



**Written Comments Submitted to the  
Ways & Means Committee  
State of Washington**

**By  
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on behalf of ASPPA**

**Hearing on SB 5791: An Act Relating to Creating the  
Washington Voluntary Retirement Accounts Program**

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Madame Chair and members of the Committee, thank you for this opportunity to testify on SB 5791. I am Yannis Koumantaros, a Director of Spectrum Pension Consultants, Inc. (Spectrum). Spectrum Pension Consultants, Inc. is a leading professional service firm that consults with businesses offering employer-sponsored retirement plan benefit programs to their organizations. Spectrum provides services to more than 450 retirement plans in the state of Washington with more than 9,400 participants. These plans hold more than \$620 million in assets for the benefit of these participants.

I also am speaking today on behalf of the American Society of Pension Professionals and Actuaries (ASPPA). ASPPA is a national organization of thousands of retirement plan professionals throughout the country who provide consulting and administrative services for qualified retirement plans covering millions of American workers, particularly those maintained by small businesses. ASPPA has about 87 members in the state of Washington.

We oppose SB 5791 because the bill is not likely to expand coverage, and may in fact do more harm than good.

**Other States That Examined State 401(k) Plans Rejected Them**

Like Washington, a number of other states have examined whether state administered 401(k) plans are a viable option to increase retirement coverage of their citizens. And every state has rejected such an approach.

The State of Maryland examined the viability of a state administered 401(k) plan and concluded that such a program would require significant long-term state expense and also

may be difficult to establish without federal legislative changes. A proposal currently being considered in California (AB 125) to authorize the state employees retirement system (CALPERS) to offer small business retirement plans was intentionally limited to plans exempt from ERISA – specifically payroll deduction IRAs and SIMPLE IRAs – because of concerns about potential cost and liability to the state.

Most recently, the Washington Department of Retirement Systems (the Department) issued a report (attached to this testimony), which examined three options for government administered retirement plans:

1. Private sector administered IRA or payroll deduction IRA offering a state specified low-cost, low-risk single choice inflation-protected simple investment.
2. Private sector administered IRA or payroll deduction IRA offering a state specified low-cost, low-risk single choice inflation-protected life-cycle investment.
3. State administered 401(k) plan.

The Department rejected the state administered 401(k) option and instead recommended the first option, the private sector administered IRA or payroll deduction IRA. The Department chose this option because it is simple for individuals and employers, it assists the private sector in marketing to a segment of the population that they have had difficulty reaching, it maintains private sector administration of private sector retirement savings plans, and it provides a low-cost, consumer-oriented option for people left out of savings plans.

In their analysis, the Department noted a number of disadvantages to the state administered 401(k) option. For example, they concluded it would increase liability/risk for the state and employers; it would require IRS approval prior to implementation and is subject to various federal requirements, such as annual testing and audits and employees would only have the option to participate if the employer chooses to start a plan.

Another important consideration the Department examined in making its recommendation is the cost associated with implementing and maintaining the 401(k) plan option. The Department estimated that the cost to the state would be an initial start-up cost of \$3.4 million over two years – and then on-going costs of \$2 million per year. This was by far the most expensive of the three options for the state.

We recommend that the Committee follow the recommendations of the Washington Department of Retirement Systems and reject state administered 401(k) plans.

### **Cost of ERISA Compliance Cannot be Avoided**

Some have suggested that a state sponsored retirement plan would reduce fees, provide incentives for small businesses to locate and grow in Washington, and would simplify the regulatory paperwork for administering retirement plans. The reality is very different.

There would be little, if any, cost savings under a state-sponsored 401(k) plan. A state-sponsored 401(k) plan for small business would be much more expensive to administer than the state's defined contribution plans. There are practical reasons any business

person should understand – like the additional cost of collecting payroll information and contributions from hundreds of small employers instead of from established governmental payroll systems. But more importantly, 401(k) plans are subject to different, far more detailed, federal rules than defined contribution plans for state employees.

ERISA, the labor law that protects employees' rights to benefits, does not apply to plans for state and local government employees – but it does apply to small employer and private not for profit retirement plans. The ERISA rules, and Internal Revenue Code non-discrimination requirements, are designed to protect rank and file workers. These rules are important – they are also complicated and time consuming.

It is critical to understand that each and every private business is required to adopt a plan, and perform required testing, as a single employer. This requirement creates a long list of responsibilities for the service provider for each plan. One of the first steps can be among the most complicated – determining if the employer is a stand-alone business, or part of a controlled group or affiliated service group. This means the state would have to request ownership information from the employer – not just ownership in the small business, but what other businesses the owners own in case the small business needs to be combined with other businesses for testing under controlled group or affiliated service rules. Once the administrator has determined what constitutes the employer for purposes of retirement plan coverage and discrimination testing purposes, the administrative tasks can begin. These tasks include (1) gathering payroll data from multiple sources; (2) determining if the data is complete, and if the right elements of pay have been included or excluded; (3) reviewing reported hours worked for reasonableness, and use the information to adjust vesting and determine which employees must be included in testing and contribution allocations; (4) determining key employees and HCE's; (5) completing discrimination and top heavy testing and retesting; (6) determining and processing refunds to correct any failed testing; (7) allocating employer contributions according to the plan's formula and (8) completing required federal filings and notices. Other services that must be provided on an ongoing basis include administering loans and defaults on loans; distribution processing; document processing and amendments; and compliance with federally mandated ERISA requirements such as providing communication, website, and educational materials necessary to fulfill its fiduciary duty to small business and the workers.

In addition, the state of Washington would become a fiduciary on all plans that are covered by their program because the state of Washington would be selecting the investments and recordkeeper. This is a huge liability that the state can ill afford! The state would need to obtain fiduciary insurance covering exposure to all of the retirement plans. All plans also would need fidelity coverage and the state, as a co-fiduciary, also may need coverage for the potential theft from employers for transactions that the state does not control.

We should note that SB 5791 attempts to relieve the state of fiduciary liability. However, ERISA preempts state law and therefore, it is unlikely that this language will be effective in limiting fiduciary liability under ERISA.

There is no easy way around the rules and there should not be – the rules are designed to protect rank and file employees. There also is no magic that will allow the state of Washington to administer hundreds of plans more efficiently than businesses that have been doing the work for years.

In the private pension system today, plan advisors – actuaries, administrators, accountants and attorneys -- help employers choose the plan that is best for that small business and its workers, and operate the plan in accordance with federal law and regulations. Is the state ready to bear this burden for each and every plan and worker? Who will represent the small business if the IRS or DOL audits their plan? And will the state recover these expenses from program assets, i.e. workers, as well? These are just a few real downsides faced by private service providers every day – and the state would bear the same burden. The state will not be able to eliminate its responsibility for the risk of non-compliance by contracting with a third party. Simply put, compliance with ERISA has a cost and there is no way around it.

### **Low-Cost Retirement Plans for Small Employers Exist in the Market Place**

SB 5791 is based on a number of false assumptions, including that small employers do not set up retirement plans because there are no low-cost options available in the marketplace. However, the good news is that low-cost retirement plans for small employers exist in the market place right now. For example, Congress created SIMPLE IRA plans, which are exempt from ERISA and thus have minimal administrative costs, for small employers that do not want the cost or responsibility of a full blown 401(k) plan.

In preparation for this testimony, we checked on fees available in Washington for SIMPLE IRA plans. We found a small employer can pay \$10 per employee to set up a SIMPLE plan and \$10 per person per year for administration – hardly burdensome out-of-pocket costs for the employer. Congress also wanted to help employers set up more flexible plans, like 401(k) plans. If an employer has not sponsored a plan for the past three years, the federal government will actually pay part of the first three years of administrative costs through a tax credit of up to \$500 per year.

Currently the average state plan costs are in line with private sector plans. In fact, the low cost funds available in the state run plans are available to other institutional investors, including private retirement plans.

Furthermore, according to the Small Employer Retirement Survey conducted by the non-partisan Employee Benefits Research Institute (EBRI), small employers mentioned a number of reasons for not offering a retirement plan – but only 16 percent of small employers cited that it costs too much to set up and administer.<sup>1</sup> The great majority of small employers – or 83 percent – named other reasons for not sponsoring a plan besides

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<sup>1</sup> Employee Benefit Research Institute, “Small Employer Retirement Survey: Small Employers Without Plans,” 2003.

cost, including uncertain revenue, employees not interested and too much goes to short-term employees.

If an employer doesn't want to set up a retirement plan, it is generally either because the employer is not educated about available options, or the employer does not want to commit to making contributions for employees each year. SB 5791 doesn't address either problem.

### **IRA and SIMPLE IRA Contribution Limits Sufficient for Most Washington Residents to Save for Retirement**

One of the arguments made in support of state sponsored 401(k) plans – as opposed to, for example, SIMPLE IRAs which are already available to Washington businesses at a low cost – is the higher contribution limits. In 2009, employees can defer up to \$16,500 to a 401(k) plan. The limit is slightly lower for SIMPLE IRAs where you can contribute \$11,500 in 2009. The traditional IRA contribution limit is \$5,000 for 2009.

However, most employees don't contribute even close to the 401(k) limit – and on average, contribute significantly less than either the SIMPLE IRA or traditional IRA limits. In 2006, the average annual employee contribution to a defined contribution plan was \$3,720.<sup>2</sup> For a 45 year old, that's \$12,780 less than the 401(k) limit and \$7,780 below the SIMPLE IRA limit. This is even \$1,280 below the traditional IRA limit. And in 2006, the median annual employee contribution to a defined contribution plan was \$2,100 – clearly well below all three limits as well.

Therefore, the higher contribution limits of a 401(k) plan are not justification for leading the state of Washington into an arrangement that will bring the state more risk, liability and cost than IRA-based arrangements. If the state of Washington feels compelled to do something to help those not covered by an employer-sponsored retirement plan to save for retirement, we encourage you to consider a payroll deduction IRA proposal, as recommended in the Department of Retirement System's study. As demonstrated above, the contribution limits for IRAs should be more than sufficient for new Washington savers. And by avoiding ERISA-covered plans, this approach would be substantially less administratively burdensome and costly for the state.

### **Washington Should Not Compete with its Own Private Businesses**

The state of Washington should not compete with its own private businesses unless there is a market failure. State governments should only step in private markets if there is an inherent unfairness which disadvantages its citizens.

In Washington, the marketplace for 401(k) plans and other pension vehicles is robust and highly competitive. Dozens of Washington private service providers compete in this market and create jobs and pay taxes. SB 5791 would allow the state to compete directly

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<sup>2</sup> Purcell, Patrick, Congressional Research Service, "Retirement Plan Participation and Contributions: Trends from 1998 to 2006," January 30, 2009.

with private service providers even though small businesses already have many options to provide pension plans, along with multiple opportunities to avoid or limit costs.

But even more egregiously, by adopting this legislation, the state of Washington would be denigrating its own business base. Essentially by this action, Washington would be telling the out-of-state clients of the state's private service providers that the state of Washington does not trust Washington companies to provide these services to its own businesses.

## **Summary**

SB 5791 is a well-intentioned, but very bad idea. The state's creation of a voluntary retirement accounts program will only cause harm to the very system it would be trying to help. The effort would be better spent on educating employers about existing options, or giving employers a tax credit to help make the contributions that are the real roadblock to establishing a plan. The Committee should oppose SB 5791 in its current form.

Although we thoroughly support the objective of expanding small business retirement plan coverage, we strongly believe, as discussed above, that the approach taken by SB 5791 is misguided. We would welcome the opportunity to work with the Committee, as well as the rest of the Washington legislature, to develop effective approaches to enable Washington citizens to achieve a secure retirement. We appreciate the Committee's time on this important issue.