Insight

Congressional Disapproval of DOL's Rules on State-Run Retirement Plans: What You Should Know

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Last year the Department of Labor (DOL) finalized rules exempting certain state-run retirement plans from the Employee Retirement Income Security Act (ERISA). The idea was to make more retirement savings options available to private employees whose employers don't offer similar plans. Before the rules were finalized, the American Action Forum (AAF) pointed out how ironic it was that DOL would propose to exempt certain retirement plans from the fiduciary rule under ERISA at the same time that it was working so hard to finalize the fiduciary rule itself.

Earlier this week, a joint resolution was introduced in the Senate that would rescind DOL's rules for state-run retirement plans under the Congressional Review Act (CRA) – the same procedural move currently being used to repeal the Consumer Financial Protection Bureau's (CFPB) rules for prepaid cards. Both are important uses of the CRA which was created to be a check on exactly the type of regulatory overreach that came out of the last administration.

Proponents of DOL's rules on state-run retirement plans argue that the exemptions will incentivize states to open up options for workers who don't have retirement savings and that those options will be just as good as the private sector options, if not better because they will be mandatory and state-run. But that could not be further from the truth.

As a practical matter, state-run retirement plans subject their investors to higher fees. For example, California's Secure Choice plan originally capped fees at 1 percent (still higher than fees on private sector IRAs), but has since removed that cap signaling that the fees will go well beyond 1 percent for retirement savers. Similarly, because so few workers are expected to participate in the state-run plans and because they are expected to contribute less on average than the average private plan contribution, the accounts will be much smaller, which means that that administrative costs per plan participant will be much higher.

DOL suggests that these state-run plans will give retirement savers more choice and greater flexibility. In reality, since these plans are "opt-out" plans as opposed to "opt-in" plans, participants will be forced into investments that they don't want. The states only have a limited number of investments in which they're willing and able to invest, and most of those investment tend to yield lower returns. In some situations, investment decisions in state-run plans are politically motivated and not in the best interest of the retirement savers.

Perhaps worst of all is the actual exemption from ERISA and all the protections that come with it. DOL's current fiduciary rule, as written, may not be the best way to protect investors, but ERISA contains many more protections that work. Just to name a few, ERISA requires plan sponsors (in this case, the states) to disclose the fees, risks, and investment objectives; consider the reasonableness of those fees, risks, and objectives; and it requires that the assets be separated from the plan sponsor's general assets, among others.

Instead of exempting state-run retirement plans from important investor protections, Congress and this administration should remove barriers for small businesses and other private employers to provide retirement accounts for their employees – private accounts that are subject to ERISA protections. Rolling back these DOL regulations through CRA is the first step in doing just that.