As a result, in most years only roughly 1 in 10 eligible individuals actually contributes to an IRA, compared to the 401(k) participation rate of about 3 in 4.

One reason for the difference is the power of automatic payroll deduction. Once an employee elects to save, saving through the payroll system continues automatically. In addition, the pattern of contributions through payroll deduction consists of regular small amounts, which enables households to avoid having to come up with several thousand dollars all at once in order to contribute. Another reason for the relative effectiveness of employer-sponsored plans is that, unlike IRAs, employer plans have nondiscrimination standards designed to give business owners and managers an incentive to encourage participation among the majority of their employees. Largely as a result, a majority of 401(k) plans have an employer matching contribution, and many employers are motivated to educate employees about saving and to encourage participation in the plan. This

¹⁴ See, e.g., J. Mark Iwry, “Promoting 401(k) Security” (Tax Policy Issues and Options No. 7, Urban-Brookings Tax Policy Center, September 2003).

in turn promotes the “water cooler effect” whereby employees may encourage one another to participate through peer group reinforcement.¹⁵

Here too, however, employees eligible for a 401(k) or similar retirement savings plan must usually take the initiative to participate (unless the plan uses automatic enrollment), and must not only choose whether to participate but, if so, how much to contribute, how to invest, and, ultimately, when and how to draw their benefits. As a result, millions who are eligible for 401(k)s “leave money on the table” by not contributing, even in the face of an employer match.

In addition, the benefits of 401(k) coverage are less than they should be. Investment returns in 401(k) plans lag behind those in defined benefit pensions or other professionally managed funds. A key reason is that employees self-direct their 401(k) investments. Yet self-directed investments are neither a legally required nor otherwise an integral element of a 401(k) plan. These plans were not originally designed and do not currently operate in a way that makes it necessary for every participating employee to act as his or her own investment manager.

Indeed, the case can be made that 401(k) investment self-direction has expanded far beyond the degree of choice that is necessary or appropriate. While choice generally is desirable, employees suffer to the extent that they are effectively forced to manage their own investments. As amateurs, employees predictably underperform the professionals who traditionally manage employer-sponsored pension investments such as defined benefit plan assets or (largely in a bygone era) employer-sponsored profit sharing investments. It is not realistic to expect investment education or advice to overcome this disadvantage. Successful investing depends not only on knowledge but on experience, regular attention, and discipline, such as the discipline involved in regular rebalancing. Even the minority of employees who are relatively sophisticated financially often lack the time or interest to run their own 401(k) investments, and often lack the discipline and professional detachment needed to do so effectively. .

Accordingly, policymakers and the market are moving toward automatic 401(k)s: automatic enrollment to maximize participation and automatic investment to maximize investment performance.¹⁶ The latter takes the form of asset-allocated and diversified default investments that permit employees to avoid having to

¹⁵ See, e.g., “Using the Private Pension System and IRAs to Promote Asset Accumulation for Lower-Income Families,” Testimony of J. Mark Iwry Before the Subcommittee on Social Security and Family Policy of the Committee on Finance, United States Senate (April 28, 2005).

¹⁶ The Treasury Department and Internal Revenue Service began to promote automatic enrollment in 1998. See Revenue Rulings 98-30 (1998-2 I.R.B. 8); 2000-8 (2000-1 C.B. 617); 2000-35 (2000-2 C.B. 138); 2000-33 (2000-1 C.B.142); IRS General Information Letter to J. Mark Iwry (March 17, 2004)(available at www.retirementsecurityproject.org). See also Gale, Iwry and Orszag, “The Automatic 401(k),” n.4 above.

make an affirmative choice, or managed accounts that give employees the benefit of professional asset management.¹⁷

As will be described below, States can help by making it easier to save in employer-sponsored plans by promoting standardized vehicles that will be attractive for employers to adopt and that reflect best practices such as automatic enrollment and investment.

[c] Most of Our Pension Tax Incentives Are Not Well Designed for the Majority of the Population

One reason small employers cite for not sponsoring plans is inadequate demand on the part of employees, who often express a preference for cash wages over retirement benefits. One of the reasons, in turn, why moderate- and lower-income people do not more often demand or contribute to retirement plans has to do with the structure of the pension tax preference. Whether an individual saves through a 401(k) or similar retirement savings plan or through an IRA, the federal income tax advantages generally are comparable. Contributions generally are excluded from income for tax purposes or, in a traditional IRA, generally are tax-deductible; earnings in the account accumulate on a tax-deferred basis; and distributions can be transferred tax-free to other tax-preferred vehicles (plans or IRAs). (In Roth IRAs and Roth 401(k) accounts, contributions are not tax-deductible, but the earnings accumulate on a tax-deferred basis, and the ultimate payment of contributions and earnings from the plan generally is excludible from income.)

However, the value of these tax incentives is proportional to the taxpayer's bracket or marginal income tax rate. A dollar of pension contribution is initially worth 35 cents to someone in the 35% bracket, and only 10 cents to someone in the 10% bracket. By using deductions and exclusions from income to deliver the tax subsidy, our system is effectively "encourag[ing] saving least for those who need to increase their saving most, and most for those who need to increase their saving least."¹⁸ This (in addition to the basic liquidity constraints confronting lower-income households) is a reason retirement saving is lower among the lower-income population.

A first step toward a solution is the "saver's credit." Starting in 2002, eligible moderate- and lower-income individuals can claim a federal income tax credit for their voluntary contributions to a plan or IRA (the "saver's credit").¹⁹ While the

¹⁷ William G. Gale and J. Mark Iwry, "Automatic Investment: Improving 401(k) Portfolio Investment Choices" (Retirement Security Project, No. 2005-4)(April 2005)(available at www.retirementsecurityproject.org).

¹⁸ *Id.* at 3.

¹⁹ Section 25B of the Code. The saver's credit is available to households filing jointly with adjusted gross income (AGI) of up to \$50,000 and singles with AGI of up to \$25,000. The saver's credit is scheduled to expire at the end of 2006, but legislation is pending to extend it or make it permanent.

proposed credit was severely truncated in the 2001 legislative process, the saver's credit as enacted still makes the reward for saving proportional to the amount saved, not to the level of the saver's income. This is because it takes the form of a tax credit instead of a deduction or exclusion from income. The saver's credit has been claimed by some 5.4 million tax filers each year it has been in effect (based on data for 2002 and 2003), but this is far fewer than those who are eligible.²⁰

[d] Per Capita Cost is an Obstacle

A key factor that helps explain why employees of small employers are far less likely to be covered by an employer-sponsored plan than other employees is per capita cost. The cost of sponsoring a retirement plan is greater on a per capita or per account basis for a small employer than a large one. There are at least three reasons for this difference.

First, larger employers can realize economies of scale by spreading fixed costs of plan administration and investment management over a larger number of accounts.

Second, small employers often have fewer managerial resources to gather and process the information necessary to choose a provider, type of plan, specific plan design, and investments, and to operate the plan, including compliance with legal requirements.

Third, larger employers' greater bargaining power helps them negotiate lower investment and plan administrative fees with financial services, consulting and third party administrator firms. By contrast, like individuals purchasing a retirement savings product on their own, small employers purchasing on behalf of a few employees have little bargaining power. They deal with the financial services industry and the pension industry on a retail rather than wholesale basis, and accordingly pay retail prices. What is said here about small employers is in most cases even more true of self-employed individuals.

[e] The Financial Services Industry Has Less Profit Interest in Small Accounts

Some financial providers are interested in selling IRAs, 401(k)s and SIMPLE plans to small employers and to individuals who are not in a position to contribute substantial amounts. However, major sectors of the financial services industry point out that very small accounts (that do not rapidly grow) tend to be unprofitable (or less profitable). Unless these small accounts are in the same

²⁰ William G. Gale, J. Mark Iwry, Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans" (Retirement Security Project Policy Brief No. 2005-2)(March 2005)(available at www.retirementsecurityproject.org).

plan as a sufficient number of larger accounts (which can cross-subsidize the smaller accounts), their modest investment returns may not exceed or even cover the costs of establishing, administering and ultimately closing the small accounts. Average account balance – as opposed to total assets under management – appears to be a key driver for many sectors of the industry. The prospect of a smaller employer with a less affluent work force generating low average account balances holds little appeal for many providers. Much of the financial services industry would be interested in taking the accounts once they have grown to a profitable size, but would just as soon have the government bear or subsidize the cost of slow-growing accounts during their “incubation” phase.

The industry does not seem to be homogeneous in this regard. Significant differences among providers’ cost structures, systems, distribution networks, levels of service, marketing strategies and compensation schemes may explain why some are less interested in selling small accounts than others. Yet the tens of millions of moderate- and lower-income families that need to save more, especially through employer provided coverage, will tend to have relatively small accounts, and much of the industry appears to lack the incentive to expend the effort necessary to sell small dollar-amount savings products. Accordingly, the market currently seems imperfectly situated to promote the public policy goal of promoting retirement security and saving for this population, which comprises the majority of the U.S. workforce.

[f] Fees and Expenses May Be High and Not Sufficiently Transparent

One aspect of the “market failure” has to do with imperfect information. It is hard for consumers – individuals and small business owners – to engage in efficient comparison shopping among competing retirement plan providers. Fees and expenses are packaged and presented in ways that make “apples to apples” comparison difficult. As a result, there is at least anecdotal evidence that market competition may not be efficiently driving down the prices of these savings products, especially in the retail setting in which individuals and small businesses relate to the financial services and pension industry.

Concern about being charged excessive fees and the burden of gathering and analyzing cost and other information in order to make a competent comparison are among the factors that discourage consumers from purchasing retirement saving products. In recent years, revelations of improper practices by some financial providers probably have eroded consumer trust and made many even more cautious, further complicating the purchase decision.

1.03 A POTENTIAL ROLE FOR THE STATES

In general, for the reasons described, households’ demand for retirement saving and their use of the existing opportunities for saving fall short of public policy

needs and objectives, as does the supply of retirement savings by employers and financial providers. As noted, this is especially true in the case of moderate- and lower-income households, which comprise the majority of the U. S. population, as well as employees of small employers.

A number of promising strategies for addressing this shortfall have been proposed. These include expanding the automatic 401(k) (notably automatic enrollment, escalation, and investment), establishing and promoting the automatic IRA, expanding and improving the saver's credit, offering taxpayers the ability to have the IRS make direct deposit of a portion of their income tax refunds to IRAs, and exempting IRA and defined contribution retirement savings from asset tests for eligibility for public assistance programs.²¹ Most of these initiatives involve some further action by the federal government to make more efficient use of the existing tax subsidies for retirement saving by encouraging the market to expand coverage and by removing barriers to increased saving.

In addition, State governments have the potential to contribute to the expansion of private-sector pension coverage in a carefully limited but effective way. One reason this possibility traditionally has received virtually no attention is that the legal framework governing tax-favored pensions generally provides that federal law relating to benefit plans for private-sector employees supersedes State law, while carving out a niche for State and local governments to provide pension coverage for their employees largely free of federal regulation. See section 1.04[1][a], below. Yet it is submitted that the States, in part because they furnish pensions to their own employees on a very large scale, could contribute importantly to the expansion of private pension coverage, and that this potential is well worth exploring.

[1] What Assets and Resources Do States Bring to the Table?

States and local government authorities generally sponsor tax-qualified retirement plans for State and local government employees. These plans account for a large portion of the entire qualified plan universe and a large portion of the associated federal tax expenditure. State and local government plans include defined benefit pensions as well as defined contribution retirement savings programs such as grandfathered 401(k) plans, 403(b) tax-sheltered annuities, and deferred compensation plans under Code section 457. Many of the State-sponsored plans cover hundreds of thousands or even millions of workers and hold assets worth billions of dollars. In general, State and local government plans are exempt from most of the provisions of ERISA, but are subject to a version of the Code's plan qualification requirements.

As a result, State governments have valuable resources that might be leveraged to promote private-sector retirement coverage in the small business sector (as well as among the self-employed), where pension coverage is particularly

²¹ For descriptions of these initiatives, see generally the publications at www.retirementsecurityproject.org.

sparse. (In fact, States could limit their efforts to employers below a specified size and to individuals.) These State resources include extensive experience and expertise in designing, managing and administering retirement programs, managing investments, communicating with participants, partnering with private financial institutions, and potentially making available economies of scale associated with their large accumulations of assets and large plan populations.

In addition, a State government, unlike private-sector employers or providers, can be expected to continue in existence on a permanent basis. This might provide greater assurance to some small employers, their employees, and self-employed individuals. It also could ultimately translate to greater portability of pensions, as a State-affiliated program might be more impervious to the effects on the participant of job losses or changes.

[2] Potential State Role

States could help in two broad ways. First, by offering a low-cost, off-the-shelf, turnkey plan that simplifies employers' and individuals' purchase decisions, and through the State's capacity for outreach, States could facilitate employer adoption of tax-favored retirement plans for their employees. Acting as aggregators rather than regulators, States could assist small businesses to pool their efforts in purchasing low-cost retirement plans. Second, for employees whose employers are not yet ready to adopt a retirement plan, States could help arrange for easier access to payroll deposit IRAs (and potentially other IRAs).

Accordingly, State involvement in promoting low-cost, portable retirement savings could potentially be structured in two tiers. Tier I involves universal payroll deposit IRAs for employees, and stand-alone IRAs for self-employed people, who choose to participate. Tier II involves employer plans, in particular the 401(k) and the SIMPLE-IRA.

[a] Tier I: Promoting an Improved IRA Saving Opportunity for Employees and the Self-Employed

As discussed earlier, it is common practice for employers to offer employees the convenience of direct deposit of paychecks to bank accounts or other financial institutions. Employees sometimes direct their employer to have a portion of their salary or wages directly deposited to make regular payments on a mortgage or automobile loan, and tens of millions of employees use the powerful direct deposit or "payroll deduction" method to save in 401(k) or similar retirement savings plans. As noted, a potential alternative for employees of employers that are not ready (for whatever reason) to sponsor a retirement plan is the payroll deduction IRA. However, the availability of this simple and virtually costless option -- requiring no employer contributions -- is not well known. Moreover, as discussed, many providers who sell retirement plans have relatively little interest in this option because account balances will tend to be small.

States could step into the breach by informing in-State employers that are not plan sponsors that they can at least offer to transmit electing employees' salary reduction contributions to IRAs.²² States could also encourage employers to consider this option by making it easy and inexpensive. In particular, this payroll deduction IRA arrangement could readily be limited so as not to constitute an employer-sponsored plan. This generally means there would be no ERISA requirements and no qualified plan requirements.

Employers that wished to do so would merely offer their payroll system as a conduit for employees interested in saving a portion of their own salary or wages. The employer would neither be required nor permitted to make its own contributions, matching or otherwise. (Employers wishing to contribute could sponsor a SIMPLE or a qualified plan. See Tier II, below.) Employers also would not be responsible for opening or designating an IRA or IRA investments, and would have no fiduciary responsibility. Using State-provided forms, employers could inform employees of the opportunity to contribute to an IRA by payroll deduction. (Employers could also be given the option of enrolling employees using automatic enrollment, although this might well require the employer to ensure that the arrangement complies with ERISA.)

The State might contract with one or more private financial institutions to serve as IRA trustee or custodian. They would be selected, pursuant to competitive bidding or other applicable State procurement procedures, to provide a standard, low-cost IRA that would bear, in an appropriate fashion, the imprimatur of the State. (An alternative approach would accommodate multiple providers, each of which meets State standards, provided that those were not subject to preemption by federal law.) This IRA would be targeted to employees who wish to participate but do not already have an employer plan or IRA. It would have a separate account for each individual who chose to participate, and would have an asset-allocated diversified default investment or professionally managed fund with a limited array of specified alternative investments. (Of course no employee would be required to participate or to continue contributing.) The State, working with the financial provider(s) and an independent expert, could specify in its request for proposals that low-cost, highly diversified index funds and Treasury

²² Without any relation to a role for State governments, the author has proposed, with co-author David John, to require certain employers (excluding the smallest and newest) that do not sponsor plans to offer payroll deduction to their employees. See Iwry and John, cited at n.12, above. Most of the material in this paragraph and the following two paragraphs – except as they refer specifically to the role of the State government -- is borrowed (verbatim or otherwise) from that written statement or working paper. In general, under the arrangements outlined here, the employer's decision whether or not to offer payroll deduction would be voluntary, unless the State decides to require a class of employers within the State that do not sponsor a retirement plan to offer their employees the opportunity to contribute wages, through payroll deduction, to an IRA.

inflation-protected securities would constitute major components of the investments.²³

The State could maintain a central program web site for use by employers and employees. Employers would have the convenience of being able to send all of the funds to a single destination, perhaps using the same schedule and even conceivably the same process that they use for State income and payroll tax withholding and deposits.

Self-employed individuals would also be able to open and save in a standard State-approved IRA that might benefit from economies of scale associated with pooling of investments. The State could facilitate participation by offering convenient electronic automatic debit arrangements, possibly using a State-sponsored web site.

Finally, States might consider whether efficiencies, such as lower investment costs, could be realized by making use of collective investments that are permissible for use with IRAs or qualified plans or both. These pooled investment arrangements might include bank common trust funds, common investment funds, or group trusts.²⁴ (IRAs are prohibited from commingling their assets with other property except in a common trust fund or common investment fund.²⁵)

[b] Tier II: Promoting Employer-Sponsored Retirement Plans

Independently of the role just described as “Tier I,” States could make it easy for small employers doing business in the State and not sponsoring a retirement plan to adopt simple, standardized, off-the-shelf, retirement savings plans for their employees. These are low-cost “turnkey” products that are available on the market today, but that most small businesses have not adopted for reasons such as those described above. The two key plan types for this purpose are the 401(k) (in the form of a “prototype” plan) and the SIMPLE-IRA.²⁶

²³ The application of federal or state securities laws to investment offerings under State-assisted plans and IRAs is beyond the scope of this statement.

²⁴ See Code section 584 (bank common trust funds); Revenue Ruling 81-100, 1981-1 C.B. 326 (assets of tax-qualified plans and assets of IRAs may be commingled and collectively invested in a group trust without jeopardizing the tax-favored treatment of the qualified plans, IRAs or group trust, provided that certain conditions are satisfied); Revenue Ruling 2004-67, 2004-28 I.R.B.28, (expanding the group trust treatment under Rev. Rul. 81-100 to include assets of eligible State and local government plans covering government employees under Code section 457(b)).

²⁵ Code section 408(a)(5).

²⁶ Another simple option is the SEP (simplified employee pension), but the basic SEP provides for nonmatching employer contributions without allowing employees to contribute. See Code section 408(k). The version of the SEP that does allow employees to contribute is the “SARSEP” (short for “salary reduction SEP”), but the SIMPLE-IRA is an improved and updated model that was designed essentially to replace the SARSEP. The SIMPLE-IRA also allows employer contributions (matching as well as limited nonmatching

Just as a State could choose to focus its efforts, at least initially, on either Tier I or Tier II (or could move forward on both), within Tier II a State could choose to focus on promoting adoption of the 401(k), the SIMPLE, or both.²⁷

States could approve and help market to small employers a State-approved, tax-qualified “master” or “prototype” 401(k) plan using the existing IRS “master and prototype” program for qualified plans.²⁸ Under this program, a financial institution or other commercial entity provides a plan, obtains IRS approval of the plan document, and, acting as “sponsor”, markets the plan to employers for adoption. Under the approach outlined here, the State would contract with one or more organizations that currently serve as prototype plan sponsors. The sponsor(s) would provide a prototype that meets State contractual specifications (to the extent permitted consistent with federal preemption of State law relating to benefit plans) and that is submitted for IRS approval in the usual manner. The specifications probably would be reflected in a request for proposals or contractual provisions rather than in State law.²⁹ To the extent consistent with federal preemption, the State might select a prototype plan that it deems worthy of receiving State government endorsement or promotion. As a condition of obtaining the State’s imprimatur, the private prototype sponsor could design its plan to satisfy State preferences.

This would offer small employers an inexpensive, standardized product that they could adopt for their employees, with limited options that the employer would select. At a minimum, this standardized approach might also make it feasible to give employers centralized assistance with 401(k) plan administration, including preparation of Form 5500 annual reports, summary plan descriptions and other employee communications, nondiscrimination testing, and other tasks.

Such administrative assistance – which might be provided in part by private contractors and in part by State government personnel -- could encourage more employers to adopt plans and could also entail significant public policy benefits in

ones) in addition to the employee contributions, though the employer contributions are limited. Employers that wish to contribute more can do so through a 401(k) plan.

²⁷ State activities would be designed so as to avoid preemption by federal law. See section 1.04[1], below.

²⁸ The IRS master and prototype (or “M&P”) program is described in Revenue Procedure 2005-16, 2005-10 I.R.B. 674. A “master plan” is defined, in pertinent part, by the IRS as “a plan (including a plan covering self-employed individuals) that is made available by a sponsor...for adoption by employers and for which a single funding medium (for example, a trust or custodial account) is established, as part of the plan, for the joint use of all adopting employers...” Rev. Proc. 2005-16, 2005-10 I.R.B. 674, section 4.01. A “prototype plan” is defined by the IRS in generally similar terms except that a separate funding medium is established for each adopting employer. Rev. Proc. 2005-16, 2005-10 I.R.B. 674, section 4.02.

²⁹ If permitted by the IRS under its M&P program, the State government itself could conceivably consider acting as the sponsor of the master and prototype plan. However, this seems like an unlikely scenario, as the State’s potential exposure to liability might be greater if it were in the position of sponsor, rather than working with an established, expert sponsor of such plans. State governments presumably have little reason to acquire internal expertise concerning ERISA or private-sector plan qualification requirements.

the form of improved small business plan compliance. This could attract favorable interest in the Employee Plans function within the TEGE (Tax Exempt and Governmental Entities) Division at the IRS, as operational compliance in the small business master and prototype sector has long been a concern. All too often, small employers have been sold a prototype plan by a broker, insurance agent, or other salesperson, without adequate followup assistance with the tasks of ongoing operational compliance.

In part because of the potential for improved compliance and efficiency, States might explore with the IRS whether it would be possible to simplify or streamline certain requirements of the current master and prototype program in this context. This might include, for example, the filing of a single annual report on Form 5500 on behalf of all participating employers, and avoidance of the need to obtain any IRS approval of plans adopted by individual employers. (Nondiscrimination testing could be avoided by adoption of a “design-based safe harbor” 401(k) format, but that would require employer contributions at a level that might discourage many small employers.)

Another possible step toward standardization and streamlining might be a uniform national prototype or model 401(k) plan document, approved in advance by the IRS and made available for endorsement by States that are interested. This approach would enable States to avoid an individual IRS approval process, while probably still leaving the investment selection to States and their private-sector partners. States using this uniform national prototype would have no flexibility in designing the detailed provisions of the plan or choosing a specific plan design, although presumably they would retain the option of shopping for IRS-approved prototype plans sponsored by private-sector providers. For employers located within a single State – as is typical of the small businesses that comprise the target audience for this proposal – State-by-State variation in State-endorsed prototypes would not matter.

In a sense, a simplified, uniform national prototype 401(k) for small business already exists. It is the SIMPLE plan, which was designed for this purpose, as a mini-401(k) for small business. The SIMPLE requires no IRS approval largely because it precludes nearly all variations among plan designs. In fact, the SIMPLE enables employers to avoid most of the administrative responsibilities associated with sponsorship of a qualified plan: it requires no annual Form 5500 reporting to the IRS, no IRS approvals, no nondiscrimination testing, and no drafting or purchase of detailed plan documents. The employer simply signs a two-page standard IRS form that states the terms of the plan. The employer may allow each participating employee to select an IRA to receive contributions (thereby avoiding employer fiduciary responsibility) or, if the employer prefers, it may designate a single financial institution to provide SIMPLE-IRAs for all participating employees (in which case the employer is choosing to take on the limited fiduciary responsibility associated with having made that decision).

State endorsement of the SIMPLE-IRA would lend itself to participation by multiple financial providers, as the plan design is nearly uniform. For both the SIMPLE and the 401(k), the State could work with providers in structuring a uniform array of low-cost investments reflecting best practices, including a default investment for employees who would rather not choose. In either case, States could consider establishing a centralized arrangement for pooled investment of plan assets, such as a single master trust or other collective investment arrangement administered by the financial institution(s) sponsoring the plan. A variation on this approach might be to mirror or “piggyback” on at least certain existing investment funds under the defined contribution plans States sponsor for their employees – without combining the private-sector ERISA-governed plans with the State employees’ plans in a way that would jeopardize the State plans’ exemption from ERISA. Whether it would be worth creating an actual pooled investment such as a master trust may depend on the degree to which this – as opposed to simply mirroring existing investment options (for example, in plans for public employees) -- would be necessary in order to realize economies of scale or other efficiencies in investments.

Another alternative model for Tier II would be an initiative whereby the State government organized and facilitated the establishment of a multiple employer plan (see Code Section 413(c)). Under this approach, each private sector employer choosing to participate would adopt the common plan for the benefit of that employer’s employees, using a common trust fund managed by a private financial institution contracting with the State and centralized administrative assistance from the State or its contractor.

As noted earlier, a potentially significant concern affecting the multiple employer approach would be the risk that any participating employer’s failure to comply with federal plan qualification requirements in administering the plan for its employees could imperil the tax qualified status of the multiple employer plan as a whole. On the other hand, the risk that the entire plan would be disqualified because of noncompliance by an isolated employer or employers is more theoretical than real. The risk might conceivably be mitigated by a special arrangement with the IRS, if the IRS were willing to consider this.

[c] Variations in Approach Among States

The framework outlined here – including the Tier I and Tier II structure -- is designed to foster diversity in the strategies States employ to take advantage of their particular strengths and opportunities. It is also intended to encourage experimentation at the State level with a view to learning what kind of State involvement might work best. Thus, a State could begin by focusing only on the basic IRA approach outlined in Tier I above without venturing into the simple employer plans described in Tier II. Alternatively, a State could begin with Tier II or could decide to implement Tiers I and II from the outset.

At the same time, it may be desirable to maintain a basic consistency among State efforts in this area insofar as they rely on established vehicles for tax-preferred saving that have been authorized by federal law. These vehicles – mainly the existing forms of IRAs and 401(k) plans, including the payroll deduction IRA and the SIMPLE-IRA plan referred to above – and the established rules and regulations governing them have been fine-tuned over the years by the market and by regulators in pursuit of effectiveness and simplicity. Use of these familiar IRA and 401(k) vehicles should also make it unnecessary to seek federal legislation, and should otherwise simplify the implementation process, including the involvement of federal regulators.

[3] How Would State Involvement Add Value?

State governments could enter into retirement savings partnerships with the private sector, leveraging their resources and expertise, as sponsors of large-scale retirement savings plans for their employees (and college savings plans), to expand private pension coverage. Such State activity could add value in a number of ways.

[a] Pooling of Small Employers and Self-Employed

One of the State government's key assets is the capacity to facilitate pooling by small employers and self-employed individuals. Pooling of employers in multiemployer plans and multiple employer plans has long been a feature of the pension landscape. Accordingly, the thought that pooling of smaller employers in arrangements similar to these might be a desirable way to encourage them to sponsor plans for their workers has been a staple of pension coverage discussions for years. Unfortunately, the development of new multiple employer arrangements -- outside of the specific collectively bargained industries where multiemployer plans are the norm – has been quite limited. By and large, pooling of small businesses to provide retirement plans has not occurred on any significant scale.

One reason is the lack of ready catalysts outside of the Taft-Hartley collective bargaining universe. To some degree, financial providers can play this role, but, given their cost structures and financial incentives, it is often unprofitable to market to and group together all willing small employers and lower-to-moderate income workers. Instead, financial providers' incentives often lead in the direction of cream-skimming and cherry-picking, with fees and expenses high enough to could deter many small employers and workers.

To some degree, a pooling function can be performed by firms that provide payroll or staff leasing services. Such firms often offer 401(k) plans on a collective basis to participating small employers. Congress and Treasury/IRS have generally limited those firms to the use of multiple employer plan arrangements. A drawback of the multiple employer plan model is the risk that a

qualification defect on the part of any participating employer will taint the entire plan, potentially imposing adverse consequences on all other participating employers and employees.³⁰ As noted, this risk may be more theoretical than real, but an advance administrative arrangement with the IRS – if one could be negotiated on behalf of all States -- would be desirable to provide a measure of assurance on this score before a State adopted a multiple employer plan.

State governments could serve as a catalyst or coordinator for pooling small businesses and individuals. It would be fair to ask why the government should get involved as opposed to leaving this to small business associations and other trade or professional organizations. In general, however, it appears that small business associations thus far have not in fact launched such large-scale pooling arrangements on their own. One reason may be that the associations have traditionally had other, higher organizational priorities, which do not necessarily include the public policy purpose of expanding retirement security and savings, and their members have traditionally viewed employer-provided health coverage as a higher priority than retirement savings. Moreover, their members may include brokers, insurance agents and others who might view efforts to assemble small business pooling arrangements that negotiate for lower costs as a threat to their business (but see section 1.03[e] and [f], below).

It should be possible, however, for a State government to partner with small business or other trade or professional organizations that are willing to collaborate in reaching out to members and potential members of those groups and offering a pooled retirement savings arrangement. Such public-private alliances also could conceivably help overcome distrust of government among some small business owners who might potentially sponsor a plan.

[b] Negotiating on Behalf of Small Employers and Individuals for Low Costs and Best Practices

It is common for State governments to contract with private financial institutions to provide investments and assist with the management and administration of the State-sponsored 403(b), 457, or grandfathered 401(k) plans for State and local government employees. In addition, States enter into arrangements with private financial institutions to provide prepaid tuition and college savings plans under Section 529 of the Code. Large-scale programs such as these obviously tend to be of interest to providers competing in the marketplace. The same might be true of a State-affiliated plan for private sector employees.

A State government might be expected to have considerable bargaining power with providers based on the prospect that a new program of this kind could ultimately grow to scale. That bargaining power and the prospect of large economies of scale could be used, for example through a process of competitive

³⁰ Treasury Regulations section 1.413-2(a)(3)(iv)

bidding and procurement, to negotiate for plans that are low in cost and incorporate best practices in enrollment, investment, and other respects.³¹

[c] Calling Attention to Valuable Federal Tax Benefits

States could make it easier for employees and employers to take advantage of the federal tax benefits for saving through employer plans or IRAs – particularly the more recently enacted tax credits specifically designed to increase coverage, which are the saver’s credit for lower- and moderate-income savers and the startup credit for small employers establishing a new plan for the first time. (The startup credit defrays 50 percent (up to \$500) of the costs of starting and administering a new plan each year for up to three years.³²) By publicizing and calling employees’ and employers’ attention to these benefits and by making it easier to adopt and maintain a qualified plan or to save through an IRA, States can help promote coverage and deliver valuable federal tax benefits to their citizens and to small employers within the State. States would also have the option of providing State tax credits as an additional inducement if they wished to do so.

[d] Simplifying Employers’ Decision to Adopt a New Plan

State government’s capacity for outreach and “public marketing” could be used to help expand coverage by encouraging employers to make the decision to adopt a new plan. The State’s involvement – backing up a private-sector prototype plan sponsor -- may provide additional assurance to small business owners that adoption of a retirement plan for their employees would be a realistic, feasible alternative. Some employers perceive retirement plans to be more complex and costly than they actually are, especially as software, electronic communications, and the internet have simplified administration and reduced costs. A simple, low-cost, standardized plan that is publicized by the State and bears the State’s imprimatur might raise small employers’ confidence level and simplify their choice among various providers and types of plans. Employers considering adoption of a plan may also be encouraged by the prospect of convenient professional assistance with plan investments, administrative tasks and compliance – arranged or provided by a State agency. In addition, State backing of a standardized IRA might similarly encourage individuals to purchase and use that product.

³¹ This statement does not explore the question whether there would be a lawful and appropriate way for States to structure their procurement or competitive bidding process to link contracts relating to State public employee plans with State contracts relating to plans for private sector employees.

³² Code section 45E.

[e] Assisting Employers With Plan Administration and Compliance

As discussed, a standardized prototype plan backed by the State might also give employers centralized support with plan administration and compliance. Uniformity of plan design and economies of scale could make it feasible to assist employers with enrollment procedures, plan amendments, filings for IRS approvals, preparation of Form 5500 annual reports, summary plan descriptions and other employee communications and customer assistance, nondiscrimination testing, and other operational tasks. However, it would be desirable to seek special relief from the IRS (and Department of Labor, as necessary) to permit the filing of a single Form 5500 for all employers participating in a State-affiliated prototype 401(k). In addition, as noted, by having all employers adopt a prototype document with identical terms (as opposed to allowing employer-by-employer variation), it may be possible to obviate the need for individual employers to seek IRS approval (determination letters) on the prototype document.

[f] Providing a Platform for Innovations, Best Practices, and Retirement Savings Education

State activity in this area could provide a platform for the implementation of 401(k) innovations and best practices as they continue to evolve. These might include practices such as automatic enrollment, automatic escalation of contributions, asset-allocated default investments, plan design involving a limited number of investment options, development and expanded use of cost-efficient lifetime guaranteed income products as distribution options, and perhaps improvements in portability such as expanded automatic rollover of benefit distributions to other retirement savings vehicles.

The involvement of the State in a facilitating or coordinating role might also make it easier to provide and disseminate financial education to individuals regarding planning, saving and investment for retirement.

1.04 SELECTED KEY ISSUES RELATING TO STATE PRIVATE PENSION INITIATIVES

The following section gives very brief attention to a number of related issues.

[1] Application of ERISA

[a] In General

ERISA imposes a variety of requirements relating to “employee benefit plans” (as defined in ERISA),³³ and, in general, supersedes any State laws insofar as they

³³ ERISA section 4(a).

“relate to any employee benefit plan.”³⁴ This preemption of State laws by ERISA is subject to certain exceptions, including exceptions for State laws regulating insurance, banking or securities, and generally applicable State criminal laws.³⁵ For this purpose, ERISA defines “State law” to include “all laws, decisions, rules, regulations, or other State action having the effect of law, of any State”, and defines “State” to include “a State, any political subdivisions thereof, or any agency or instrumentality of either, which purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by this title.”³⁶

As noted, plans sponsored by State governments or local government authorities for their employees are exempt from ERISA as “governmental plans.”³⁷ Carefully delimited activities of State governments designed to promote savings for their citizens in the private sector, as proposed in this testimony, would be separate and distinct from – and should not affect ERISA’s express statutory exemption for -- States’ sponsorship of plans for their own employees. Even if a State government were considered a fiduciary under ERISA in respect of its activities relative to a plan sponsored by a private-sector employer for that employer’s employees that was subject to ERISA, there would be no reason why ERISA coverage of those State activities should extend to the State’s activities relating to plans for State and local government employees. Moreover, as briefly discussed below, it appears that State governments should readily be able to structure their involvement in activities to promote private-sector retirement savings opportunities in a way that avoids ERISA compliance problems or complexities with respect to those activities.

[b] Avoiding ERISA Preemption

IRAs (at least ordinary “standalone” IRAs that are not sponsored by employers or unions for their employees) generally are exempt from ERISA.³⁸ Payroll deduction IRAs would likewise be exempt to the extent that the employer does

³⁴ ERISA section 514(a).

³⁵ ERISA section 514(b)(2), (4).

³⁶ ERISA section 514(c).

³⁷ ERISA section 3(32), 4(b)(1).

³⁸ 29 C.F.R. section 2510.3-2(d). See ERISA 3(2)(A), 201(6), 403(b)(3)(B). The Department of Labor has promulgated an “IRA safe harbor” in which it takes the position that ERISA does not apply to an IRA if no contributions are made by employers or unions, participation by employees is completely voluntary, the employer’s or union’s sole involvement is “without endorsement to permit the sponsor [typically the financial institution that provides the IRA and serves as its trustee or custodian] to publicize the program to employees or members, to collect contributions through payroll deductions or dues checkoffs and to remit them to the sponsor,” and the employer or union receives no consideration except for “reasonable compensation for services actually rendered in connection with payroll deduction or dues checkoffs.” 29 C.F.R. section 2510.3-2(d)(iii), (iv). In addition to other provisions of the Code (e.g., sections 408, 408A), IRAs are subject to the prohibited transaction rules under Code section 4975.

not make contributions of its own and that its role is otherwise limited in accordance with Department of Labor interpretations (which is what is contemplated here).³⁹ In fact, the Department of Labor has stated that,

“It has been the Department’s long-held view that an employer who simply provides employees with the opportunity for making contributions to an IRA through payroll deductions does not thereby establish a “pension plan” within the meaning of . . . ERISA. . . . Thus, an employer may, with few constraints, provide to its employees an opportunity for saving for retirement,. . . without thereby creating a pension plan under Title I of ERISA. The guidance provided herein is intended to clarify the application of the IRA safe harbor . . . and, thereby, to facilitate the establishment of payroll deduction IRAs.”⁴⁰

Accordingly, the “Tier I” State government role (see section 1.03[2][a], above) and activities described in this statement with respect to IRAs should be largely exempt from ERISA to the extent that the IRAs are not considered “employee benefit plans” under ERISA, and therefore those State activities should not be subject to preemption by ERISA.

By contrast, ERISA would apply to the “Tier II” 401(k) plans, whether sponsored by for-profit or by not-for-profit employers in the private sector for their employees.⁴¹ SIMPLE-IRA plans are also subject to ERISA, though only to a more limited extent, consistent with their character as a mini-401(k) with some characteristics of an IRA.⁴² Therefore, if a State purported to regulate or otherwise impose legal requirements on such plans, ERISA preemption would come into play. Accordingly, States would need to frame their activities promoting such plans in a manner that takes into account the need to steer clear of preemption by ERISA.

For example, a State might offer what amounts to a “seal of approval” and outreach assistance to all prototype private-sector 401(k) plans that satisfied certain conditions relating to plan design, investments, and cost, as set forth in a State request for proposals. A good case could be made that this would not

³⁹ Id.; 29 C. F. R. section 2509.99-1.

⁴⁰ 29 C. F. R. 2509.99-1(b). The Department issued a special interpretive bulletin in 1999 that details the conditions for exemption of a payroll deduction IRA from ERISA and enumerates activities an employer may undertake without converting the payroll deduction IRA program into an ERISA plan. Those activities include such things as encouraging employees to save for retirement by giving them general information on the IRA payroll deduction program (including materials that include the employer’s name and logo), and answering employee questions about how the program works, provided it is clear to employees that the employer’s involvement is limited to facilitating employee contributions through payroll deduction as opposed to endorsing the IRA sponsor or its investment or other financial products or giving employees any additional benefit with respect to the program. For example, an employer may, without triggering ERISA coverage, limit the number of IRA sponsors to which employees may transfer payroll deduction contributions or may designate a single IRA sponsor as the recipient of those contributions, but may not influence the investments permitted, negotiate special terms and conditions for its employees, or bear costs that the IRA sponsor would otherwise expect employees to bear (except for internal costs such as overhead or bookkeeping). 29 C.F.R. section 2509.99-1(c), (d), (e).

⁴¹ ERISA section 3(2), (3), (5), (6).

⁴² See ERISA sections 101(h), 403(b)(3)(B), 404(c)(2); 29 C.F.R. section 2510.3-102(b)(2).

amount to State law or the imposition of regulation or regulatory requirements relating to ERISA-governed employee benefit plans so as to trigger preemption by ERISA. Under this view, such State activities would only constitute support for or partnership with certain competitors in the provider market, and the State would be regarded as acting in a manner similar to a private participant in the market that was negotiating a contract. (Although it might be somewhat far-fetched, a counter argument might be made that State action relating to ERISA plans should be subject to preemption if and to the extent that it imposes requirements as a condition of conferring major, unique benefits of a kind that only a State could confer.) One possibility would be to apply for a Department of Labor advisory opinion confirming that specified State activities do not raise ERISA preemption concerns.

[2] Could There Be a Role for Sidecar or Deemed IRAs?

An interesting issue is whether private-sector employees and self-employed individuals could be allowed to keep their IRA assets in the State government's plan for its own employees without jeopardizing the State plan's exemption from ERISA. The question is whether this could be done by establishing State-affiliated "sidecar" or "deemed" IRAs, trustee by the State or by a financial institution contracting with the State, that are effectively attached to or associated with State-sponsored retirement plans covering State government employees.⁴³ If such IRAs could be established for self-employed individuals and employees of small businesses that are not ready to sponsor a plan – without losing the State plan's ERISA exemption – those individuals could benefit from the economies of scale associated with the same investments that are offered by the State's plans for its employees.

In general, "sidecar IRAs" or "deemed IRAs" can have investments that mirror those of the State employees' plan because they are permitted to commingle their funds with those of the plan; and a State or other governmental entity that meets certain requirements may serve as the trustee of a sidecar IRA that it establishes as part of its employer plan.⁴⁴ The Department of Labor has ruled in an advisory opinion that the establishment of sidecar IRAs as part of a governmental plan would not subject the plan or the sidecar IRAs to Title I of

⁴³ Sidecar IRAs and the qualified employer plan may share the same trust (with separate accounts for each individual's IRA) or may maintain different trusts (with the IRAs either grouped in a single trust or with a separate trust for each IRA). However, use of a single trust for both means that, if either the IRAs or the plan fails to satisfy their respective qualification requirements, the other is automatically disqualified as well. This risk can be avoided by maintaining the plan and the IRAs in separate trusts or in a common trust fund or common investment fund. See Code section 408(q). IRAs may be attached to a qualified employer plan or to an eligible State government plan under Code section 457(b) that is sponsored by a State government for its employees.

⁴⁴ See Proposed and Temporary Treasury Regulations section 1.408 -2(e)(8) & -2T(e)(8). See also Elizabeth T. Dold, "Deemed IRAs – A Welcomed New Plan Design Feature," *Pension & Benefits Week* (RIA) (November 18, 2002), pp. 7-12.

ERISA where the individuals for whom the IRAs were established were governmental, not private-sector, employees.⁴⁵ There is no assurance, however, that a governmental plan would retain its exemption from ERISA if it established sidecar IRAs for more than a de minimis number of private-sector employees. In any event, the relative importance of this question depends on whether, as a practical matter, sidecar IRAs would deliver benefits beyond those that might be realized by the more traditional methods of pooling investments.

[3] Competition With Existing Providers

As noted, many financial providers have limited or no interest in serving small employers that sponsor plans with low average account balances. However, some financial institutions, as well as some consulting or administration firms, are interested in selling plans and plan-related services in this market. These firms could be expected to consider whether State government activity of this kind – pooling employers and employees, negotiating lower fees and costs, etc. – would be a threatening form of competition.

The proposed State activity would not impede or restrict competition in the market. In fact, the State's role might have the effect of increasing competition, especially for the smallest or lowest-wage firms. Second, it is contemplated that the States would contract with private financial institutions and other providers, as they do with the plans they sponsor for their employees (and perhaps to some degree as they do with their Section 529 plans). Third, the State's involvement, if successful, might help the pension industry and related providers penetrate the small business market. This could help create thousands of new retirement savings accounts, many of which can ultimately be expected to be rolled over to IRAs maintained by private financial institutions.

In addition to those considerations, if the financial services industry is not avid in its marketing to most small employers and groups with low average account balances, then it is legitimate for government to step in and promote saving in this market segment. In the long term, the result may be to establish a saving infrastructure in which all working Americans have an IRA or similar individual account in which they are encouraged to save, invest, and own assets. Ultimately, in general, more saving for retirement and other long-term needs increases retirement security and tends to accumulate more investment capital to enhance national productivity and more assets under management for the financial services industry.

Finally, if State activity leads to more active price competition in a market where consumers often lack the information and ability to compare and shop for price, and if this in turn helps drive down fees and expenses, that may be all for the good. However, to mitigate potential competition with private-sector providers, a State could make its plan available only to employers below a specified size. As

⁴⁵ Department of Labor Advisory Opinion 2003-01A (January 24, 2003).

a variation on that approach, a State might even consider making its plan available only to small tax-exempt employers if it believes that, as a broad generalization, those entities might have somewhat lower compensation levels and that there might be less competition for their business.

[4] Cost and Potential Liability

States should have only limited costs because federal preemption would preclude them from actually regulating ERISA-governed plans, and because they would neither fund nor regulate the plans. The objective would be for States to recover their administrative costs from plan investment returns. Conceivably, private-sector contractors might help absorb start-up administrative costs.

States could design their role to minimize their potential liability in the event of a market crash or other unexpected developments. Depending on the services it provides or the functions it performs in relation to ERISA-governed plans and their investments, a State government agency might conceivably be treated as a plan fiduciary under ERISA. A State agency might either limit its activities and functions so as to avoid fiduciary status or accept the possibility or certainty of fiduciary status but structure the arrangements to limit its potential exposure as many ERISA plan sponsors do. For example, the State might contract with prototype plan sponsors or other third party pension or investment professionals to assume appropriate responsibility, and it might delegate key functions or decisions to, or obtain advice from, independent fiduciaries and experts. Whether it may also be advisable to consider enactment of statutory protection from liability, if necessary under State law, is beyond the scope of this statement.

[5] Should State Bonds Be Permitted As Potential Investments?

Could or should there be a role for State-issued bonds within such a program – either in a balanced or life cycle fund or in a conservative fixed income investment option? Such an approach could give the State a greater stake in expanding pension coverage – an additional incentive to take an interest in launching and marketing the plan – and an additional means of defraying costs of startup and administration. On the other hand, State bonds would raise diversification concerns unless limited to a very small fraction of the portfolio. Of course the safety of the bonds would depend on their ratings and the financial strength of the State at any given time. The credit history of certain municipalities and counties, for example, is not entirely reassuring, and some States' bonds might be more vulnerable than alternative fixed income investments to fluctuation of principal value as interest rates and credit ratings change. In addition, giving the State a financial interest in the investments might raise conflict of interest concerns and might generate at least some suspicion among employers and individuals regarding the State's motives for endorsing the plan.

[6] Relation to Defined Benefit Pension Plans

The assumption implicit in the foregoing discussion is that, in recent years, small employers generally have shown themselves to be more receptive to adoption of new 401(k) (and SIMPLE-IRA) plans than new defined benefit plans. The portability, relative simplicity, low cost, and “name recognition” associated with the 401(k) has made it particularly appealing to smaller employers. Accordingly, the most realistic strategies to expand coverage in the market segment where coverage is most sparse – the small business sector, as well as among moderate- and lower-income workers – might lead with these types of plans.

Such an approach, however, is by no means intended to give up on defined benefit pensions. Generally, depending on the specifics of the plan design, defined benefit plans have particular advantages. In fact, it is not inconceivable that State governments might play a role in encouraging defined benefit coverage through collective arrangements that are beyond the scope of this testimony.

The initiatives outlined here are very much intended to steer clear of the debates within some States over whether to shift from defined benefit to defined contribution plans for State and local government employees. The witness believes it is desirable to encourage and preserve well-designed defined benefit plans as well as defined contribution plans, and that it is particularly important to protect and perpetuate existing defined benefit plans that effectively cover substantial numbers of middle- and lower-income workers. A pension coverage strategy seeking to penetrate the small business market based on the perception that small businesses are more likely to consider adopting a new 401(k) than a new defined benefit pension plan should be viewed as having no intended impact on debates about the future of defined benefit plans covering hundreds of thousands or millions of State and local government employees.

1.05 FIRST STEPS TOWARD IMPLEMENTATION

[1] In general

A number of incipient efforts are under way in several States to implement the concept outlined here. As of this writing, it appears that no State has implemented the concept, but the witness has participated in designing and drafting proposed legislation reflecting this approach that has been introduced as bills in Washington and Maryland, and that appears likely to be introduced soon in Michigan and Vermont. In a number of other States as well, the witness has been in contact with legislators, Executive Branch officials and stakeholders who are beginning to explore the possibility of a limited State government role in promoting saving and private pension coverage.

Each of these legislative efforts could implement the concept of State-assisted private-sector retirement saving in a slightly different way, reflecting the views and preferences of the relevant legislative sponsors and Executive Branch officials in each of these States. The bills introduced thus far (and future bills that may be introduced in other States) can be expected to undergo changes in the course of the legislative process, and the outcome – whether they are ultimately enacted and how they are actually implemented -- is uncertain.

[2] Maryland

Early in 2006, a bill to establish the “Voluntary Employee Accounts Program” was introduced in the Maryland House of Delegates by Delegate Samuel I. (“Sandy”) Rosenberg.⁴⁶ The legislation was suggested by the witness to authorize the State to promote the adoption of the programs described in Tier I and Tier II, above – voluntary IRAs, payroll deduction IRAs, and employer-sponsored SIMPLE-IRA and 401(k) plans. The proposed legislation authorizes the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans to contract with private financial institutions to help establish and administer such a program. The authority embraces master and prototype programs, collective investment and administrative arrangements, and authority to obtain federal agency approvals.

[3] Michigan

As of this writing, the introduction of a bill in Michigan appears to be imminent. Based on the witness’s 2005 presentation to the National Association of State Treasurers, then State Treasurer Jay Rising suggested the concept to Governor Jennifer Granholm. The Governor, in her State of the State address on January 25, 2006, called for developing a State-assisted 401(k) plan for small businesses in Michigan that do not currently sponsor plans and that choose to adopt the new program.⁴⁷ The witness has been involved in the effort to draft legislation focusing on a Tier II approach.

[4] Vermont

Vermont State Treasurer Jeb Spaulding and a tri-partisan group of Vermont legislators – Representative Donna Sweaney, Senator Diane Snelling, Senator Susan Bartlett, and Rep. Sarah Edwards – recently announced that legislation would be introduced next year to promote the concept in Vermont. (Their news release is appended to this statement.) The Vermont Voluntary Retirement Savings Program would be based also on the witness’s 2005 presentation to the National Association of State Treasurers.

⁴⁶ The bill, HB 1414, was cosponsored by Delegate Richard S. Madaleno, Jr., and was amended in March 2006.

⁴⁷ The effort is now being spearheaded by Chris DeRose, director/CEO of Michigan’s statewide retirement systems. See Amy Lane, “Fahrenheit 401(k),” *Crain’s Detroit Business* (March 13, 2006), pp. 3, 29.

[5] Washington

To date, the State of Washington has made more progress than any other State in moving the proposal forward in the legislative process, owing mainly to the work of Marilyn Watkins and John Burbank of the Seattle-based Economic Opportunity Institute.⁴⁸ Legislation with bipartisan cosponsorship, revised to reflect in large part the witness's 2003 proposal, has been pending in the State legislature for several years, and has been favorably voted out of committees in both houses.⁴⁹

As in Maryland, the legislation authorizes the State to promote the adoption of the programs described in Tier I (voluntary IRAs and payroll deduction IRAs) and Tier II (employer-sponsored SIMPLE-IRAs, and master and prototype 401(k) plans). Unlike Maryland, the sponsors of the Washington legislation chose to require small employers that do not sponsor a retirement plan to cooperate with the State Department of Retirement Systems to facilitate their employees' participation in payroll deduction IRAs. In other words, while employers would not be required to sponsor plans for their employees, small employers that do not sponsor a plan would be required to offer their employees the opportunity to save through payroll deposit to an IRA (which would be made available by the State). The State Investment Board would manage the investment of the contributions. Implementation would await necessary federal approvals and identification of funds for startup of the program. If the program were not self-supporting after six years, the Director would be required to recommend a method of terminating it.

1.06 CONCLUSION

State-assisted saving, as described here, has the potential to serve the legitimate interests of workers, employers, and the public, including the States.

⁴⁸ In Washington, the original impetus for a State government role in expanding private pensions appears to have come from Dean Baker, Co-Director of the Center for Economic & Policy Research in Washington, D.C., working with Ms. Watkins. Dr. Baker's article, "Pensions for the 21st Century" (Century Foundation, 2000) summarizes and evaluates the federal Universal Savings Accounts proposal (which the witness participated in developing while serving in the Executive Branch in 1999-2000) and two other proposals, suggests that selected elements of each be combined in an amalgam approach, and notes that this could be administered at the federal or state level.

In 2002 or 2003, the witness recommended that Washington consider the specific two-tier framework summarized in his April 2003 written statement for the Washington legislature (and in this testimony), based on the use of four existing federally-regulated retirement savings vehicles -- the IRA, the payroll deduction IRA, the SIMPLE, and the master and prototype 401(k) -- and on the hope of avoiding the need for new federal legislation to authorize such State activity.

⁴⁹Second Substitute Senate Bill 5544 and Substitute House Bill 1570, creating the "Washington Voluntary Accounts Program".

Saving for retirement by employees and the self-employed could be facilitated through plans that are more available, simpler, cheaper, and portable. This approach could help small businesses to more effectively recruit and retain valuable workers and reduce turnover through simpler, cheaper plans for employees that create less distraction from running the business. (In addition, small employers could obtain the startup costs tax credit for establishing a new plan.)

In addition, State-assisted saving could be a wise investment for the State and the Nation. Citizens could become more financially independent and self-sufficient, therefore less likely to end up as charges upon the State. This could tend to relieve pressure on State and federal public assistance programs. Moreover, the State role outlined here would be feasible at reasonable cost to the States because they would not contribute to fund these plans, would not regulate them, and could recover administrative costs from investment returns. States would use their ability to pool small employers and their collective buying power, their accumulated expertise and experience, perhaps some of their administrative infrastructure, their capacity for outreach, and their credibility to encourage saving and expand pension coverage in the private sector.

Finally, the strategy outlined here would likely spawn differing approaches to promoting retirement security and expanding coverage in various States, to the extent consistent with federal preemption. The potential for creativity at the State level would be a key advantage, permitting States – in Justice Brandeis’ classic words – to “serve as a laboratory”...and “remould, through experimentation, our economic practices and institutions to meet changing social and economic needs.”⁵⁰

⁵⁰ *New State Ice Co. v. Liebmann*, 285 U.S. 262, 310-311 (1932)(Brandeis, J., dissenting).

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Tri-Partisan Effort to Boost Retirement Savings Launched in Vermont

Montpelier – Recognition that half of today’s workforce is not covered by any retirement savings plan has prompted a proposal by a tri-partisan group of Vermont legislators and the State Treasurer to provide for a statewide voluntary retirement savings program. The proposal would leverage the resources and expertise of Vermont’s state level retirement plans to assist small businesses in providing a 401(K)-type retirement savings plan for their employees.

Introducing the Vermont Voluntary Retirement Savings Program, State Treasurer Jeb Spaulding explained, “We know that a large percentage of Vermonters are not currently saving for retirement and that taxpayers will bear the ultimate responsibility for seniors with insufficient savings. We also know people are more likely to save if a simple retirement plan is available at work and that by providing a simple, inexpensive, high-quality, and safe retirement plan option for small employers and self-employed Vermonters, we can increase critical savings for retirement.”

Legislative members of three political parties (Democrat, Republican, and Progressive) expect to sponsor enabling legislation next year and will spend the summer and fall working with citizens, legislators, and business partners to promote the concept.

According to Representative Donna Sweaney, D-Windsor, four states – Washington, Maryland, Michigan, and Vermont – are actively moving to create voluntary retirement savings programs and several others have expressed interest in the concept, which was developed and promoted by former U.S. Treasury official Mark Iwry, currently at the Brookings Institution in Washington, DC. “We will be devoting a major portion of an upcoming New England Women Legislators Symposium to this subject,” Rep. Sweaney stated.

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The Vermont proposal calls for the creation of a voluntary retirement savings program as an option for employers and employees, and self-employed Vermonters, sponsored by the state, and at no cost to the taxpayers. The program would take advantage of economies of scale by piggybacking on the State's existing retirement plans to offer businesses the option of providing a 401(K)-type retirement plan for their employees. Administrative costs will be covered in the fee for plan participants.

“This collaborative effort will bring the resources of the State Treasurer’s Office, legislative leaders, and the private sector to bear on a major issue facing Vermonters – the lack of adequate savings to meet future retirement needs, especially as the baby-boomers begin to leave the work force. Many of Vermont’s small businesses want to provide retirement plans for their workers, but are unable to do so because of cost and administrative barriers. This plan provides a straightforward voluntary approach to assist these businesses,” said Senator Diane Snelling, R-Chittenden.

“People are living longer and not saving enough. This public/private partnership can be a win-win-win proposition: Vermonters will have more savings and a better quality of life at retirement, businesses will be able to attract and retain employees with enhanced benefits at little or no cost, and state government will avoid some future liabilities for those with inadequate retirement savings,” stated Sarah Edwards, P-Brattleboro.

According to Senator Susan Bartlett, D-Lamoille, Chair of the Senate Appropriations Committee, women have distinct retirement challenges that would benefit from the Vermont Voluntary Retirement Savings Program. “An alarming number of older women face the reality of moving from the middle class to poverty when their spouse dies. Since women live longer, often interrupt their careers to raise children or care for aging parents, and are paid less than men, they often end up with inadequate retirement savings. Making it easier for them to save would be very helpful,” she explained.

Iwry, who serves as Senior Adviser to the Retirement Security Project at Brookings, said of the Vermont proposal, “Leveraging their resources and bargaining power, states can assist small businesses in pooling their efforts to help employees save. Vermont can act as a powerful catalyst, partnering with the private sector to expand private pension coverage.”

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