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What Mandatory Auto-Enrollment IRAs Actually Mean

'As an added incentive, the proposal would subsidize retirement savings through a refundable Savers Credit at tax time'



by [Israel Goldowitz, Jon Schultze and Mark Greenstein](#) · October 6, 2021 · ⌚ 4 minute read



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All eyes are on Congress as it wrestles with a \$1 trillion infrastructure bill and a \$3.5 trillion budget reconciliation bill. The House Ways and Means Committee markup of the reconciliation bill would require certain employers with five or more employees to automatically enroll employees in a payroll deduction IRA. This requirement would take effect on January 1, 2023.

The proposal could help reduce poverty in old age. While more than 90% of employers with 100 or more employees offer a retirement plan, fewer than half of those with under 100 employees do. And one-third of all workers retire with no retirement savings. The proposal could also help sustain the economy, as retirees generally spend their distributions on necessities purchased locally.

Under current law, an employer may provide a 401(k), an annuity plan, a SEP, or a SIMPLE IRA, among other options. Under the proposal, existing plans would not be subject to the new requirements, and an employer that currently offers no plan would be required to offer an IRA as the default choice.

An employee who is at least 21 years old and has at least one year of service or has worked at least 500 hours in two consecutive 12-month periods would be automatically enrolled for payroll deductions of up to 6% of pay. That percentage would increase by one percentage point per year until it reaches 10%.

The IRA limit, currently \$6000, or \$7000 if the employee is over age 50, would apply. After-tax Roth IRAs are expected to be the default choice.

An employee could choose to contribute a lower percentage or opt-out entirely. But the auto-enrollment and auto-escalation features would harness behavioral economics, to “nudge” employees to save for retirement. One study shows that employees are more than ten times more likely to save if they must opt out rather than opt in.

As an added incentive, the proposal would subsidize retirement savings through a refundable Savers Credit at tax time. With the credit, the federal government would pay a fifty-percent matching contribution to the IRA of up to \$1,000 and no less than \$100.

Proponents estimate that the proposal would add 62 million retirement savers and an unprecedented \$7 trillion in retirement savings over ten years.

Under the Ways and Means proposal, the employer could select the IRA provider or could allow each employee to make a selection. Investment offerings would need to include a target-date fund, a balanced fund, and a capital-preservation fund, and others that the Treasury Department may prescribe.

If an employee's account balance exceeds \$200,000, a lifetime income option would need to be offered for half the balance. This feature would be exempt from the Internal Revenue Code's rules against discrimination in favor of the highly compensated.

Though no employer match would be required, employers are justifiably concerned about costs. Small employers lack economies of scale, so start-up and ongoing costs of even a payroll-deduction IRA arrangement can be disproportionately high. To ameliorate this concern, an employer would get a \$500 tax credit for setting up such an arrangement.

An employer could obtain Treasury Department certification of its arrangement. An employer that fails to set up a qualifying arrangement would be subject to a penalty of \$10 per day per employee for up to three months. The penalty for unintentional failures would be capped at \$500,000. The Treasury Department would publish information to assist employers in obtaining certification.

State retirement savings platforms with an auto-enrollment feature, such as CalSavers and similar programs in Connecticut, Illinois, Maryland, and Oregon, would be treated as qualifying plans. (In July, the Ninth Circuit upheld CalSavers on the grounds that it is not an ERISA “plan” and therefore is not preempted by ERISA.)

The proposal would create opportunities and challenges for investment managers, third-party administrators, and others who serve employee benefit plans.

Questions, questions ...

The proposal also raises a number of technical questions under ERISA and the Internal Revenue Code. For example:

- How would small employers effectively carry out their obligations to prudently select and monitor service providers? For example, should

there be a safe harbor for use of providers on a Treasury Department-approved list?

- How would the proposal's requirement that employers auto-enroll employees who have worked at least 500 hours in two consecutive 12-month periods square with the Internal Revenue Code's existing requirement that 401(k) plans allow part-time employees who have worked at least 500 hours in *three* consecutive 12-month periods to make salary deferral contributions?
- Would every new 401(k) plan need to include auto-enrollment and auto-escalation provisions? Will this discourage employers from adopting 401(k) plans due to the added complexity and potential for errors?

Of course, it is too early to predict passage. The reconciliation bill requires only 50 votes in the Senate, and at this writing, Democrats are divided on how much to spend and what to spend it on. The budget estimate for the Ways and Means proposal is \$47 billion.

The SECURE Act 2.0 also has an auto-enrollment provision, though it would not be mandatory for employers. SECURE 2.0 would also allow employer matching contributions to defray employees' payment of student debt. Congressman Richard Neal, Chairman of Ways and Means, has said that he also expects SECURE 2.0 to pass.

Beyond that, auto-enrollment IRA proposals raise fundamental questions about the future of retirement savings. When employees become retirement savers, will they eventually demand 401(k)s, employer matching contributions,

or variable benefit, cash balance, or even traditional defined benefit plans? Or will auto-IRAs crowd out other models?

Economic inequality is a defining issue. The retirement savings gap is an important aspect of that issue. Initiatives to broaden retirement coverage can only help sustain support for our current system. Therefore, it is important to watch what Congress does in the retirement space.

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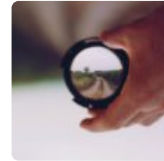
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The role of third-party ESG ratings providers in the fund selection process

While ratings can be a helpful tool to identify and understand potential ESG risks and opportunities, we believe they should be just one of several

tools used to implement ESG investing.

by **MFS** · October 6, 2021 · ⌚ 3 minute read

In recent years environmental, social and governance (ESG) ratings providers proliferated, including a mix of firms both familiar and new, such as MSCI, Morningstar, Refinitiv, Bloomberg and FTSE. ESG ratings

Article Presented By:

providers are an increasingly prevalent input for ESG investing, with recent studies showing that the portion of invested assets that rely on ESG ratings has increased by 34% since 2016.¹ Additionally, in the first quarter of 2021, ESG designated funds, many of which construct their portfolios based on third-party ESG ratings, experienced record inflows.²

Methodology differences from one ESG ratings provider to the next creates challenges for advisors and investors who use these ratings to achieve financial return and manage risk.

What's in a rating?

While most ESG ratings providers generally employ a single-score approach (*i.e.*, assigning a security or fund with a rating) the methodology by which this score is determined varies. Consider the following:

- ESG investing often involves considering risks or opportunities that are intangible and difficult to measure (*e.g.*, how a company treats its workforce).
- Standardized data is more challenging to obtain as it relates to E, S and G factors compared to traditional financial metrics. Providers may use different data sources as inputs into their rating, which can result in varying outlooks for a company across ratings providers.
- One ratings provider may place more emphasis on one E, S or G factor compared to other providers.
- ESG ratings are often backward-looking and some may not consider recent progress a company has achieved to improve its ESG profile.

The above factors, among others, make it challenging to accurately use the one-size-fits-all approach most ESG ratings providers employ when evaluating securities or funds. As a result, many ESG ratings providers disagree with each other on their views of certain companies.

The methodology differences among ESG ratings providers create challenges for advisors and investors who use ESG ratings to achieve financial return and manage risk. While the term “rating,” as it is typically used in financial services, connotes an objective and fact-based view, the dispersion in ESG ratings providers demonstrates that this is not necessarily the case when it comes to ESG investing. Understanding how investment managers may use third-party ESG ratings when making investment decisions is an important consideration for advisors and investors. Furthermore, it is a good practice for advisors evaluating ESG investments to familiarize themselves with the methodologies employed by the various ESG ratings providers to help clients make educated decisions to meet their sustainability-related goals.

Advisors can play an important role in helping investors understand what an ESG rating captures, as well as what it might be missing.

Moving beyond ESG ratings

Because ESG ratings from third-party providers have inherent limitations and biases, it is important for advisors to have additional inputs in evaluating an

investment manager's approach to incorporating ESG factors in the investment decision making process.

What does MFS think?

Ratings can be a helpful tool for advisors and investors to identify and understand potential ESG risks and opportunities. That said, MFS believes that ratings should be just one of several tools used to implement ESG investing.

As ESG investing continues to grow in assets and popularity, as we believe it will, advisors can play an important role in helping clients understand what an ESG rating captures, as well as what it might be missing. It is crucial for advisors to develop their own processes for evaluating investment managers' approaches to ESG investing, which can include third-party ESG ratings among other qualitative inputs. We believe this holistic approach to evaluating ESG investments can be another way advisors demonstrate their value to clients.

Endnotes

¹ Source: Berg, Florian and Kölbel, Julian and Rigobon, Roberto, Aggregate Confusion: The Divergence of ESG Ratings (May 17, 2020). Available at SSRN: <https://ssrn.com/abstract=3438533>, or <http://dx.doi.org/10.2139/ssrn.3438533>.

² Source: Morningstar, Reuters <https://www.reuters.com/business/sustainable-business/sustainable-fund-inflows-hit-record-high-q1-morningstar-2021-04-30/>.

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