Spotlight

AARP Public Policy Institute

Retirement Saving Policy

Consumer Protections in State-Sponsored Retirement Plans for Private-Sector Workers

Karen Friedman and Norman Stein
Pension Rights Center

A state-sponsored retirement savings plan could help millions of private-sector workers who are not covered by an employer plan build financial security. Several features will help a plan become more effective and produce more secure retirements. This report discusses how to ensure that consumers' money and rights are fully protected.

States around the country are leading a movement to expand retirement savings for workers who are not covered by employer-based plans in the private sector. Over the past few years, a number of state legislatures have introduced or passed legislation that authorizes or studies ways for state retirement systems either to administer new savings plans themselves or to promote a variety of approaches that could be enhanced by state involvement.

Massachusetts was the first state to adopt legislation to help its citizens save for retirement. In 2012, Massachusetts enacted "An Act to Provide Retirement Savings Options for Nonprofit Organizations," which authorized a state-sponsored retirement plan for employees of small nonprofits. Later that same year, California adopted legislation that provides a blueprint for a state-sponsored plan—the California Secure Choice Savings Trust. California began a feasibility and implementation study the following year.

Once implemented, the California plan would provide an easy, efficient, and cost-effective system of automatic enrollment— payroll deduction individual retirement accounts (IRAs)—to help millions of people who are now uncovered by employer-sponsored plans save for retirement. Legislators from other states have looked to the California plan as a model for their own legislative proposals. On May 7, 2014, the Connecticut General Assembly passed a bill that allocated $400,000 to help lay the groundwork for a new state-sponsored retirement savings plan that would include many of the features of the California plan.

As legislators across the country consider similar approaches, it is important that their plans include consumer protection features to safeguard the retirement income of participants and their spouses.

What Consumer Protections Are Needed?

To determine which consumer protections are needed, legislators first need to figure out which structure is *right* for their state and then think about what can go *wrong* in designing and implement-

AARP® Real Possibilities

ing that kind of structure. Some types of problems will be unique to a particular plan structure, whereas other problems will be common to all plans regardless of how they are designed and how thoughtfully they are implemented. For instance, what happens if an employer does not remit employee money into the plan? What happens if the contributed amount or the account balances are disputed? What happens if account balances are disputed in a divorce or when the participating employee dies?

To help think through those issues, we have developed a checklist of best practices for legislators and their staffs.

Consumer Protection #1: Board of trustees. A board of trustees that has the best interests of the workers and retirees in mind should run the program. The board of trustees should be composed of investment experts, retirees, union and other employee representatives, employer and financial institution interests, and government employees. The board should help implement and design a plan that is right for the employees in the state. The board should have no affiliation with the money managers or service vendors who are running the plan. If the state retirement system administers the plan, as in California or Massachusetts, the board should take on fiduciary responsibility for overseeing the plan according to state law, ensuring that the money is invested solely in the interests of workers and retirees. If the state is developing an approach that uses private vendors, the board should ensure that the participating private vendors who are offering plans through the state program abide by the rules developed by the board, unless participants in that type of structure are adequately protected by other laws, either state or federal.

Consumer Protection #2: Automatic enrollment. Employees should be automatically enrolled with opt-out provisions for participants. Most of the plans or proposals developed to date envision employees having an automatic process for saving through their workplace. Under such an arrangement, the employee is enrolled into the plan at a set contribution unless he or she opts out; employers are only obligated to send a designated portion of their employees' paychecks to the plan. If a plan has an automatic enrollment feature, it is critical that employees have an opportunity to opt out. Someone who is enrolled, but changes his or her mind, should have the option of withdrawing the money without penalty for a reasonable period after the initial enrollment. New employees, or those who have opted out, should be given the opportunity to be reenrolled during regular periods—at least once a year and preferably more frequently—as designated by state legislators or the board that helps design the plan. In addition, self-employed individuals should be able to make individual contributions at least as often as the enrollment periods designated for employers.

Consumer Protection #3: Dispute resolution. A plan should include a process for resolving disputes or have an ombudsperson (appointed by the board of trustees but independent from it) to address and protect the interests of participants when problems arise. For instance, if an employer does not remit all or part of the employees' designated contributions, the board must take action to ensure that the employer meets its obligations and remits contributions. If employees or retirees believe that their reported account balance is incorrect, there needs to be a claims and appeals process. The dispute resolution office or ombudsperson, or some other plan office or official, should be available to answer participants' and employers' questions about the program and to catalog problems and complaints they receive in order to continually improve the plan. States might also consider having the ombudsperson prepare for the trustees an annual report on the plan and possible improvements, which is then submitted to the state's legislative and executive branches.

Consumer Protection #4: Spousal protections. Any plan or program should recognize that retirement savings is generally a family enterprise, with spouses and domestic partners having an important interest in the outcomes. Thus, if a state decides to establish a new savings plan for private-sector workers, then it would be in the best interest of families to require that the spouse or domestic partner (if the state does not recognize same-sex marriage) be the default beneficiary—unless the spouse or domestic partner waives those protections. The state plan should also establish an efficient administrative process to divide plan assets in a divorce or separation, consistent with the state's laws on martial property and divorce.

Consumer Protection #5: Clear disclosures to employees and retirees. Every plan should provide regular disclosures, written in plain language and understandable to workers and retirees, about (a) how their money is invested, (b) how much money has been accumulated in their account balances, and (c) how much the plan, or the individual, pays in investment and administrative fees—shown in dollars. Also, if the plan provides for the accumulations to be paid as lump sums, the disclosure should show realistic illustrations of how much the current accumulations would produce if they were converted to lifetime streams of income at retirement age. All of these disclosures should be sent in hard copy by mail—unless individuals choose affirmatively to have that information delivered electronically. Private vendors should also be required to do the same if they choose to participate in any program that is authorized by the state. If the money is pooled and professionally invested, and if individuals have notional—rather than real—accounts, the disclosure should summarize how the money is invested and how the investments are performing. The board of trustees could post such a summary on the plan's website.

Consumer Protection #6: Standards for private vendors. If the state administers a plan, it should be the default option. If private vendors want to compete with the state-administered plan, as they are allowed to do under the California Secure Choice arrangement, the state should consider setting substantive standards for all vendors of IRAs to the extent permitted by federal law. In that regard, legislators should study whether the state, or the appointed board of trustees, can be empowered to require that outside IRA providers that want to participate in the state program adhere to rules developed by the program's board of trustees, such as (a) full disclosure of investment and administrative fees, (b) regular disclosures of account balances and investment options, and (c) conflicts of interest. Also, consideration should be given to making private vendors part of the same dispute resolution process developed for the state-administered plan. If the state establishes a low-fee plan, and the participating employer chooses to enroll employees in a private vendor plan instead, employees should have the right to have their money directed to the public plan.

Conclusion

Taking new approaches to expand coverage through states is a novel idea that has the potential to expand retirement savings to millions of private-sector workers who are not covered by an employer's plan. However, while developing such programs, states must ensure that consumers' money and rights are fully protected.

Spotlight 7, October 2014

AARP Public Policy Institute,
601 E Street, NW, Washington, DC 20049
www.aarp.org/ppi
202-434-3890, ppi@aarp.org