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From the Editor

ERISA Lite

More Benefits, Fewer Rules

When a statute is no longer serving its purpose, the governmental reflex is to double down, adding more rules and regulators—which only makes it worse. Such is the case with our beloved ERISA (the Employee Retirement Income Security Act). Over the past 40 years, it has morphed into an actual hindrance to a fair system of retirement benefits for all workers. We don't need a legislative patch or an ERISA-on-steroids; we need ERISA lite, something that is fundamentally simple, flexible, and user-friendly.

In the beginning, of course, ERISA filled a gaping hole. The collapse of Studebaker in the late 1960s, with the loss of promised retirement benefits by many employees and retirees, was the most visceral example of what was wrong with the post-war retirement landscape. Other examples included essentially nonexistent vesting rules, weak fiduciary standards, lax funding rules, and the lack of spousal benefit rights.

ERISA and her progeny closed much of the gap. Post-ERISA, fewer people got screwed out of their benefits. Retirees from the many steel, airline, auto parts, and other bankrupt business had the Pension Benefit Guaranty Corporation (PBGC) to cover much or all of their unfunded pension benefits.

Unfortunately, like an unkempt garden, the thicket of ERISA rules and regulations grew, overwhelming and frustrating employers. Employers began freezing and terminating their plans. The first to fall were the more heavily regulated defined benefit (DB) plans and, more recently, even DC plans are affected. A significant indicator not captured by government statistics is that the number of new plans formed has not kept pace with the growth of the labor market. Even counting 401(k) and other defined contribution plans (DC), today only about 65 percent of private sector workers have access to a retirement plan and roughly half actively participate. That means half of older US workers eventually may be solely dependent for their support on Social Security—and the hope of being able to continue working well into their "retirement" years.

Because ERISA covers private sector but not state and local government retirement plans, its passage became an experiment in the consequences of both over- and under-regulation. In 1975, before ERISA took effect and private-sector and state government DBs were generally covered by the same lax Internal Revenue Code (IRC) rules, private-sector DB plans held $186 billion in assets, while the 50 states plus the top 50 cities had combined DB assets of only $86 billion. Forty years later the situation has reversed; any one of the largest state pension systems could swallow the top five corporate-sponsored plans in one gulp. Thus, the lightly regulated state and municipal plans have close to 100 percent employee participation while the ERISA-regulated private sector struggles at 50 percent coverage. Unfortunately, the dark side of too little regulation is apparent from DB funding: most private-sector DB plans are adequately funded, while an absence of federal oversight has left state and local plans underfunded by trillions of dollars, leaving some states and cities and their workers in a precarious situation. Neither an absence of regulation, nor an excess, has left workers in a good place. Goldilocks knew what she was talking about.

DC plan investments are another example of the way the heavy hand of ERISA regulation has undermined employee needs. Essentially, every DC plan in the country permits employees to invest their own accounts, switching funds around with impunity. Indeed, a company would be foolhardy not to turn the keys over to participants, because ERISA imposes significantly greater fiduciary liability and risk on employers that retain investment control than on those that pass it on to their employees. Yet, even with widespread access to financial education and good online tools, most workers have proven that they lack the time, ability, or temperament to effectively manage their investments for retirement. ERISA has pushed employers in exactly the opposite direction of where they should go.

In spite of the heavy hand of ERISA regulation, behavioral economists have recently devised nifty ways to gently nudge employees to better prepare for retirement. Automatically enrolling employees in DC plans and automatically escalating their contributions annually, both with opt-outs, have proven phenomenally effective in getting folks to save, especially when combined with an adequately diversified default investment. Perversely, ERISA initially stymied such useful innovations. It took a long-winded statutory amendment plus contorted regulations before employers felt comfortable putting employees on autopilot with access to such investment tools.

Currently, pension alchemists are looking to bring DB plans back to life by combining auto-enrollment and auto-escalation with DB-like concepts of common investments funds, risk sharing, and lifetime income. Indeed, there already are a number of solid ideas for new-style retirement programs that encourage employees to save and invest wisely and that promote lifetime retirement income, without overly burdening employers. One example is Secure Choice Pension, which harnesses the investment and recordkeeping infrastructure of state government plans by allowing employers to voluntarily contribute to a separately funded and secure side fund managed by the state. Another is Shared Risk, a DB in which pensions are adjusted up or down if investment performance or mortality falls outside a stated range and the employer has made all required contributions. A third is USA Retirement Funds, which allows employees to contribute to an IRA-like payroll savings vehicle invested in by the federal government. One thing all these new ideas have in common: they would be illegal under ERISA.

The solution: replace the ERISA regulatory thicket with a few simple and common sense rules. Ignoring transition issues, here's my outline for ERISA Lite:

- **Bring back E-Z discrimination testing.** Eliminate the current math-based discrimination testing rules in favor of something akin to the "old" pre-1986 rule: a plan may not discriminate in favor of highly compensated employees (undefined). The current system of hyper-complicated mathematical tests actually makes it easier to stack plans in favor of the highly paid. As one smart actuary I know put it: If you can't get a plan to pass, you're not trying hard enough. A system with fewer rules will be self-regulating and actually encourage employers to expand coverage.

- **Eliminate Social Security integration.** Social Security is financially unstable and is likely to change in ways that no one can predict. Employer-provided retirement benefits are a totally separate program and should not be cut on the basis of a merely hypothetical future government payout to workers. The two systems should be decoupled.

- **Make it limitless.** Eliminate all compensation, benefit, and other limits in determining benefits. These rules were intended to make plans fair by encouraging companies to increase benefits to lower-paid workers so their managers also could receive more. The opposite happened: highly paid employees lost interest in the rank-and-file company retirement plans and found other means of rewarding themselves. Take away the benefit limits, and management will regard ERISA plans as a benefit for themselves, not just a business cost and liability. It's amazing what can happen when everybody eats from the same pot.

- **Accelerate vesting for all.** Plan participants should be 100 percent vested after one year, tops. This would maximize portability and help even job hoppers to accumulate meaningful benefits. However, vesting protection should not cover every nuance of a plan's payout options and side-rules. Protections provided to employers by IRC Section 411(d)(6) to these largely administrative provisions do far more harm than good. Generalized discriminations rules would better discourage any shenanigans that benefit management. Section 411(d)(6) should be dumped and vesting limited to benefits.

- **Recognize when less disclosure is more.** Only lawyers and bureaucrats think more disclosure is always better. The reality is that the average person is unwilling or unable to parse any legal disclosure that's longer than a page or two, whether it's in "plain English" or Greek. Has any plan participant actually read through their summary annual report or the notice that their employer is applying for an IRS determination letter? Additionally, federal bureaucrats, especially at the DOL, should recognize that electronic media is ubiquitous and authorize any and all available communication media, whether electronic, paper, skywriting, or whatever.

- **Eliminate forced dis-saving.** Eliminate all minimum distribution rules for the participant and spouse. These rules are confusing and ridiculous. (Where did they get the rule that a former employee must begin taking his or her benefits by the April 1 after reaching age 70-1/2?) Let people decide for themselves when to spend their retirement savings. The IRS will get its tax dollars because eventually the participant/spouse will take the money or die, in which case the beneficiary will take it. In the meantime, the retirement funds are invested in stocks, bonds, or whatever, supplying capital to the economy.

- **Change the rules on loans: it's not a piggy bank.** All plan loans and hardship distributions should be eliminated going forward. Retirement money, especially 401(k) contributions should be treated for the sole purpose of retirement.

No one thinks of their DB benefit as a piggy bank, and the same should be true for DC plans.

- **Kill top-heavy rules.** If a plan passes the reasoned-based discrimination test, that's enough. There's no need to consume companies' time in drafting plan documents, complicated top-heavy testing, and fighting with agents over irrelevant minutia.

- **Do over DB funding.** Two types of DB funding should be allowed. The first, similar to our current system, would put the employer on the hook for underfunding plans but continue to give them access to excess plan assets (without any excise tax). However, funding would be based on rock-solid actuarial assumptions and methods. Designing well-reasoned and sound funding rules is above my pay grade, but I'm absolutely certain that if we put a bunch of really smart actuaries in a room they could come up with guidelines that would put any DB plan on excellent footing. After that: don't ever modify the rules because of interest rate changes, or stock market fluctuations, or because Congress is looking for a budgetary gimmick to fund an unrelated project. If an employer can't make its contribution, the plan should immediately freeze all benefit accruals and subsidized benefits until it can. No waivers. No false promises.

- **Institute DB funding 2.0.** Right now, the biggest DB disincentive is that employers never know whether their pension obligations are covered until the plan is terminated, yet any overfunding of the plan is penalized by a 50 percent excise tax. Instead, an alternative funding regime would base an employer's annual contribution on ultraconservative assumptions that would keep the plan fully funded in almost any circumstance. There would be no reversions. Any overfunding would be used for additional benefits or to make up for previous cutbacks. Any underfunding—say, due to a bad investment market—would trigger a reduction in benefits to active and retired participants until the plan recovered. The benefit cutbacks would be shared in a defined manner and prioritize the interests of participants who are at or near retirement. What's key is that employers would not be left on the hook for any underfunding as long as it made the required contributions. This would be a win-win.

- **Eliminate the PBGC and its insurance program.** Currently, financially solvent employers pay for the deadbeats, and the high premiums make it harder for the struggling employers to cover their plan obligations. The PBGC insurance program has done a tremendous amount of good. However, sound funding rules would render it unnecessary, enabling an entire bureaucracy to be eliminated.

- **Recognize that multiple employers can be better than one.** Unrelated employers should be able to team up in multicompany DB or DC plans run by a state pension system, insurance company, mutual fund, bank, or other responsible vendor. Under current law, however, employers that participant in a joint plan are on the hook for one another's errors and violations—a major disincentive. Yet such group plans, similar to the Section 529 college funds, would offer economies of scale, more sophisticated management, and investments that would enable significantly lower fees.

- **Take a dose of fiduciary sense, please.** The mind-set of the folks who wrote, and now regulate, ERISA is that everything is prohibited unless the government says otherwise. Example: Section 408(c) states that it is not illegal for a participant to collect his or her own benefit. Really? Was someone worried that an employee otherwise might be sued for retiring? ERISA Lite would preserve the general concept of trustee-like fiduciary duties, but leave plenty of space for common sense and a changing financial marketplace. Case in point: an employer should not have to worry about being sued for investing DC plan assets for all participants, or giving participants a very limited choice, as long as the investment regime is reasonable and follows current investment theory. That would offer a share of predictability, even if the choice of investments proves overly or inadequately conservative.

- **Decide: who's the boss?** Simplifying ERISA will be possible only under a single regulatory body. The current triumvirate of the IRS, DOL, and PBGC (and at times the SEC) has been unworkable from the start. Generally, the IRS has shown more creativity (see its self-correction program for easily fixing administrative errors), so it gets my vote. Having a dedicated benefits court along the lines of the Tax Court also would be useful, rather than subjecting employers and employees to the sometimes goofy decisions issued by judges who don't understand or really care about ERISA. Plus, it might discourage meritless class-action suits, in which participants receive pennies, lawyers get millions, and employers give up on offering good benefits.

- **Provide something for the other half.** A voluntary system, even one that is lightly regulated, still will leave some workers uncovered. ERISA Lite cannot address the problem of workers who do not have access to any retirement plan (although, there will be a lot fewer with a reformed ERISA). However, a separate statute that requires employers that do not maintain any plan to withhold a set amount from each workers' paycheck, with an opt-out, and contribute it to an approved fund (like a Section 529 college savings program) is well worth considering. The employer would have zero liability after it delivered the withholding to the fund.

- **Follow principles, not rules.** Crafting rules to cover every circumstance never works. Real bad guys simply ignore them and less-bad scofflaws will either play the audit lottery or find ways to follow the letter of the law, ignoring the intent. The vast majority of employers that want to do the right thing by their employees often end up terminating or scaling back their retirement plans. Regulatory simplicity is a must. A voluntary system with basic "thou shalts" and "thou shalt nots" would be an incentive to employers to create more retirement plans, nudge employees to do a better job saving for retirement, and leave room for real innovation.

It's been fun, but ERISA is no longer helping workers as it should. Let's wish ERISA a happy 40th birthday, give her a big thank you, and say goodbye.

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