Will ERISA Be Balkanized?

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Most people would acknowledge that the private retirement system, as it has evolved with 401(k) plans as its mainstay, has been a great success in delivering broad-based retirement security, as well as providing for a uniform, nationwide set of fiduciary and administrative standards. One of the essential reforms to the system made by the enactment of ERISA is the requirement to hold plan assets in a trust where they cannot be reached by creditors of the employer or the employee and are subject to strict fiduciary standards in their management. In a 401(k) plan, these assets consist of employee salary deferrals, employer contributions, and investment earnings.

Despite its success, the private retirement system has in recent years been subject to the criticism that it is not sufficiently accessible to low wage workers, which has resulted in numerous proposals that would establish government-sponsored retirement savings arrangements for private-sector workers. Before signing off on these parallel systems, we should carefully examine the security of the funds they would control and whether their special rules would undercut support for the current system.

Social Security

Historically, government programs, such as Social Security, do not set a good precedent for the management of retirement savings. Although there is a so-called "Social Security Trust Fund," it is not a trust in the conventional sense. The Social Security Board of Trustees, made up of government officials, does not hold legal title to the assets, the beneficiaries (*i.e.*, the general public) do not have enforceable property rights in trust assets, and the whole arrangement can be amended or repealed at any time. In other words, the Social Security Trust Fund is no more than an account of the U.S. Treasury that has been labeled as a trust for the sake of appearances. In reality, Social Security tax revenues go directly into the Treasury's general fund where they are spent, while the trust fund receives a credit for these taxes in the form of special issue Treasury bonds guaranteed by the government. These securities are redeemed for face value, as needed to pay Social Security benefits.

MyRA

The administration's "MyRA" proposal, which would offer Roth IRAs to low wage workers through employers that volunteer to participate in the program, is much like Social Security in that the IRA will be invested solely in a special U.S. Treasury bond guaranteed by the government. This bond is intended to be similar to the "G-Fund" obligation under the Federal Thrift Savings Plan that invests solely in U.S. savings bonds. Accordingly, it would appear that, like Social Security taxes, contributions to a MyRA will go into the Treasury's general fund, and the obligation to the MyRA participant will be a government "IOU" owned by the custodian of the MyRA account. Contributions as low as $5.00 can be made, which is good for low wage earners. However, the MyRA initiative has been criticized for using worker money to support government bonds when better returns are available from private-sector investments, and it might be argued that the MyRA's low-paying bond would not meet ERISA's prudence requirement if it were an investment in a retirement plan, such as a 401(k) plan.

California Secure Choice Program

In contrast to the MyRA program, California's proposal to provide state-sponsored IRAs to private-sector workers involves real assets held in a trust administered by a seven-member Investment Board appointed by political officeholders. While the statute does not specify that the Investment Board's responsibilities and powers include holding trust assets, this will necessarily be the case, since a trust, by definition, must have a trustee that holds legal title to the trust assets. Among other things, this presumably means that the California Investment Board will need to execute a written trust instrument and complete a certification process for authorization to act as non-bank IRA trustee, as required by IRS regulations.

Despite the existence of a real trust holding nongovernmental equity and debt securities, the California proposal has the potential for conflicts of interest. The California law takes investment decisions away from IRA owners and provides that the Investment Board will select the investment manager for the trust assets. It is frequently mentioned that CalPERS is the front runner for this position. The California proposal also would authorize the pooling of IRA assets and allow them to be invested in conjunction with the investments of California's own public retirement plans. Thus, management by state authorities and commingling with public plan funds are two ways that the state could control assets in a way that furthered its own interests at the expense of the exclusive interest of participants, as required by ERISA.

There are other troubling signs. Implementation of the California program is conditioned on receiving approval from the DOL that the program is not an ERISA plan, but instead constitutes a "payroll practice." In anticipation that ERISA would not apply, the California program provides that employee contributions to the IRA trust are to be protected by

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an ERISA-like exclusive benefit rule. Interestingly, the California statute provides for the use of trust funds to purchase insurance that will indemnify the state against liability arising from the funding of retirement benefits under the program. This would appear to be a diversion of funds in violation of the exclusive benefit principle. Moreover, while the California program aims to be exempt from ERISA, if ERISA had applied and the state met the definition of a fiduciary, the insurance requirement of the state IRA program would violate ERISA's prohibition of agreements purporting to relieve a fiduciary from responsibility or liability for its ERISA duties.

NCPERS

The National Conference on Public Employee Retirement Systems, a trade organization for public-sector pension funds, has proposed amending ERISA and state laws to allow the establishment of state-administered multiple employer cash balance plans covering private-sector workers. Like the California IRA proposal, the NCPERS program calls for pooling assets and taking investment decisions out of the hands of participants. The assets of an NCPERS plan would be held in trust separate from state plan assets, but the proposal envisions that these assets would be invested in tandem with the assets of a state retirement system. Thus, the state would generally make investment decisions, and these decisions would be subject to political influence and the risk of misallocation.

The plan covering private-sector workers would be governed by its own board of trustees which would be subject to fiduciary standards of care. Therefore, it is surprising to see that the proposal also provides this board with immunity from fiduciary-based lawsuits. (Investment managers and vendors would remain subject to ERISA fiduciary liability.) Providing immunity from fiduciary claims would require a special exemption under ERISA and, most likely, the DOL would not grant such an exemption to private individuals. Therefore, the intention must be to seek exemption on the basis that the board will be made up of public officials. If this is the case, then state government will have full control over all matters under these plans.

USA Retirement Funds Act

Senator Tom Harkin's proposal to establish a new universal retirement system utilizing automatic enrollment is similar to California's IRA arrangement in that it will exempt employers from ERISA fiduciary responsibility. An employer's involvement in a new investment vehicle to be called a USA Retirement Fund is limited to fulfilling the enrollment requirements and transmitting employee contributions.

Each of these funds would be privately run by a self-perpetuating board of trustees overseen by the DOL. Each board would establish procedures allowing participants to petition the board to remove a trustee and to comment on the management and administration of the fund. The

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trustees would be subject to many of ERISA's fiduciary responsibilities and required to act prudently and in the best interests of plan participants and beneficiaries. Subject to a standard of reasonableness, they also would be able to set their own compensation from the fund, something that a fiduciary would never be allowed to do under ERISA.

End of Uniformity

Each of these initiatives has the potential to reduce support for and diminish the private retirement plan system. Moreover, they all contain features that raise concerns regarding the protection of retirement savings. Perhaps most insidious, they represent the possible Balkanization of fiduciary standards with each parallel system having its own special exceptions from the core duties of prudence and loyalty that are the essence of ERISA. This should be avoided. ❖

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