Administrative Costs of State Run Defined Benefit Plans

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In response to studies showing inadequate retirement savings by workers, some states are considering legislation that would require private employers who don't already offer a retirement plan to automatically enroll employees into a retirement program. In evaluating the merits of these proposals, it is important to consider the administrative requirements and costs of these efforts.

QUALIFICATION REQUIREMENTS

The Employee Retirement and Insurance Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) contain requirements that apply to retirement plan arrangements of private employers. ERISA requirements apply to all plans. IRC requirements must be met in order for the program to be "qualified," which allows investment earnings and employer contributions to be tax-deferred. These laws and regulations try to ensure retirement programs are adequately funded and attempt to prevent abuses such as shady investments or employers only providing benefits to the most highly compensated employees.

Retirement programs fall into two main categories: Defined Benefit (DB) plans and Defined Contribution (DC) plans. DB plans typically provide a monthly benefit at retirement, usually based upon the compensation and years of service of the employee. DC plans typically provide a lump sum benefit equal to the accumulated value of contributions made on behalf of the employee.

Plan qualification requirements differ between DB and DC plans. For example, defined benefit plans must pay annual premiums to the Pension Benefit Guaranty Corporation (PBGC), a federal government agency that guarantees benefits provided by defined benefit plans. Defined benefit plans are also required to have an actuarial valuation done each year to determine the appropriate funding amount.

Defined contribution plans are not covered by the PBGC, do not need to pay premiums to the PBGC, and do not require actuarial valuations.

ADMINISTRATION

Administrative requirements that apply to retirement plans sponsored by private employers include the following:

- Plan document drafting
- Summary Plan Descriptions
- Periodic amendments to maintain compliance with federal laws and regulations
- Annual auditor report (if 100+ eligible)
- Periodic benefit statements
- Record-keeping
- Investment oversight
- Trust accounting
- Nondiscrimination testing
- Benefit processing

In addition, the following items apply to defined benefit retirement plans sponsored by private employers:

- Annual actuarial valuation
- Annual PBGC premium filing
- Annual funding notices

A retirement program with multiple employers may be able to reduce the administrative burden by qualifying as a multiple employer plan. However, a recent ruling from the Department of Labor (DOL 2012-04A) states that a multiple employer plan that consists of unrelated employers "does not constitute a single multiple employer plan for purposes of ERISA, but rather an arrangement under which each participating employer establishes and maintains a separate employee benefit plan for the benefit of its own employees."

This distinction is important. If a state run retirement program is a collection of single employer plans, annual government filings will be required for each participating employer. In addition, if the state run retirement program is a defined benefit plan, the funding of the program will require individual actuarial valuations for each private employer *(IRC Section 413(c)(4)(A))*.

EMPLOYERS WITHOUT RETIREMENT PLANS

The number of private employers that would be subject to a mandatory state run retirement program could be quite large. This is because small employers are much less likely to offer a retirement plan than large employers (Figure 1). And there are a lot more small employers than large employers (Figure 2 for California Businesses).

Figure 1
Percentage of Workers Whose Employer Does Not Sponsor Retirement Plan

Size of Employer (# of employees)	% Without Retirement Plan
Less than 10	82.4%
10-49	67.5%
50-99	54.9%
100-499	43.3%
500-999	40.0%
1000 +	31.1%

Source: *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010 by Craig Copeland, Employee Benefit Research Institute*

Figure 2
California Businesses With at Least 5 Employees

Number of Employees	California Businesses
5-10	150,566
10-49	182,613
50-99	29,706
100-499	19,204
500-999	1,444
1000 +	865
Total	384,398

Source: *California Employment Development Department, Labor Market Information Division for Third Quarter, 2010*

Combining the results in Figure 1 and 2 produces an estimate of 272, 801 employers in California that do not offer a retirement plan (Figure 3).

Figure 3
Estimated Number of California Businesses Without a Retirement Plan

Number of Employees	CA Businesses w/o Retirement Plan
5-10	124,066
10-49	123,264
50-99	16,309
100-499	8,315
500-999	578
1000 +	269
Total	272,801

ESTIMATED ADMINISTRATIVE COSTS

Administrative costs for retirement plans generally fall into two categories: fixed costs that apply regardless of plan size and variable costs based upon the number of plan participants. Fixed costs include such things as the drafting of a plan document detailing the terms and conditions of the plan, and annual government filings. Variable costs include such things as record-keeping and the payment of PBGC premiums for defined benefit plans.

Administrative costs vary greatly among retirement plans depending upon whether it is a DB or DC design, the complexity of the plan, and the extent of any customization. A state run plan could be designed to minimize complexity and could require that the same plan provisions apply to all employers. Still, it is unlikely that the fixed costs for a state run DB plan could be less than $500 per employer per year, plus an additional amount based upon the number of participants.

In California, the administrative costs for CalPERS, which covers about 1.6 million state and local government members is about $350 million per year, or $218 per member. The administrative costs for CalSTRS, which covers about 850,000 teachers is about $110 million per year, or $129 per member. CalPERS and CalSTRS are both governmental plans exempt from PBGC premiums and many of the requirements of ERISA and the IRC.

Based upon the above, a low estimate of the per participant administrative cost for a state run DB plan for private employers is $100 per participant, plus PBGC premiums. However, the administrative costs could easily exceed this amount since DB plans for private employers are subject to additional ERISA and IRC requirements that don't apply to governmental employers.

PBGC premiums for DB plans are currently $35 per participant per year, plus an additional amount for underfunded plans. The $35 per participant premium is scheduled to increase to $49 per participant in 2014.

Using these assumptions, the estimated administrative costs for a state run DB plan in California consisting of 200,000 employers and 5,000,000 participants could be $775,000,000 or more (Figure 4).

Figure 4
Estimated Annual Administrative Costs of State Run DB Retirement Plan

Fixed cost per employer	$500
Employers	x 200,000
Fixed costs	$100,000,000
Administrative and PBGC costs	$135
Participants	x 5,000,000
Variable costs	$675,000,000
Estimated annual administrative costs	$775,000,000

Assumptions:
(1) Multiple employer defined benefit plan subject to individual employer funding calculations pursuant to IRC 413(c)(4)(A)
(2) Fixed costs of $500/yr per employer
(3) Administrative costs of $100/yr per participant
(4) PBGC premiums of $35/yr per participant

IN SUMMARY

While a state run defined benefit plan for private employers may help increase the retirement income for workers of private employers, the administrative costs of a defined benefit program will be substantial, due to the laws and regulations that apply to retirement plans of private employers.

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