Illinois Expands Pension Coverage

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MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

The State Introduces Automatic Retirement Savings Plan for the Uncovered

The **Illinois Secure Choice Savings Plan**, once up and running, will require employers (with 25 or more employees) that do not maintain a retirement plan to enroll their employees in Roth IRAs. Employees can opt out. Lack of coverage is a major problem nationwide since surveys show that **about half** of private sector workers do not participate in a retirement plan at their current job. This announcement puts Illinois ahead of California in states' efforts to cover the uncovered.

The default contribution rate will be 3 percent, and employees can allocate their investments among funds approved by the Illinois Secure Choice Savings Board. One of the investment options must be a life cycle fund in which the allocation between stocks and bonds is determined by the age of the participant – that is, a target date fund – which would serve as the default investment for those who fail to select another option. Although the state will cover the startup costs, participants will pay all the administrative expenses thereafter, with a fee on their balances that cannot exceed 0.75 percent.

As envisioned, the employer's only responsibility would be to transfer after-tax payroll money to the fund.

The precise timing of the implementation of the program will be determined by the Board but will occur within 24 months after enacted, provided that two hurdles are surmounted. First, the Internal Revenue Service must confirm the saving through this new plan will qualify for the favorable federal income tax treatment that is normally accorded IRAs. Second, the Department of Labor must determine whether the arrangement would be covered by the Employee Retirement Income Security Act (ERISA), which regulates private pension plans. ERISA coverage would mean that the state or the employer would become fiduciaries, a responsibility that they do not want. Further, ERISA may impose additional reporting and disclosure requirements on employers in addition to the state tax reporting requirements included in the legislation.

The strengths of this program are that participants are automatically enrolled (nothing happens if the decision is left up to the individual!), that the IRA is a Roth (which allows cash-strapped participants to withdraw money penalty free), and that the default investment option is a target date fund. The drawbacks are that the automatic contribution rate is only 3 percent (it sounds like a higher rate was simply not politically possible) and the plan contains no provision for automatically increasing the individual's contribution over time. In addition, the proposal exempts employers with less than 25 employees, and a fee of 0.75 percent seems quite high.

Nevertheless, Illinois deserves great credit for undertaking this major initiative to extend coverage to those without a retirement plan. Nothing is happening at the federal level, where Congress has taken no action on the President's auto-IRA proposal. In the face of no federal action, the states are stepping up and trying to solve this major challenge of inadequate retirement income. If the Illinois program really gets off the ground in the next 24 months, it will be leading the way. A number of other states have shown interest in similar efforts and will learn a lot from the Illinois experience.

And as one who has repeatedly criticized Illinois' management of its plans for public employees, it is lovely to be able to praise a pension initiative in the state.