State Savings Initiatives Moving Forward in California and Connecticut

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Auto-IRAs to cover workers who lack employer plans appear promising.

Feasibility studies suggest that initiatives to broaden access to retirement plans **can generate sufficient account balances and employer support** to be successful.

At any given moment, about half of private sector workers are not covered by any employer-sponsored retirement plan. To close this coverage gap, 18 states are considering savings initiatives to **create a retirement system** for uncovered private sector workers.

Two states – California and Connecticut – are well along in the process. Both states have recognized that the key to the success of their programs – both in terms of increasing retirement security and in terms of financial feasibility – is achieving a large pool of participating employees. Thus, both states took the auto-IRA approach, which imposes a mandate on businesses without a retirement plan to automatically enroll their employees in an IRA.

The mandate is necessary because small employers have shown little interest in offering plans. Automatic enrollment is necessary because many more employees will participate if the requirement is to opt out rather than to opt in.

California and **Connecticut** have completed "feasibility studies" to determine whether their initiatives can generate sufficient account balances and employer support to be successful.

Employee Response

Automatic enrollment only works if workers actually stay in the program, i.e., they do not "opt-out." The California and Connecticut research suggest relatively low opt-out rates, with participation rates ranging from 73 to 84 percent depending on the state and the contribution rate being considered. Further, the small difference in participation between 3 and 6 percent in the Connecticut experiment and 3 and 5 percent in the California experiment suggests that states can likely default workers in at a higher contribution rate without risking low participation. Since workers tend to anchor around defaults, setting a high default is the best way to ensure the program produces retirement security for workers. However, Connecticut's experiment does show that if contribution rates are automatically increased to 10 percent over four years, participation will decline.

In addition to contribution rates, Connecticut's experiment also examined how uncovered workers respond to two other potential design features: annuitization and guarantees. On the annuitization front, when workers were told their account balances at retirement would be used to provide a monthly income "like Social Security," participation was higher than when they were told they could simply withdraw their account balances at retirement. Workers were not enthusiastic about guarantees when they were told they would be guaranteed a 1-percent real rate of return but that their return was unlikely to be higher than 1-percent (as in a money market fund). This result is confirmed by evidence from the California survey that workers – by a ratio of two to one – prefer their money invested in a balanced fund relative to a money market fund.

The bottom line on employees is that if they are automatically enrolled they are likely to stay.

Employer Response

To understand how employers view the proposed programs, California interviewed employers and business associations in California, and Connecticut conducted focus groups of Connecticut employers. In addition, Connecticut worked with Nielsen, Inc. to conduct a phone survey of 199 small Connecticut employers that do not offer their employees a retirement plan and thus would be affected by Connecticut's coverage requirement. The results of this phone survey indicate that employers are split in their support of Connecticut's program with 48 percent opposing and 40 percent supporting.

Given the mixed support, an obvious concern is that employers will encourage workers not to participate. But the Connecticut phone survey suggests that this problem will not occur; just 9 percent indicated they would encourage their workers to opt out.

Overall Assessment

In short, both the California and Connecticut feasibility studies find that high levels of employee participation would result from a requirement to offer an auto-IRA, and therefore that account balances and total plan assets would be high enough to allow their programs to cover their costs at relatively low fees. While employers have some objections to state savings programs, they would not discourage participation and may view the program differently if their administrative burden is minimized. The next step in the process is to overcome the implementation hurdles.