

Comments on Voluntary Employee Retirement Accounts, SB 417

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The West Virginia Center on Budget and Policy is a non-partisan, non-profit research institute based in Charleston. Our primary mission is to focus on how policy decisions affect all West Virginians, especially low- and moderate-income families. Over the past two years, the Center has worked closely with AARP, the State's Treasurer's Office, and other stakeholders on developing a system of voluntary retirement accounts aimed at promoting pension coverage and retirement savings.

Millions of Americans and thousands of West Virginians are approaching retirement without the resources they need to make ends meet. According to the Federal Reserve, half of all households headed by adults near retirement age (55-59) had no more than \$15,000 in a 401(k) type account or IRA in 2004.ⁱ

Employer-sponsored pension plans play a critical role in supporting retirement security. However, over 300,000 West Virginia workers – more than half of the workforce – are not covered by a pension plan at work.ⁱⁱ The smaller the business, the less likely they are to offer a retirement plan. Nationally, about two-thirds of small businesses do not offer retirement plans to their employees.ⁱⁱⁱ This is unfortunate because small businesses tend to employ low and moderate-income workers who would benefit the most.

The state could help workers boost their retirement savings by sponsoring a program of Voluntary Employee Retirement Accounts (VERAs). The goal of the program would be to assure that all private-sector workers have a low-cost and simple way to save. The primary market for these accounts would be small businesses and their employees, self-employed persons, and other workers who don't have access to retirement plans at work.

The State Treasurer's Office could oversee the program and contract with a financial institution or eligible broker to administer it. The Treasurer's Office has a strong track record with two comparable programs – the SMART 529 college savings program and the Retirement Plus 457 deferred compensation program for public employees.

There would be no net cost to taxpayers for a West Virginia VERA program. It would cost \$3 million over a 3-year period to set up the program. This cost would be recouped over time through ongoing fees paid by those who participate. The State would not be responsible in the event of a market crash or other unexpected developments. The state does not guarantee savings, but provides the bridge between workers and IRS-approved private-sector retirement plans.

There are several reasons why state government has a role in a retirement system for workers at small businesses.

1. **VERAs address an unmet need.** In theory, any worker could open an IRA, but in reality only a handful do. In addition, less than a third of small businesses sponsor retirement plans. Barriers include high fees for the small investor and an overwhelming array of investment options. The financial services industry typically doesn't market retirement plans to small businesses due to the small profit made from accounts that do not accumulate large balances.
2. **Smaller businesses face higher costs.** The per person cost of sponsoring a retirement plan is much higher for small employers than larger ones. A study in *Pensions & Investments* found that firms with fewer than 100 employees paid twice the amount per worker in 401 (k) plan costs than firms with more than 1,000 employees.^{iv} This is because large businesses spread costs over a larger number of accounts, have more managerial resources, and can bargain for lower administrative fees. A recent survey by the Employee Benefit Research Institute found that 52 percent of small businesses indicated that they did not offer plans because of costs, administrative burdens, or concern about revenues.^v
3. **VERAs would give employees of small businesses higher retirement incomes.** West Virginia's Retirement Plus Program – the 457 deferred compensation program for state employees administered by the State Treasurer's Office – has an accumulated balance of \$76 million with over 8,200 participants.^{vi} These assets give the state enormous leverage to pool together small businesses and offer them a very affordable investment through increased participation and lower fees. For example, West Virginia's Retirement Plus program for state employees charges annual fees as low as 0.2 percent of held assets, which is less than one-sixth of the 1.32 percent fee charged by typical private-sector plans.^{vii} This difference adds up to a lot over time. For example, a worker who contributes \$1,000 for 35 years to a private plan with an annual fee of 1.32 percent will accumulate about \$54,928 by the time she retires (based on an annual rate of return of 3.8 percent). If the same worker had contributed \$1,000 annually for 35 years to a VERA system with an annual fee of 0.2 percent, she would have accumulated \$66,674, or more 21 percent more.^{viii}
4. **VERAs will be simple and portable.** Small business owners are usually more concerned about meeting payroll, providing health care to their workers, and trying to run their business than they are navigating the complex maze of retirement plan options. A VERA program would reduce complexity and make it easy for small businesses to enroll, give them an option for contributing to employee savings, and provide a low-cost way to

provide retirement benefits and retain workers. VERAs would also be portable, allowing workers to keep building assets, even when they change jobs.

5. Workers who retire without adequate savings will rely more heavily on public programs. For example, many low-income seniors qualify for basic assistance programs like food stamps and Medicaid (for health care costs not covered by Medicare). The situation will become even more critical as the population ages. With 15.4 percent of its population over the age of 65, West Virginia ranks third oldest, behind Florida and Pennsylvania.^{ix} By 2025, the U. S. Census Bureau projects that one in four state residents will be elderly.^x By tackling this problem now, the state will save money in the long run, as well as promote more stable and secure future for its seniors.

In the final analysis, this legislation will not only help small businesses and low- and middle-income workers save for retirement, but will also make the state a more attractive place to live, work, and do business.

ⁱ Brian Bucks, Arthur B. Kennickell, and Kevin B Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol.92 (February 2006), p. A1-A38 (available at <http://www.federalreserve.gov/PUBS/oss/oss2/2004/bull0206.pdf>)

ⁱⁱ Employee Benefit Research Institute Issue Brief No. 299, November 2006

ⁱⁱⁱ Craig Copeland, "Employment-Based Retirement Plan Participation: Geographical Differences and Trends, 2007," *EBRI Issue Brief* N0.322, October 2008

^{iv} WV State Treasurer's Office

Judy Markland, "The No-Growth in Pension Coverage Problem: Myths About the Role of 401(k) Plans," September 1996, <http://www.lmstrategies.com/p&i.html>

^v The 2003 Small Employer Retirement Survey was conducted by the Employee Benefit Research Institute, in coordination with the American Savings Education Council. 300 employers with 5-100 full-time employees were interviewed for the survey.

^{vi} Frank Picarelli, "State of West Virginia Retirement Plus Program: An analysis of Investment Performance Through September 2008," *Segal Advisors* November 2008

^{vii} "Study of 401(K) Plan Fees and Expenses," Department of Labor, Pension and Welfare Benefits Administration, April 13, 1998

^{ix} U.S. Census Bureau, American Community Survey, 2007

^x <http://www.censusbureau.biz/population/projections/state/9525rank/wvprsrel.txt>