Colorado Secure Savings: Initial Design Considerations

There are several design considerations the Colorado Secure Savings Board must address prior to publishing Requests for Proposals for program administration and investment management services as well as formal rulemaking. These high level design choices will provide clarity, and create stable expectations for accurate pricing and break even analysis for potential vendors and Program staff alike.

Items that require immediate action include:

- Default Contribution Auto-escalation Rates
- Enrollment Phases
- Core Investment Options

This memo will provide context, considerations, and recommendations for default contribution and auto-escalation rates, enrollment waves, and default investment options and structure.

Contribution Rate Auto Escalation

Context:

Statute dictates that the default contribution rate must be five percent for automatically enrolled participants. Beyond the five percent default contribution rate, the Board has the option of determining automatic escalation rates and frequency, as well as flexible participant contribution elections that may be less than five percent. This section will focus on, and provide recommendations for automatic escalation rates and frequency in alignment with statutory requirements. Flexible contribution elections will be addressed directly in rules.

Current state practices for default contribution and automatic escalation are as follows:

	California (CalSavers)	Illinois (Illinois Secure Choice)	Oregon (OregonSaves)
Default Contribution*	5%	5%	5%
Automatic Escalation	1% up to 8%	Participant may elect, but must be increased by no less than 1%	1% up to 10%
Frequency	Annually	Participant Choice	Annually

*Each state allows participants to elect to contribute as little as 1% and up to 100% of wages provided they adhere to Roth IRA annual contribution limits.

Considerations:

The default contribution rate, in addition to the automatic escalation design, has a significant role in determining the Program's timeline to self-sufficiency. This is critical for both the state and any vendors services procured, as startup funds invested are estimated to be significant.[1]

Additionally, small increases in participant contribution have a consequential impact over time on the growth of savings. Consequently, increases in participant savings over time have a multiplier effect on their future financial health. For example, a $15/hour employee ($31,200/year) will have an annual difference of nearly $1000 contributed to savings at an 8% contribution rate versus 5%. For a 30-year-old individual, the savings difference between the two rates amounts to roughly $120,000 over their working lifetime.[2]

While Oregon has opted for an annual automatic escalation up to 10%, continued increases in cost of living throughout Colorado may give program participants second thoughts about contributing a full 10% of their salary to retirement savings. Conversely, California's utilization of automatic escalation annually up to eight percent is significant for retirement savings, but may not prove detrimental to savers from a month to month budgeting perspective to individuals and their families. Illinois leaves escalation up to individual participants. Based on the study board reports, it is unlikely that many participants will choose to increase contributions.

Recommendation:

Based on this analysis, the Board should consider approving a default automatic escalation policy that increases from the five percent default contribution at an interval of one percent every year for participants. Automatic escalation should be capped at eight percent.

Enrollment Waves:

Context:

CSSP is tasked with enrolling an estimated 21,000 employers with over 900,000 workers throughout the state into a retirement program. Consequently, the Board must develop an enrollment strategy that takes into consideration rapid program scaling, quality control, and accessibility.

Statute provides the Board with flexibility to explore multiple avenues for employer enrollment. Additionally, the experience of our state partners can also inform our strategy. Specifically, of the three states with a program, two have eligibility criteria that roughly aligns with Colorado law (five or more employees, in business for two or more years).

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[1] Details on estimated investment in startup costs and their relationship to program revenue can be found in the Boston College reports prepared for the study board.

[2] Based on projections assuming stable contributions monthly, and assumes contribution cap is not reached on an annual basis. Variation in wages, contributions, or market conditions are not taken into account.

States have used the following enrollment strategies thus far:

	California (CalSavers)	Illinois* (Illinois Secure Choice)	Oregon** (OregonSaves)
# of Phases	3	3	6
Employer Size (by # of employees)	Phase 1: 100+ Phase 2: 50+ Phase 3: 5+	Phase 1: 500+ Phase 2: 100 – 499 Phase 3: 25 - 99	Phase 1: 100+ Phase 2: 50-99 Phase 3: 20-49 Phase 4: 10-19 Phase 5: 5-9 Phase 6: 4 or fewer
Interval	1 year in between phases beginning June 2020	Phase 1: Nov. 2018 Phase 2: July 2019 Phase 3: Nov. 2019	Phase 1: Nov. 2017 Phase 2: May 2018 Phase 3: Dec. 2018 Phase 4: May 2019 Phase 5: Nov. 2019 Phase 6: Jan. 2021

*Employer eligibility in Illinois was limited to employers with 25+ employees until 2021
**Employers of all sizes are required to participate in Oregon

Considerations:

As with all the design elements discussed in this memo, the enrollment waves will have an impact on the revenue projections for the program. Waves separated by longer intervals will slow enrollment and participant savings.

Moreover, a higher number of enrollment waves adds complexity for employers and program administrators alike. However, segmenting eligible employers by firm employment size is necessary to ensure an even rollout of the program, and a manageable method for scaling once a successful pilot has been completed.

Finally, it should be noted that employers and employees that are not subject to the state mandate may also wish to participate. The Board should be aware of that participation may include employers and individuals not subject to the state mandate. Accordingly, it will be necessary to create an enrollment structure to accommodate employers and employees not subject to the mandate, however, this should not be done at the expense of priority employer and employee populations. This segment should be addressed more formally in the Program's regulations.

Recommendation:

Based on the available information from the three states with operating programs, as well as the lessons learned during their implementation, Colorado should consider three enrollment waves spaced no more than six months apart. Additionally, it is recommended that enrollment phases mirror California's firm size segmentation (i.e. wave one - 100+ employees, wave 2 – 50+ employees, and wave 3 – 5+ employees). Consequently, program implementation would occur in three waves over the course of a year and a half.

Default Investment Options & Structure

Context:

As the Board drafts its investment policy statement, it is important that it also provides clear guidance on the core investment menu to guide the next round of RFPs.

Statute requires the Board to provide participants with the following investment options[3]:

-A low-risk investment portfolio;

-Target date funds; and

-Other investment funds as determined by the board

[3] CRS 24-54.3-104(2)(d)(I-III)

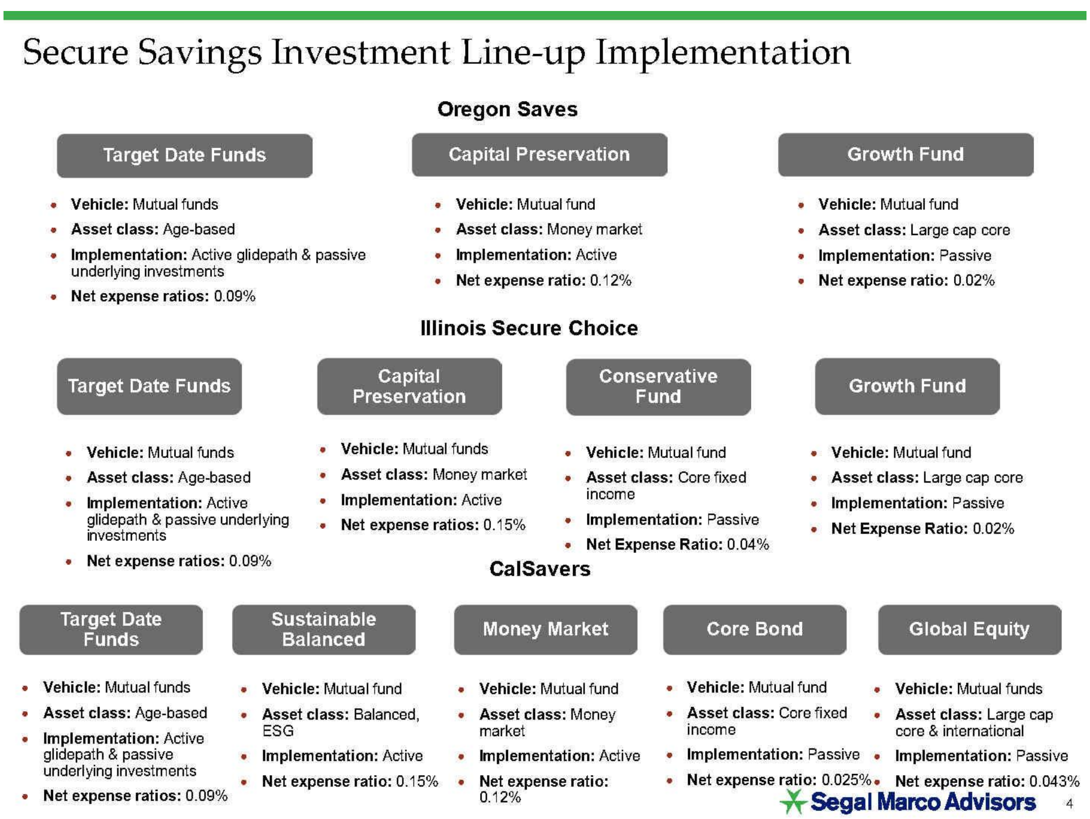
Additionally, the Board is required to minimize fees associated with the program. Specifically, the program may not exceed 100 basis points in aggregate fees for the first five years of the program, and may not exceed 75 basis points from year six on.

While the specific investment vehicles and asset classes will be formalized in the investment policy statement, the RFP requires general guidance for potential bidding firms.

Two items require clarification:

1. Default IRA structure: Simply, the Board must determine whether participants will default into a Roth or traditional IRA. All states who have implemented a program utilize Roth IRAs as the default account structure for program participants. Roth IRAs are preferred for a number of reasons including their tax implications and lack of early withdrawal penalties for participants, as well as administrative ease for Program staff and recordkeeping services.

2. Core Investment Options: The formal investment options will be clearly articulated and formalized in the investment policy statement, however, general guidance on the asset classes and investment vehicles are needed for our RFPs. Other state programs have structured investments in the following ways:



Source: Segal Marco Advisors, "Colorado Secure Savings Program: Investment Structure Discussion," August 2021

Considerations:

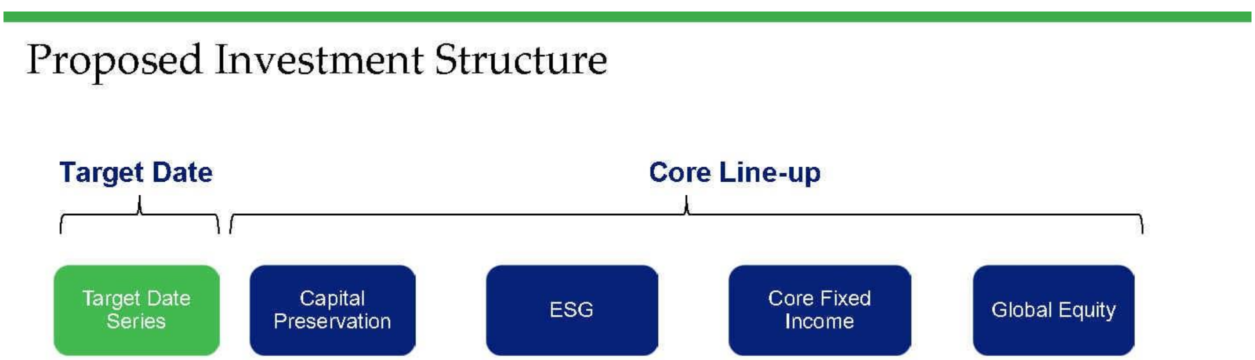
The potential investment structure provides the Board with flexibility in some areas, and constraints in others. Constraints include statutory requirements that include a low-risk portfolio, target date funds, and fee caps, meaning the Board must include a target date series and will mostly likely need to emphasize passively managed asset classes to remain within the fee cap. Beyond the statutory requirements, the Board may choose any other investment options to offer participants, provided risk is adequately managed, and the asset class is a permissible investment vehicle in the context of IRA accounts.

Recommendations:

For the purposes of producing general guidance for the next round of procurement, the Board need only make determinations on the high level investment structure available to program participants. As such, it is recommended that the Board approve an investment structure that aligns with recommendations presented by Segal Marco Advisors at the August 16 meeting.

First, the Board should confirm that Roth IRAs are the default account structure.

Second, the Board should confirm the broader investment structure recommended by the investment consulting team. The general recommendations are as follows:



Source: Segal Marco Advisors, "Colorado Secure Savings Program: Investment Structure Discussion," August 2021

Specifically, the Board should approve recommendations to incorporate a target date series, capital preservation, ESG, core fixed income, and global equity options into the investment structure.[4]

[4] It is important to emphasize that while the Board will be clarifying the general structure, the specifics of the investment menu will be discussed in greater detail in the Program's investment policy statement. The investment policy statement is not required for a successful procurement process