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Small Employers' Economics of Offering Retirement Savings Plans

Financial and administrative considerations prevent widespread adoption of retirement benefits

Whether an employer provides its employees access to retirement savings hinges on the employer's willingness or ability to sponsor a retirement plan. That's especially true for small-business employers, usually defined as employers with 100 employees or fewer. These employers generally believe that providing retirement plans will help them attract and retain talented workers, but more than 40% of small-business employers don't offer retirement benefits, in part because offering a plan costs employers money and often involves consulting with financial professionals to administer and manage plan investments. And retirement plans can involve risk for employees as well: High plan fees can cut into the employee's account balance at retirement, while costly or inappropriate investment choices can reduce returns and limit overall savings.

This report—based on Pew research[1] and financial industry and U.S. government publications—explores the various costs facing small-business employers who want to offer retirement savings plans to their workers. Among the key findings:

- Small employers who offer retirement plans to their employees do so for a number of reasons, including wanting to hire and retain workers and to help their workers improve their financial picture.
- But the costs associated with managing workplace savings plans may pose a burden that some employers are unable or unwilling to shoulder.
- Small-business employers generally incur higher fees for sponsoring a retirement plan than do larger firms, which tend to have lower fees because they can spread their fixed costs over more participants and a larger asset base.
    - Plans with more assets under management generally have lower costs than comparable plans with fewer assets under management—if many costs are relatively fixed but are spread over fewer employees and all other factors are equal.
    - Larger employers, which can often afford to have a dedicated benefits staff, may be more sophisticated than smaller employers about searching for and implementing lower-cost retirement savings plans. And larger employers may face a greater likelihood of being the target of fee-related lawsuits, which gives them a further incentive to seek out reasonably priced plans.
    - Smaller plans have less bargaining power with providers than larger plans because they offer fewer investment assets for management.
- But small businesses often overestimate the financial costs and administrative burdens of offering a plan. While cost-effective retirement plans are available in the marketplace, small employers are often not aware of less expensive providers or options such as Savings Incentive Match Plan for Employees (SIMPLE) plans.
- Employers have a range of solutions to reduce costs and thereby boost retirement security for their workers, including new state-facilitated automated savings programs; federal tax incentives; and plans designed specifically for the small employer.
- For its part, the federal government should increase transparency of fees and, though education and marketing, promote awareness of these solutions.
- The costs associated with sponsoring a retirement plan have different components, and many types of fees can be paid by either the employer or the participant.

The small employer plan universe

The U.S. Bureau of Labor Statistics reports that 57% of private-sector firms with fewer than 100 workers offered a retirement benefit plan as of 2023, while 86% of companies with 100 or more workers—and 91% of firms with 500 or more workers—offered a plan.[2]

Because many American employees work for a small business or organization, in 2021 more than 630,000 defined contribution retirement savings plans had fewer than 100 participants—representing 88% of all pension plans and holding over $1.1 trillion in assets that year,[3] with about 13 million active and inactive participants belonging to such plans.[4] Another study, which measured plan size by assets held, found that 6 million workers (8% of participants in retirement savings plans of any asset size) were in plans with less than $1 million in assets, and 29 million workers (39% of participants) were in plans with $50 million in assets or less (however, the database used for this study may not capture small employers well).[5]

Why employers do—and don't—offer retirement savings benefits

A 2016 Pew survey of small employers found that 89% of firms that offer a plan agreed that their plan helps them hire and retain workers; moreover, 96% said they did so because they wanted to help their employees.[6] Separately, a survey by the Transamerica Institute found that 69% of firms with fewer than 100 employees said that offering a retirement plan was somewhat or very important to attracting and retaining workers.[7]

Gusto, a payroll and employee benefits platform, found that offering a 401(k) plan can lead to annual savings to a business of more than $100,000 in reduced costs from employee turnover; employees with access to an employer 401(k) plan are almost one-third (32%) less likely, on average, to leave their current employer in any given month during their first year on the job. This increased employee retention may translate to a cost savings to employers of twice the initial cost to the employer of offering the 401(k).[8]

So if retirement benefits are an important tool for employers, why do half of businesses not offer such benefits? The most common reasons that employers gave Pew for not providing a plan were cost (37%) and their firm's lack of administrative resources (22%). Only 17% said their workers were uninterested in saving for retirement.[9] Another survey found that, to some extent, firms may overestimate the financial and administrative costs of offering a plan.[10] In any event, it seems clear that if cost concerns could be addressed—through the provision of additional inexpensive options and a better awareness of the range of actual costs—more small businesses would provide retirement benefits to their workers.

Retirement savings plans available to sole proprietors and small employers

Small-business owners and sole proprietors have a range of plan options to consider beyond traditional[11] and Roth IRAs.[12] Table 1 describes traditional 401(k)s, solo 401(k)s, SIMPLE 401(k) plans, and SIMPLE and Simplified Employee Pension (SEP) IRA plans. The same table also describes employee contributions; employers' contributions are described in Table 2, which outlines key costs to employers.

Employers' lack of familiarity with these various options is an obstacle to offering a retirement plan. In Pew's 2016 survey of small employers, 11% of employers said they were not familiar with any of the plan types described: 401(k) plans, SEPs, SIMPLE plans, or *myRAs*, the U.S. Treasury's now-closed program for individual savers. Just 13% said they were at least somewhat familiar with all four. And a third (34%) said they were familiar only with the 401(k), even though the SEP and SIMPLE programs were designed explicitly to be less expensive for smaller employers and easier for employers to establish and administer than other options.[13]

Governments, chambers of commerce, and trade associations could take on a larger role in educating small employers about these low-cost options. In the same Pew 2016 survey of business owners, respondents were asked for their sources for information about retirement plans, and 62% said they would go to an insurance agent or financial adviser if they wanted to learn more—despite the fact that these sources may be compensated for recommending one retirement plan product over another.[14] This suggests that the commercial and marketing channels that reach small businesses may fail to provide information about the range of retirement plan options available to a small-business owner. Additional outreach to, and education of, employers could result in employers choosing more cost-effective plans.

Table 1

Retirement Plans Available to Small Employers

Variations on 401(k) and IRA plans are simpler and cheaper to small businesses

Traditional 401(k)[a]	Solo 401(k)[b]	SIMPLE 401(k)[c]	SIMPLE IRA[d]	Simplified Employee Pension (SEP) IRA[e]
Available to firms of any size. Generally must be offered to all eligible employees. The employee contributes from pretax earnings up to an annual maximum ($22,500 in 2023, plus a catch-up contribution of $7,500 for workers aged 50 and over) to an account that is held in their name. Total employer and employee contributions are capped at $69,000 in 2024. Plan may permit loans or hardship withdrawals.	Available to sole proprietors and other small businesses that have no employees other than a spouse. The business owner in a one-person 401(k) plan is both employee and employer. They can make contributions to the plan in both roles, up to the higher of 100% of compensation or an annual limit of $66,000 in 2023—not counting catch-up contributions for individuals age 50 and over. Self-employed individuals make a special computation. (Employer nonelective contributions are described in Table 2.) Loans and withdrawals are permitted subject to income tax, although withdrawals by plan participants younger than 59½ are subject to penalty.	Available to firms with 100 or fewer employees and no other retirement plans. If the plan is offered, it must be offered to all eligible employees. An employee can elect to defer up to $15,500 in 2023, plus an additional $3,500 if age 50 or over. Loans are permitted. In-service withdrawals, which are those made while a worker is still employed with the company sponsoring the plan, are permitted subject to income tax and subject to possible 10% penalty if the plan participant is younger than 59½.	Available to firms with 100 or fewer employees. If the plan is offered, it must be offered to all eligible employees. Any employee earning at least $5,000 annually can contribute up to $15,500 in 2023 and an additional $3,500 if they are at least 50 years old. Loans are not permitted.	Available to employers of any size. If the plan is offered, it must be offered to all eligible employees. Only the employer contributes, and the employer may decide whether to contribute from year to year (described in Table 2). Loans are not permitted. Withdrawals are permitted at anytime subject to federal income taxes; withdrawals if the plan participant is younger than 59½ may be subject to an additional tax.

a U.S. Internal Revenue Service, "401(k) Limit Increases to $23,000 for 2024, IRA Limit Rises to $7,000," news release, Nov. 1, 2023, https://www.irs.gov/newsroom/401k-limit-increases-to-23000-for-2024-ira-limit-rises-to-7000; U.S. Internal Revenue Service, "401(k) Plan Overview," accessed April 15, 2024, https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview; U.S. Internal Revenue Service, "2024 Limitations Adjusted as Provided in Section 415(d), Etc., Notice 2023-75," https://www.irs.gov/pub/irs-drop/n-23-75.pdf.

b U.S. Internal Revenue Service, "One-Participant 401(k) Plans," accessed Oct. 13, 2023, https://www.irs.gov/retirement-plans/one-participant-401k-plans.

c U.S. Internal Revenue Service, "Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)," accessed March 21, 2023, https://www.irs.gov/publications/p560.

d U.S. Internal Revenue Service. "Retirement Plans for Small Business."

e U.S. Internal Revenue Service, "Simplified Employee Pension Plan (SEP)," Dec. 1, 2023, https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employee-pension-plan-sep.

Total costs of offering retirement savings plans

Calculations of what are known as "all-in" costs or "total plan" costs summarize the combined impact of the various administration and investment management fees for 401(k)s or 403(b)s that are paid by employers and participants to all parties providing services to the plan. These services may include, for example, investment management, recordkeeping, trustee, or communication services. Employers may provide some or all of these services, or they may negotiate with outside parties who provide individual services or bundle some or all of them together. Total plan costs exceed fees paid by employers alone because they include fees generally paid by plan participants (such as investment management fees).[15]

Larger plans, with more assets and participants, tend to have lower fees than smaller plans as a percentage of assets because the firms that provide administrative and other services can spread over a larger asset base their fixed costs—those expenses that remain constant regardless of the amount of assets or number of participants, such as providing investor education or a call center or plan document services. As a result, asset size is the important driver of costs (by itself, an increase in participant numbers would increase total costs). Larger plans also tend to have lower fees, per capita or as a percentage of assets, because a greater share of their assets—compared with the share of assets in smaller plans—are invested in low-fee index funds.[16]

One report on the all-in fees for 401(k) plans with $1 million to under $10 million in assets found that plans with 100-499 participants paid providers of administrative and investment management services a median all-in fee of 1.12% of assets, which fell to 0.70% for plans with 1,000 to 4,999 participants.[17] Total costs for small plans—those with $25 million or less in assets—are about twice as high as they are for plans with more than $500 million in assets, at 0.84% of assets versus 0.40%, respectively. Furthermore, fees range much more widely among smaller plans, with 35% of small plans paying over 1% total to investment managers and other service providers.[18]

Another study of the smallest plans—those with less than $2 million in assets—found a similar pattern of declining fees as plan size increased. Plans with less than $2 million in assets paid an average all-in fee of 2.35% of plan assets to providers of administrative and investment management services. And within even this subset of small plans, the smallest plans paid the highest fees to providers of such services. Plans with up to $250,000 in assets and an average of 12 participants paid an average all-in fee of 3.64% to providers of administrative and investment management services, while plans with $250,000 to $1 million in assets and an average of 25 employees paid average all-in fees of 1.95% to providers of such services, which is just a little more than half of the cost paid by firms with less than $250,000 in assets and an average of 12 participants. Plans with $1 million to $2 million in assets and an average of 28 employees paid an all-in average of 1.45% of assets to providers of administrative and investment management services.[19]

Another source found similar trends in fees. BrightScope's Total Plan Cost (TPC) measure for 401(k)s includes investment management fees paid by participants; administrative costs paid largely by employers; advice fees paid by plan sponsors or participants; and other fees from firms' Form 5500 reports and audited financial statements. For firms with less than $1 million in assets, the TPC in 2020 was 1.26% of plan assets when weighted at the plan level (when an average fee is calculated, the fees each plan pays are treated equally), and 1.23% and 1.27% when fees are weighted by participants (the fees each participant pays are treated equally in the average) and assets (each dollar a participant invests is treated equally), respectively.[20] Fees weighted by plan assets dropped to 1.01% among plans with $1 million to $10 million in assets, compared with 0.40% for plans with $250 million to $500 million in assets and 0.37% for plans with $500 million to $1 billion in assets.

Cost categories—and who pays the costs

The costs of offering a retirement plan fall into five broad categories: startup costs, administrative services such as recordkeeping, regulatory and compliance services, investment management, and any contributions to participants' accounts that an employer may choose or be required to make. (For an exhaustive list of 401(k) plan startup and administrative fees, see the U.S. Department of Labor's employer tool.)[21] Table 2 describes these costs, with the exception of investment management fees—which are generally paid by the plan's participants and are described in the CFA's companion piece, on participant-paid fees, to this report.

Employers who sponsor 401(k) and 403(b) plans ("plan sponsors") are required to provide participants annually with information about the plan, potential administrative and individual costs, and a comparative chart with key information about the plan's investment options—including the various options' investment fees and expenses.[22]

There is some variation with 401(k) and 403(b) plans as to who pays what fee: The U.S. Department of Labor requires employers to pay the costs associated with the initial plan design and any design changes,[23] while the employer determines how other costs are distributed. Employers' cost arrangements vary.

Many employers choose to cover some or all other 401(k) or 403(b) costs that legally they could charge to plan participants. For example, employers may choose to subsidize some or all third-party services charged by the plan's payroll or recordkeeping providers; they may also provide some of these services directly, again relieving participants of the cost. As an example, an employer could conduct payroll and recordkeeping functions in-house, including directing contributions from payroll to retirement savings accounts, instead of hiring third parties to perform these services.[24]

But costs not paid by the employer are shouldered by plan participants, either directly or indirectly. Administrative fees paid directly by plan participants are either allocated among savers' individual accounts in proportion to each account balance or passed through as a flat, per-account fee.[25] Transaction fees, also known as individual service fees—such as a loan, withdrawal, or change in investment elections—are usually levied as one-time fees per transaction and are deducted from the participant's account.[26]

Plan participants usually pay the largest category of retirement plan fees—those related to managing the plan's investment options.[27] These fees are assessed as a percentage of assets and are deducted from plan assets on a scheduled basis. Because investment management and employee transaction fees, such as for plan loans and account withdrawals, are typically paid by participants, they are not discussed further in this report (including in Table 2). But employers need to pay attention to these fees; they affect participants by reducing their asset growth and retirement income. The CFA discusses the impact of investment management fees on participants' account balances in its companion piece to this report.

Participants may also pay indirect, less transparent fees. These can include revenue sharing, in which some part of investment management charges to participants' assets are used to pay administrative service providers (such as recordkeepers).

Employer costs may include the additional expense of annual nondiscrimination testing to ensure that the plan doesn't favor highly compensated employees (HCEs) over non-highly compensated employees (NHCEs); both employer and employee contributions are subject to this testing. ("Safe harbor" plan designs address potential discrimination issues by requiring mandatory, tax-deductible employer contributions; employers who adopt safe harbor designs are exempt from testing related to deferral rates and matching contributions among HCEs and NHCEs. But other testing—for example testing related to deferral limits—may still apply.)[28]

Other indirect fees can include fees for annuity wraps—investments in which an annuity is "wrapped around" a mutual fund, creating a deferred annuity in which the payout varies with the performance of underlying investments chosen by the plan participant—or 12b-1 fees, which are charged by investment managers for marketing and selling their fund shares.[29] Such indirect fees may be buried in the reported total investment fees or the expense ratio, making it difficult for the plan participant to detect them; one study found that 75% of plans offered by small businesses charge these types of indirect fees.[30] Certain features add substantially to the costs to a participant of an investment option: Annuity wrap fees, for example, can be 1% or more, turning a participant's low-fee mutual fund into a higher-fee variable annuity.[31]

Employers may also contribute to participants' accounts, including employer matches to employees' contributions and so-called nonelective contributions, which are contributions that an employer makes regardless of whether employees make their own contributions. While these may be an effective tool for boosting employees' savings and participation, these contributions can be a significant expense for employers. In 2020, about 56% of 401(k) plans with up to $1 million in assets offered employer matching or nonelective contributions, as did more than 90% of plans with $10 million or more in plan assets.[32]

Small-business owners may also contribute to employees' SEP plans; they need not do so every year, but in contribution years, the employer must contribute to all eligible employees' accounts without discriminating in favor of HCEs. On the other hand, employers must contribute to employees' SIMPLE IRA and SIMPLE 401(k) plans each year. Employer contribution amounts to SEP, SIMPLE, and 401(k) plans vary in amount and from year to year.[33]

Table 2

Main Costs Potentially Incurred by Sponsors of 401(k), SIMPLE, and SEP Plans

Costs range from startup to administration, regulatory and compliance, and employer contributions

Startup	Administration	Regulatory and compliance	Employer contributions
• Plan design • Startup plan documentation, including potentially drafting a written plan document (traditional, solo, and SIMPLE 401(k) plans); seeking an IRS determination letter (individually designed plans); or completing IRS forms (SEP and SIMPLE plans) • Plan setup, including creating a plan document arranging a trust to hold plan assets; developing a recordkeeping system; and providing information to plan participants • Startup enrollment • Consulting services, if used • Legal advice, if taken	• For multi-participant plans: recordkeeping, including processing participant contributions; issuing participant statements; and maintaining the plan's records • For non-IRA plans: trustee services, including holding plan assets in trust and issuing certified annual trust statement • Transaction fees related to participants' investment elections, distributions (loans and withdrawals), insurance, and annuity services • Employee education • Participant communication, including summary plan materials, web services, and call center if offered • Brokerage window, if offered • Maintenance of an employer stock fund, if offered • Plan amendment, termination, or conversion (moving from one provider to another)	• **Traditional 401(k) and 403(b).** Employer must adopt a written plan, arrange a trust for the plan's assets, develop a recordkeeping system, provide information to employees, and file Form 5500 annually. Nondiscrimination rules and testing apply unless the employer makes required "safe harbor" contributions. • **Solo 401(k).** Employer must adopt a written plan, but a business owner with no employees doesn't need to perform nondiscrimination testing; this advantage vanishes if the employer hires employees. A one-participant 401(k) plan is generally required to file an annual report on Form 5500-EZ if it has $250,000 or more in assets at the end of the year. • **SIMPLE 401(k).** Employer must create plan document and file Form 5500 annually. Because employer makes required contributions (as with a safe harbor traditional 401(k)), the plan is not subject to the nondiscrimination rules that apply to traditional 401(k) plans. • **SIMPLE IRA.** Can be established by completing the appropriate IRS form (which isn't filed with the IRS) or an individually designed plan document (requiring an IRS determination letter stating that the plan complies with applicable laws and regulations) and meeting employee notification requirements. Not subject to nondiscrimination rules if the plan meets conditions (including matching contributions). • **SEP IRA.** Employer must execute a formal written agreement. If using 5305-SEP, no prior IRS approval or determination letter is required and an employer is usually relieved from discrimination testing and from filing annual plan information returns with the IRS and Department of Labor. • Consulting services, if used • Legal advice, if taken	• **Traditional 401(k) and 403(b).** Employers generally contribute matching percentages. Total 401(k) contributions by the employee and employer in 2024 are capped at $69,000. Additionally, total contributions cannot exceed 100% of an employee's annual compensation. • **Solo 401(k).** The business owner contributes as both employee and employer. As an employer, the owner makes nonelective contributions (contributions made to a participant's account regardless of whether the participant contributes) of up to 25% of compensation. Self-employed individuals make special computations. • **SIMPLE 401(k).** Unlike in a regular 401(k) plan, the employer must make either: (1) a matching contribution up to 3% of each employee's pay; or (2) a nonelective contribution of 2% of each eligible employee's pay. • **SIMPLE IRA.** Employers are required to contribute in one of two ways: (1) matching contributions up to 3% of contributing employees' annual compensation, or (2) nonelective contributions of 2% of annual compensation for all employees, including those who don't contribute. • **SEP IRA.** Only the employer contributes, and the employer may decide whether to contribute from year to year. Employer may contribute up to 25% of the employees' pay, but no more than $69,000 in 2024, to traditional IRAs (established as SEP IRAs) set up for each eligible employee.

Sources: U.S. Internal Revenue Service, "Retirement Plans for Small Business." U.S. Internal Revenue Service, "One-Participant 401(k) Plans." U.S. Internal Revenue Service, "2024 Limitations Adjusted as Provided in Section 415(D), Etc., Notice 2023-75." U.S. Internal Revenue Service, "Choosing a Retirement Plan: SIMPLE 401(k) Plan." U.S. Internal Revenue Service, "Choosing a Retirement Plan: Simple IRA Plan." U.S. Internal Revenue Service, "Simplified Employee Pension Plan (SEP)." Paychex, "How to Set Up a 401(k) Plan for Small-Business Employees."

Estimating retirement plan cost components to employers

Because of a lack of data, it's difficult to settle on a specific estimate for individual plan cost components, but some surveys and other sources provide a glimpse.

Employers who sponsor pension plans often bring in financial professionals to administer and manage plan investments unless they're able to provide some of these services in-house.[34] Even providing some or all of these services in-house, however, can entail costs in terms of a firm's time and resources.

Startup costs for small firms begin at $250 for a solo 401(k) plan. For a 401(k) plan, the costs of startup or switching to a new provider can range from $500 to a few thousand dollars, depending on the provider and features chosen.

Ongoing administrative costs for small firms also vary with the provider and level of services. Many providers offer several tiers of services, starting with a basic level and increasing in cost for additional services and customization. For example, one provider offers employers three tiers of 401(k) plans: The first tier starts with a $1,200 annual base fee and $60 in annual recordkeeping charges per participant and provides simplified payroll integration and fiduciary services with administrative, compliance, and investment support; a second tier entails a $1,800 annual charge plus $72 in annual recordkeeping fees per participant, and brings additional support, benefits, and customization; and a third tier is available for $3,500 a year plus an annual recordkeeping cost of $96 per participant, and offers expanded compliance support and financial coaching for employees.

A different provider offers a 401(k) plan to firms with fewer than 30 employees for a base annual fee of $1,500 plus a custody fee of 0.08% of plan assets. And another 401(k) provider offers plans starting at $39 per month plus $4 per month per active participant, ranging up to $149 per month plus unspecified active participant fees.

Employers also may need to consider compliance costs. Many plan providers charge $250 to $750 annually to prepare Form 5500s for 401(k)s — and, as laws and regulations change, some plan providers charge $1,500 for 401(k) plan restatements to update compliance. SIMPLE and SEP IRAs were designed to have reduced compliance requirements if the plan meets certain conditions.

These fee schedules, for startup and administration, do not appear extremely high, although a firm's revenue levels and stability would obviously play valid roles in a company's calculations about whether to offer a retirement savings plan.

Yet a recent survey found that more than half of small firms believe that offering a retirement plan would cost them more than $10,000 each year—and nearly 30% thought a retirement plan cost more than $20,000 a year.[35] The same survey found that most small-business owners also believe they would need to spend at least several days a month administering a retirement plan, while in reality operating a plan after initial setup should require just a few hours a year. And not only do many small-business owners clearly overestimate the financial and time outlays involved in offering a retirement plan—and are unaware of less expensive alternatives—but they may also underestimate the potentially large cost savings that offering a retirement plan may bring by lowering employee turnover.

Minimizing costs: Federal tax incentives

Federal tax incentives are available to many small employers. For example, the federal Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) created or expanded two tax credits for employers who establish new retirement savings plans. First, eligible employers[36] with 100 or fewer employees may claim a tax credit of up to $5,000 for starting up a SEP, SIMPLE IRA, or qualified plan such as a 401(k) in each of the first three years of the plan.[37] (The credit amount is 50% of startup costs, up to the greater either of $500 or of the lesser of $5,000 or $250 multiplied by the number of NHCEs who are eligible to participate in the plan.) Second, employers who include auto-enrollment in their 401(k) and SIMPLE IRA retirement savings plans may be eligible for a federal tax credit of $500 per year for the first three years the auto-enrollment feature is available.[38]

Separately, employer contributions in the form of a match or revenue sharing that falls below 25% of the employee's annual compensation are, for many plans, exempt from federal, state, and payroll taxes.[39] And employers with 50 or fewer employees may be eligible for a tax credit for contributions of up to $1,000 per employee; a reduced credit is available to employers with 51 to 100 employees.[40]

New solutions: Automated savings plans, multiple employer plans (MEPs), and pooled employer plans (PEPs)

Small employers who want to offer a retirement savings benefit but can't afford to sponsor their own plan may be able to take advantage of an innovative program if their state is one of the 16 that (as of April 2024) offer automated savings programs.[41] These state-facilitated programs—sometimes known as "auto-IRA," "work and save," or "secure choice"—allow workers to set up and contribute to IRAs; typically, workers are enrolled automatically but can opt out at any time. There is no cost to employers, who simply facilitate their workers' contributions to the plans.[42] California, Oregon, and Illinois launched the first automated savings programs; they've since been joined by 13 other states in enacting such programs, which, depending on the state, are either just starting up or have begun to take contributions. Lawmakers in other states are working to enact similar programs.

While automated savings plans bring new options to workers who didn't have them before, annual contributions in the plans are capped at IRA limits rather than at the far more generous limits for other retirement savings vehicles; in 2024, the contribution limit for automated savings plans and other IRAs is $7,000, rising to $8,000 for workers age 50 or older.[43] These caps are appreciably lower than the 2024 401(k) employee contribution limits of $23,000, or $30,500 for workers age 50 and over; altogether, total 2024 employee and employer contributions to a 401(k) can rise to a ceiling of $69,000 in 2024.[44] SEP contributions are also capped at $69,000 in 2024.[45]

Other options for small-business owners include multiple employer plans (MEPs) and pooled employer plans (PEPs), which allow employers to join with other companies in one plan to share the administrative and financial burdens and are typically administered by private financial services providers.[46] (Massachusetts, where lawmakers are concerned about low savings among the state's residents, also administers a statewide MEP for small nonprofits.[47]) However, smaller MEPs and PEPs may not always be able to engage low-cost administrative and investment management providers, which is consistent with other retirement plan pricing structures in which large plans have lower fees than small plans.[48] Additionally, excessive fee cases have been brought against a small number of MEP providers.[49] As more data on PEPs becomes available, it will be possible to assess their impact on reducing total costs among smaller plans.

Collective investment trusts (CITs), which are pooled vehicles that offer many of the same investment strategies as mutual funds, can be less expensive than other retirement savings options because they're not marketed or regulated in the same way as traditional mutual funds. A number of barriers, however, may prevent small businesses from using them, including CIT minimums that are often higher than their mutual fund counterparts; lack of familiarity among small employers of what CITs are and how they work; and failure by some plan consultants, providers, or advisers to recommend CITs.[50]

Conclusion

Fees and costs can affect retirement outcomes: High setup and administrative fees can prevent employers from offering retirement benefits and can also reduce their ability to make discretionary contributions to a retirement plan. Fees passed on to participants by employers and investment managers can erode plan participants' earnings, with the effects compounding over time to reduce savings balances at retirement.[51]

Employers have a fiduciary responsibility to pay "reasonable" fees and expenses to plan administrators and investment managers.[52] While this fiduciary responsibility may mean making a "reasonable" effort to select the most competitively priced retirement product, small businesses are limited to the choices that recordkeeping, investment management, and other third-party providers offer them, and generally face higher costs than large employers for starting up and maintaining retirement plans.

Cost is not the only criterion that affects employer decision-making, however; other considerations include whether the type of services that plan providers offer meet employees' needs; the quality of a provider's services; and a provider's anticipated performance. The lowest-cost provider is not necessarily the best choice.

Federal programs, such as SIMPLE IRAs, SIMPLE 401(k)s, and SEP IRAs, are designed to reduce administrative and compliance costs for small business. But only 12% of firms with 1 to 199 employees offer these plans.[53] Many employers are not aware of these federal programs, possibly because private-sector plan providers are unlikely to mention them. In addition, many small firms greatly overestimate the costs of working with a private-sector provider.

There are a number of solutions available. Better awareness of low-cost plan options, and a more realistic understanding of the financial and time outlays involved with offering a plan, could help small businesses tackle some of the perceived barriers that such business owners often cite. Automated savings programs offer small employers an additional solution in the 16 states that sponsor them; these programs are available at no cost to employers, who simply facilitate their workers' contributions to plans that are run by state governments and private-sector investment managers.

Whatever solutions small-business owners choose, they have more options, and some less expensive options, than many of them believe they do. Finding a way to offer their employees a retirement plan will help them attract and retain employees.

Endnotes

1 The Pew Charitable Trusts, “Employer Barriers to and Motivations for Offering Retirement Benefits,” 2017, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/06/employer-barriers-to-and-motivations-for-offering-retirement-benefits.

2 U.S. Bureau of Labor Statistics, “Employee Benefits in the United States—March 2023,” news release, Sept. 21, 2023, https://www.bls.gov/news.release/pdf/ebs2.pdf.

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