Insight

DOL: Still Messing with Your Retirement

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The Department of Labor (DOL) has had a busy year, having finalized almost 100 regulations costing nearly $13 billion. So it's understandable that their rule writers would be tired and seemingly very confused. Last month DOL proposed a rule that would exempt certain state-run retirement plans from the regulatory labyrinth that is 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. If ERISA sounds familiar it's because it's seen a lot of action lately. It's the same Act under which DOL re-proposed its fiduciary rule earlier this year.

Yes, that's right: DOL just proposed a rule to exempt certain retirement plans from the very rule DOL proposed a few months ago to protect those retirement plans. It makes no sense, but may be good because the fiduciary rule is unworkable and would end up hurting those investors it's seeking to protect. The problem is that this more recent rule, dubbed ever-so-generically as "Savings Arrangements Established by States for Non-Governmental Employees" will end up costing taxpayers a lot of money.

So far only a handful of states have enacted or considered enacting one of these state-run retirement programs. Washington, California, and Illinois are leading the way with Connecticut, Maryland, and others not far behind. Maryland projects startup costs for its program around $1.3 million with ongoing costs of $400,000 a year in addition to service provider fees up to 1 percent of total assets, or another $400,000 per year if they reach their goal of $40 million assets under management. Washington estimates are a little higher, which reflect set-up and implementation costs between $1.8 and $3.5 million and annual costs between $1.4 and $2.1 million. Taking the cake for spending the most taxpayer dollars is Illinois' program, which, by its Treasurer's own estimates, will cost $35 million dollars *each year* to operate, and that doesn't take into consideration the startup costs or any costs of compliance.

California provides perhaps the best estimates of what such a program would cost since they already have CalPERS and CalSTRS in place which cover retirement accounts for state employees and teachers. At $350 million per year and $110 million per year in administrative costs alone these are two of the costliest programs of their kind in the nation. Recently, it was reported that, in addition to the hundreds of millions in administrative fees, CalPERS was paying $1.1 billion to the companies that manage a portion of its investments and another $700 million to those companies in profit sharing. For a portfolio that's reporting a return of only about $4 billion before these fees, that's significant – well over 25 percent. As a result, the 586,959 beneficiaries of CalPERS are effectively seeing their annual allowances reduced by over $3000.

A recent Milliman study used data from CalPERS and CalSTRS to estimate what a state-run retirement plan might cost. Based on the number of California employees without a retirement plan and the per-participant costs of operating such a plan, Milliman suggests that the annual administrative cost of a California run state retirement plan would be $775,000,000. Add that to the management costs that will be paid to an investment company as they are with CalPERS, and the question becomes whether the cost is worth the benefit. It would be a more efficient use of the state's resources to educate the public on saving for retirement though any number of private savings or investment options.

To make matters worse, DOL's proposed rule is riddled with inconsistencies and contradictions. For example, page 13 of the proposal states that "[t]he proposed regulation *requires* that participation in the program be *voluntary for employees*." Two sentences later, DOL explains that it "intends to make clear that the proposed regulation, unlike the existing safe harbor, would allow the state to *require employers to automatically enroll employees*." (Emphases added) If a state requires an employer to automatically enroll their employees in the state-run retirement savings program, then the program definitively is not "voluntary for employees." DOL admits in its own footnote on page 9 that simply having an employee opt-out arrangement would not render a plan as completely voluntary.

On the next page, DOL says, "Limited employer involvement in the program is the key to a determination that a state savings program is not an employee pension benefit program." It then says that "the employer's facilitation must be required by state law." Any mandated employer facilitation of the plan is inherently not "limited employer involvement."

Two pages later, DOL proudly declares that they may have their cake and eat it too: "This proposed regulation would provide that certain state savings programs would not create employee benefits plans [under ERISA]. However, the fact that state programs do not create ERISA covered plans does not necessarily mean that, if the issue were litigated, the state laws would not be preempted by ERISA." So DOL wants to waive all ERISA rules for these plans to make sure they are implemented quickly, but if something goes wrong and someone gets sued, DOL wants to be sure that the plaintiffs' attorneys have the full battery of ERISA laws at their disposal. That's bad policy; really bad policy.

As pleasing it is to see something exempt from the looming fiduciary rule and as entertaining as it may be to read DOL's paradox of a rulemaking, the bottom line is that this rule will end up costing a lot of Americans a lot of money. Exactly how much money will, of course, depend on how many states decide to form such a plan, what sort of plan they form, and how many workers decide to enroll in it. The comment period for DOL's proposal is open until January 19, after which we should hope to see some hearings and further consultation on this rule. Don't be fooled – this is not DOL trying to help workers save for retirement, this is DOL's attempt to socialize the retirement savings and investment industry, and that's not helping anyone.