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Spotlight

What Types of Costs Would a State-Sponsored Retirement Savings Plan Impose on Employers: A Case Study Using the Illinois Secure Choice Savings Program

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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 the costs of such a program to employers using Illinois's Secure Choice Savings Program as a case study. Although each state program may be slightly different, the Illinois program is typical of a simple, IRA-based program.

A number of studies have shown that roughly one-half of all private-sector workers in the United States do not have access to an employment-based retirement plan.[1] As a result, those workers have minimal savings to supplement Social Security benefits, a program that was never intended to fully support them in retirement.[2] The situation is most bleak for lower-wage workers who have the lowest levels of retirement savings and who tend to be more concentrated in industries that do not offer retirement savings plans. One national proposal to address the situation was to establish an automatic individual retirement account (IRA) program. Such a program would require employers who have more than 10 employees and who do not offer a retirement savings plan to enroll their workers in an IRA funded through payroll deductions. Despite bipartisan support[3] when originally presented, the proposal has languished at the federal level.

The Illinois Secure Choice Savings Program and How It Affects Employers

In the absence of action by the federal government, states including Illinois, Massachusetts, Connecticut, California, Washington, and Oregon have begun to address the issue. Illinois has recently taken the lead by passing the Illinois Secure Choice Savings Program Act, becoming the first state in the nation to adopt a statewide automatic IRA program to cover private-sector workers.[4] Illinois began to implement the plan in 2015.

The Illinois Secure Choice Savings Program (IL Secure Choice) establishes a retirement savings account program and automatically enrolls workers whose employer does not choose to offer a different employer-based payroll deduction retirement plan. The program specifies a target date life-cycle fund with 3 percent of income contribution

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as the default, but workers may choose among a limited number of other investment options and can change the contribution amount if they want. Employees may opt out of the program entirely at any time. Employers who choose to use the IL Secure Choice program will simply enroll their employees, set up the automatic payroll deduction, and deposit the contributions with the program. Employers will not be permitted to contribute and will have no managerial or fiduciary responsibilities or liabilities.

The IL Secure Choice program applies to any business with more than 25 employees that has been in existence for at least two years and that does not currently offer a retirement savings or pension plan. Businesses with fewer employees may participate in the program on a voluntary basis. The program will be monitored by a seven-person state board, but a private financial company will be responsible for investing the funds and managing the accounts. The accounts will be portable, and workers with more than one job will be able to contribute from paychecks from multiple employers, if they so desire.

The costs that the program would impose on employers figured prominently in the debates over IL Secure Choice.[5] A related concern was how those costs compared to the costs an employer would bear in setting up a comparable retirement plan for employees as a purely voluntary initiative without the statutory mandate.

The roles that employers play in IL Secure Choice are limited to enrolling employees and sending their payroll deduction contributions to the IRA provider. Although the program is designed to minimize the expense to employers, it could incur costs in four ways:

1. The initial cost of enrolling employees or having them opt out of the program
2. The cost of setting up the payroll deduction to collect the employees' contributions
3. The cost of making the deposit into the IRA
4. The annual cost of the open-enrollment period for employees

Uniform Enrollment Materials Help to Keep the Cost of Enrolling Employees Low

As part of its responsibilities, the seven-person board that operates and administers the IL Secure Choice program must prepare and provide to all employers an information packet for enrollment, including a disclosure form and an enrollment or opt-out form. All that employers have to do is give the packet to their employees, collect the completed forms, and set up the deduction for employees who do not opt out. IL Secure Choice enrollment, therefore, is similar to many other benefit programs, such as health insurance, that provide the employer with all of the necessary information and forms to enroll employees at no cost to the employer. Because IL Secure Choice is an automatic enrollment system, employees need do nothing to participate. Thus, employers need only collect forms from employees who opt out of the program. Distributing the materials and collecting any opt-out forms should result in minimal costs. Employers will incur the greatest inconvenience from distributing the information packet to their employees in the initial enrollment period because the program will cover all existing employees. After the initial enrollment, the cost of that step will be the marginal difference in human resources or administration cost for processing one additional enrollment for each participating new employee.

Having Only One Provider Simplifies the Cost of Setting Up the Deduction

IL Secure Choice is mandatory only for employers not offering another payroll deduction retirement savings plan or pension and who had at least 25 employees for the entire preceding calendar year, thereby exempting smaller businesses that may be more likely to manually process payroll.[6] According to a 2007 Automatic Data Processing Inc. survey,[7] 97 percent of employers with more than 10 employees used computer software or an outside service for processing payroll and deductions. That figure is almost certainly even higher today. Integrating the new payroll deduction required by IL Secure Choice, therefore, will impose only a minimal cost on those employers. The cost will be the employer's time either to add the new deduction in the software or to call its outside payroll company and have it incorporate the deduction. For the few covered employers[8] who may still be processing payroll manually, the up-front cost of switching to in-house software or using an outside service would be offset over time by the savings resulting from the conversion.[9]

IL Secure Choice makes the deduction simple for the employer to set up. The plan has only one possible provider, and employees can choose from only four investment options. If employees accept the automatic target date fund as their investment choice, even that step will not be necessary. The only other information needed to set up the deduction is the amount or percentage of the employee's wages to be deducted, which will be readily available to the employer.

The Minimal Cost of Making Deposits and Conducting the Annual Open-Enrollment Period

For employers participating in IL Secure Choice, the cost of depositing employees' contributions into the IRA will also be minimal. A 2010 survey of small businesses found that 65 percent of employers with between 20 and 50 employees offered direct deposit for payroll, and the percentage increased to nearly 80 percent for larger employers.[10] Those employers are almost certainly also making payroll tax deposits electronically. As a result, IL Secure Choice will require only one additional electronic payment periodically[11] for the employees' IRA contributions. Those payments will be handled similarly to the way employers already remit payroll taxes or pay for unemployment insurance because all of the contributions will go to one provider. For employers who use paper checks to submit taxes withheld to the government, the cost will simply be the time to total the amount withheld and the marginal cost of preparing and mailing one additional check representing that total, along with a form indicating how much each employee has contributed during that deposit period.

IL Secure Choice, like many other benefit programs, requires employers to open enrollment for all employees annually to provide the opportunity for employees who have opted out to enroll. As with the initial enrollment, the open-enrollment period for IL Secure Choice requires only relatively minor action from the employer: distribute the materials, collect the forms, and enter the data for the deduction.

How the Costs of IL Secure Choice Compare to Existing Alternatives

The related cost issue is how the costs to employers for IL Secure Choice compare with existing alternatives. The closest analogy to IL Secure Choice is payroll deduction IRA programs for small businesses.[12] Those programs mirror many of the features of Secure Choice. They are funded solely by employee contributions through a payroll deduction, and the employer's role is simply as a conduit between the employee making the contributions and the company managing the investments. In neither IL Secure Choice nor payroll deduction IRA programs does the employer have any reporting requirements or fiduciary responsibility for the investments.

As far as the costs to employers, the two programs are almost identical. Most major providers that offer payroll deduction IRA programs do so with no set-up or annual maintenance fee. To make the payroll deduction IRA programs more attractive to employers, providers also supply the disclosure and enrollment materials, as will the provider for IL Secure Choice. Also, providers handle all of the investment decisions and reporting requirements that the investment manager for IL Secure Choice will handle when the program begins operating.

An existing payroll deduction IRA program could offer some modest cost savings for employers who IL Secure Choice does not. Some providers may be willing to set up the deduction or input the initial enrollment forms for the employer, for example. Although that service could, theoretically, reduce the administrative costs for an employer, it is unlikely to do so in practice because employers may be reluctant to allow the provider access to their payroll systems. If the provider were given that access and had to be monitored by the employer during the set-up and input operations, the employer would not realize much cost saving from allowing the provider to do the work. The provider may also reimburse the employer for the actual cost of remitting the payroll deductions, a small saving over IL Secure Choice.

From the employer's perspective, IL Secure Choice has one major cost advantage over existing payroll deduction IRA programs. Employers have to take time, which costs money, to select a provider from among multiple options to establish a payroll deduction IRA program and to select investment options; that cost to employers is not present with IL Secure Choice because the board chooses the provider, and the investment options are limited by statute. Under IL Secure Choice, employers do not have to (a) choose among banks, investment houses, or insurance companies; (b) decide whether to offer multiple providers; or (c) decide which investment options meet the needs of their employees. The array of choices that employers face when deciding whether to offer a payroll deduction IRA program may be one reason why such programs have not achieved a significant level of employer participation. The employer has to be willing to put in the time and effort to initiate and complete the process, and that imposes a cost that is not present in the IL Secure Choice program.

Conclusion

The IL Secure Choice model is one tool to address the looming retirement income insecurity facing many private-sector workers. The cost to employers is modest: one additional deduction to set up and one additional deposit to make periodically. Compared with the closest existing alternative, IL Secure Choice is a less costly alternative because the employer does not have to take the time to investigate and make choices about the IRA program provider and investment options. In addition, the employer does not have any legal responsibility for making those decisions.

1 J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security through Automatic IRAs" (Paper No. 2009-3, Retirement Security Project, Washington, DC, 2009); Spencer M. Cowan, "Coming Up Short: The Scope of Retirement Insecurity among Illinois Workers" (Report, Woodstock Institute, Chicago, 2012).

2 Nari Rhee, "The Retirement Savings Crisis: Is It Worse Than We Think?" (Report, National Institute on Retirement Security, Washington, DC, 2013).

3 The proposal was authored by J. Mark Iwry of Brookings Institution and David C. John of the Heritage Foundation. It was supported by both 2008 presidential candidates, Barack Obama and John McCain, and the concept was endorsed by the *New York Times* and the *National Review*.

4 IL Secure Choice requires employers who had 25 or more employees during the previous calendar year and did not offer a retirement plan to enroll their employees in a Roth IRA funded by employee contributions. A seven-person state board will operate the program and will choose an investment company to manage the funds. The default contribution is 3 percent of the employee's wages, to be invested in a life-cycle fund based on the employee's age. The employee may opt out, choose from three other investment options, or change the contribution percentage.

5 Other cost concerns are the cost to employees who will be contributing to the IRAs capped in the statute at a maximum of 75 basis points (0.75 percent), and the cost to the state for its role in implementing and overseeing the program, which, according to the statute, will be reimbursed through a charge on investments.

6 Businesses with fewer than 25 employees may participate in the program if they so choose.

7 See "Most Small Employers Face Low Costs to Implement Automatic IRAs" (AARP Research Report, Washington, DC, 2009).

8 According to the Bureau of Labor Statistics, 24,388 establishments in Illinois have 20 to 49 employees. If 3 percent of those establishments still process payroll manually, then 732 employers in the entire state would face the choice of switching to in-house software or contracting with an outside provider.

9 The median hourly wage for a payroll and timekeeping clerk, not including benefits, was $18.59, according to data from the US Bureau of Labor Statistics. One of the leading payroll services costs $20 per month plus $2 per employee, according to its website. A 30-employee firm would pay $80 per month to have the payroll service process its payroll and file taxes, the equivalent of 4.3 hours per month of the payroll and timekeeping clerk's wages, or less than 2.2 hours per pay period for bimonthly checks. If the clerk spent more time than that, the employer would save money using the service.

10 The survey of 2,249 businesses was conducted in November 2010 by NACHA (previously, the National Clearing House Association). The results are available at http://www.slideshare.net/pmcadam/small-business-adoption-of-payroll-direct-deposit.

11 The statute requires the employer to make the deposits monthly or by the due date for income or unemployment insurance tax deposits.

12 Those programs are described in Internal Revenue Service (IRS) Publication 4587 (Rev. 12-2012). A payroll deduction IRA does not permit employer contributions, unlike most other employment-based retirement savings plans, which is why it is the program most similar to IL Secure Choice. For a comparison of payroll deduction IRAs with other small business retirement plan options, see IRS Publication 3998 (Rev. 12-2012).

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