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Government Mandated, State-Run Auto-IRAs Can Cause Real Harm

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A number of states have recently enacted employer mandates that force companies who don't offer retirement plans to enroll their workers in a state-run, auto-IRA plan. Oregon's program – known as OregonSaves – is the oldest and most established. By mid-2020, Oregon's mandate will cover all companies; it currently covers companies with twenty or more workers.

One myth – perpetuated by the National Employment Law Project – is that state mandates expand opportunity to retirement savings, especially for low-income workers. They don't. OregonSaves initially defaults worker contributions into a conservative capital preservation fund before redirecting contributions to a life-cycle fund once balances exceed $1,000. Since inception in 2004, the capital preservation fund has offered a paltry nominal return of 1.52% (essentially an inflation-adjusted return of 0%). OregonSaves also assesses an administrative fee of 100 basis points (that is, 1%) regardless of investment choices, further diminishing this return. This set-up isn't really an opportunity for Oregon workers, because they already have access to Roth IRAs and investments with a more beneficial set-up. A 25-year-old worker might actively choose a life cycle fund with no minimums for initial investment or additional contributions, along with administrative fees of 75 basis points, significantly lower than OregonSaves. Choosing an index fund that tracks the S&P 500 could have administrative fees as low as 1.5 basis points. Without mandating Oregon

employers to enroll their workers, OregonSaves would struggle to compete in a vibrant marketplace with many inexpensive alternatives for retirement contributions.

If government mandates don't improve access to retirement plans, why have the program? The real reason is that the programs increase participation through inertia; simply put, many workers are asleep at the wheel. Many workers don't take active steps to plan for retirement regardless of how a program is designed. If the default choice is to actively enroll, many workers won't participate. If the default choice is automatic enrollment with an opt-out option, many workers do participate. Oregon's 28% opt-out rate is relatively high, highlighting some of the problems of the program's design. Among those enrolled, fully 93% of participants stick with the specified contribution rate and an astonishing 79% of all fund balances are invested in the capital preservation fund. Almost all remaining balances are invested in target date funds, likely for workers who have exceeded the $1,000 contribution.

Worker inertia is real, meaning that design choices like opting in or out, asset classes and contribution rates are likely to stick. The one-size-fits-all design of OregonSaves can cause real harm for many workers, an issue I explored with my colleagues in a new study for Journal of Retirement. If OregonSaves were adopted nationally, 24.2 million workers aged 25-64 would initially be opted-in. Approximately 33% of affected workers carry high-interest credit card debt, with balances averaging nearly $5,500. Around 15% of affected workers struggle to meet basic needs like paying rent or utility bills. Workers in these situations come out ahead by paying down debt or meeting basic needs, and siphoning off 5% of their paycheck will likely worsen their overall financial situation.

Financial planning websites consistently emphasize paying off revolving high-interest debt before saving for retirement (unless a company offers a match rate), yet auto-IRAs fail to take these investment lessons into account. Advocates for government mandates emphasize the benefits of compounding for assets in an IRA, while curiously ignoring the reality that unpaid debt compounds in the exact same manner! At an 18% interest rate, an unpaid $5,500 credit card debt would mushroom to $28,800 in ten years. The same amount of money directed

towards OregonSaves might accumulate to $12,900 under rosy assumptions about investment returns. Ultimately, our study shows a significant number of workers are in situations like this, and auto-IRAs would do more harm than good for them.

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