AN AFFORDABLE CARE ACT FOR RETIREMENT PLANS?

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In the United States, the availability of tax subsidies for retirement savings is largely based on an individual's employment status and whether such individual's employer has voluntarily chosen to offer a tax-favored savings vehicle. Even where an individual has access to an employer-sponsored retirement plan, such plans are too often suboptimally designed. This article proposes an incremental reform that ensures universal access to tax-favored retirement savings irrespective of employment status or employer decisions. Borrowing from the model of the Affordable Care Act, the article calls for the creation of an optional, universally available retirement plan, which would be designed according to both retirement savings and behavioral best practices. Such a plan would be designed to increase the number of Americans saving for retirement, as well as the likelihood that individuals will accumulate sufficient savings to maintain their standard of living throughout retirement. After discussing the design details for such a plan, the article concludes by examining the legal and practical challenges of implementing a universal retirement plan at either the federal or state level.

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I. INTRODUCTION

Given the current challenges of implementing the Affordable Care Act (ACA), it is perhaps unwise to suggest that the ACA's model should be replicated in the retirement plan context, as the title of this article suggests. However, the basic structure of the ACA, which provides all Americans with access to health insurance regardless of their employment status or their employer's choices, provides a promising model for enhancing retirement savings and security.

Many Americans are ill equipped for their retirement, having failed to save a sufficient amount to maintain their standard of living in

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retirement.[1] Much blame for this failure has been placed on the widespread shift in the design of employer-sponsored retirement plans.[2] Instead of being offered traditional, defined benefit pension plans that offer a set level of lifetime income, most employees are now offered only a defined contribution plan, usually in the form of a 401(k) plan.[3] These defined contribution plans depend for their success on individual participants making rational decisions and executing them in a timely manner. Yet, there is significant evidence suggesting that many individuals fail to make rational decisions and implement them in a timely manner. As one prominent scholar succinctly put it, "It's crazy that we ended up with this as our retirement system."[4] The popular 401(k) plans, she explained, were meant to supplement traditional forms of lifetime income, such as social security and defined benefit pension plans.[5] "It was supposed to be money that you could use to go to Paris. Instead, it's become our basic system."[6]

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[1] *See, e.g.*, Jack VanDerhei & Craig Copeland, *The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects*, 334 EMP. BENEFIT RES. INST. ISSUE BRIEF 1 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1645412 (estimating that 47.2% of early baby boomers are at risk of not having sufficient resources to pay for basic retirement expenditures and uninsured health costs). One large administrator of 401(k) plans recently reported that average 401(k) plan balances for those age 65-69 were $136,800. Jill Schlesinger, *The Latest on America's 401(k)s*, CHI. TRIB., Feb. 27, 2013, *available at* http://articles.chicagotribune.com/2013-02-27/business/sns-201302271600--tms--retiresmctnrs-a20130227-20130227_1_retirement-savings-fidelity-plans-fidelity-investments.

[2] *See, e.g.*, Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451 (2004); James M. Poterba, *Individual Decision Making and Risk in Defined Contribution Plans*, 13 ELDER L.J. 285 (2005); Susan J. Stabile, *Is It Time to Admit the Failure of an Employer-Based Pension System?*, 11 LEWIS & CLARK L. REV. 305 (2007).

[3] Craig Copeland, *Retirement Plan Participation and Asset Allocation, 2010*, 34 EMP. BENEFIT RES. INST. NOTES 9, 11 (2013), *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_04_Apr-13_CDHPs-RetPart1.pdf (finding that among working heads of households who participated in an employer-sponsored retirement plan, 18.9% participated only in a defined benefit plan, 65% participated only in a defined contribution plan, and 16.1% participated in both).

[4] Jeff Sommer, *Suddenly, Many Nest Eggs Look Fragile*, N.Y. TIMES, June 15, 2013, http://www.nytimes.com/2013/06/16/your-money/suddenly-retiree-nest-eggs-look-more-fragile.html?pagewanted=all&_r=0.

[5] *Id*.

[6] *Id*.

While the problems associated with individual retirement savings decisions are well documented, this article seeks to highlight another weakness of our current reliance on 401(k) plans to deliver retirement security – suboptimal *employer* decision-making. Our retirement savings system relies on employers voluntarily offering retirement plans. Some employees do not have access to tax-favored retirement savings plans simply because their employer does not offer one. And even when employers do offer a plan, they often offer a plan that is not well-designed to help participants accumulate sufficient retirement savings. These plans often minimize employer costs while failing to take into account the abundant literature on 401(k) plan designs that can help overcome some of the well-known weaknesses in individual retirement savings decisions. To address the potential problems with employer decision-making in the 401(k) plan context, this article suggests both federal and state solutions that borrow from the ACA model for health insurance to ensure that all Americans who wish to save for retirement have a well-designed option available to them in the event their employer either fails to offer a plan or offers a plan that is suboptimally designed. The goal of this proposal is to minimize both suboptimal participant-level decisions regarding retirement saving and also suboptimal employer-level decisions regarding plan design.

II. WEAKNESSES IN THE CURRENT MODEL OF RETIREMENT SAVINGS

The weaknesses in individual decision-making within participant-directed 401(k) plans are well documented. Individuals struggle to begin saving at an early enough age to meet their retirement goals, they often fail to contribute sufficient amounts, and have difficulty navigating investment and distribution options. Less appreciated is the fact that many employers make poor decisions when they design their 401(k) plans. This Part will review the weaknesses in the 401(k) plan model that might explain why so few Americans appear to be able to achieve financial security through such plans.

A. INDIVIDUAL DECISION-MAKING

Section 401(k) plans are premised on classic economic theory, which posits that welfare will be optimized where each individual makes his or her own rational savings and consumption decisions within a fully functioning market.[7] The success of a 401(k) plan in providing adequate retirement income depends on an individual making several important decisions: whether and when to participate in the plan, what amount of salary to defer to the plan, where to invest plan contributions, when (if at all) to access retirement savings prior to retirement, and the rate at which to withdraw savings once retirement age has been reached. If an individual is perfectly rational, this type of retirement plan should work very well, as it can be customized to match the individual's preferences.[8]

We have good reason to believe, however, that most individuals are not perfectly rational and do not make optimal decisions within the 401(k) plan context.[9] These problems with participant-level decision-making have been well documented elsewhere,[10] and therefore this article provides only a high-level overview of the key findings. For plans that require an individual to take affirmative action to enroll in the plan, participants often procrastinate in implementing the decision to participate, thereby shortening the period of time they are saving for retirement.[11] In addition, many studies have shown that once individuals elect to participate they are overwhelmed by the decisions they are required to make, such as selecting a contribution level and making investment decisions, and therefore stick to the defaults or allow the plan's framing of choices to

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[7] *See* Amy B. Monahan, *Addressing the Problem of Impatients, Impulsives and Other Imperfect Actors in 401(k) Plans*, 23 VA. TAX REV. 471, 480–81 (2004).

[8] *See id*.

[9] *See, e.g.,* James J. Choi et al., *For Better or for Worse: Default Effects and 401(k) Savings Behavior, in* PERSPECTIVES ON THE ECONOMICS OF AGING (David A. Wise ed., 2004); Julie R. Agnew & Lisa R. Szykman, *Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience*, 6 J. BEHAV. FIN. 57 (2005); Shlomo Benartzi & Richard H. Thaler, *Heuristics and Biases in Retirement Savings Behavior*, 21 J. ECON. PERSPECTIVES 81 (2007); Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001); Olivia S. Mitchell & Stephen P. Utkus, *Lessons from Behavioral Finance for Retirement Plan Design* (Pension Research Council, Working Paper No. 2003-6, 2003). For a helpful overview of the literature on retirement savings decisions, see Melissa A. Z. Knoll, *The Role of Behavioral Economics and Behavioral Decision Making in Americans' Retirement Savings Decisions*, 70 SOC. SEC. BULL. 1 (2010).

[10] *See* sources cited *supra* note 9.

[11] Knoll, *supra* note 9, at 8–9.

impact their decisions.[12] There is also strong evidence that hyperbolic discounting affects retirement savings decisions causing individuals to give more weight to current consumption than to future needs, thereby under-saving for retirement.[13] Many studies have shown that simply changing plan defaults results in dramatic changes in behavior – which would not be predicted under standard economic theory.[14] According to standard economic theory, a rational decision-maker will simply opt out of any defaults that do not maximize her preferences.[15] Yet, the evidence on the impact of defaults in the retirement savings context suggests that cognitive biases are impacting many individuals' decision-making.[16]

B. EMPLOYER DECISION-MAKING

A less explored weakness inherent in relying on 401(k) plans to provide retirement security is the fact that they depend on sound employer decision-making.[17] In theory, employers should act as effective agents for their employees and offer retirement plans that maximize their employees' preferences.[18] But there are various reasons why employers may not, in fact, offer plans designed to produce adequate retirement income. The subparts below illustrate the ways in which employer decision-making can negatively impact employees' retirement security.

1. Failing to Offer a Plan

Employers are not required to offer any type of retirement plan to their workers. It is a completely voluntary decision, driven by labor market

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[12] *See, e.g.*, Agnew & Szykman, *supra* note 9, at 66; Choi et al., *supra* note 9, at 125.

[13] *See, e.g.*, David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q.J. ECON. 443 (1997).

[14] *See, e.g.*, Choi et al., *supra* note 9.

[15] *See id*. at 81.

[16] *See id*. *See also* Madrian & Shea, *supra* note 9.

[17] For an examination of the role of employers in employees' health and retirement security, see Amy B. Monahan, *Employers as Risks*, 89 CHI. KENT L. REV. 751 (2014).

[18] *See* Gregory Acs & Eugene Steuerle, *The Corporation as Dispenser of Welfare and Security*, *in* THE AMERICAN CORPORATION TODAY: EXAMINING THE QUESTIONS OF POWER AND EFFICIENCY AT THE CENTURY'S END 360, 361 (Carl Kaysen, ed. 1996).

pressures.[19] We would expect an employer to voluntarily offer a retirement plan in lieu of other forms of compensation where it believes that doing so will help it attract and retain workers.[20] Indeed, pension formation is typically explained as a contract driven by worker demand to provide workers with security and income protection.[21] But it is widely acknowledged that pensions also offer other benefits to employers, in addition to simply helping them attract and retain employees. For example, pensions can help employers control their employees' tenure and turnover by designing plans to encourage retirement at certain ages.[22]

But allowing labor market pressures to determine whether a retirement plan is offered has shortcomings. It aggregates the preferences of employees. If the majority of employees of a given employer do not value retirement benefits, the employer is unlikely to offer a plan. For those minority employees that would value a retirement plan, their only option would be to find a different employer that offers the desired benefits. Because many factors enter into a decision to work at one firm over another, it may be that many who desire a retirement plan are not offered one. And bear in mind that a job switch is in fact the only complete solution if an employee's current employer fails to offer a retirement plan. While there are individual tax-favored retirement accounts available outside of the employment context, none can duplicate the extent of the tax benefits available to employer plans. An employee can currently defer up to $17,500 of her salary tax-free per year to a 401(k) plan,[23] but can only contribute $5,500 annually to an Individual Retirement Account (IRA).[24]

Prior to health care reform, we saw the same dynamic at play in an employer's decision to offer a health plan to employees. Employers

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[19] *See* TERESA GHILARDUCCI, LABOR'S CAPITAL: THE ECONOMICS AND POLITICS OF PRIVATE PENSIONS 2 (1992).

[20] *See* Alan L. Gustman et al., *The Role of Pensions in the Labor Market: A Survey of the Literature*, 47 INDUS. & LABOR REL. REV. 417, 426 (1994).

[21] GHILARDUCCI, *supra* note 19. For alternative explanations of pension formation, see *id.* at 2–7.

[22] *Id*. at 2–3.

[23] I.R.S. News Release IR-2013-86 (Oct. 31, 2013), http://www.irs.gov/uac/IRS-Announces-2014-Pension-Plan-Limitations;-Taxpayers-May-Contribute-up-to-$17,500-to-their-401(k)-plans-in-2014. Participants who are age fifty or older are permitted to contribute an addition $5,500 each year, for a total of $23,000 per year. *Id*.

[24] *Id*. Participants who are age fifty or older may contribute an additional $1,000 per year to an IRA, for a total annual contribution of $6,500. *Id.*

decided to offer a health plan based on labor market pressures,[25] and employees had little ability to replicate the benefits of an employer plan by seeking individual level coverage.[26] Health care reform will change this reliance on employers, as discussed in more detail in Part II.

2. Offering a Suboptimal Plan

Even if an employer offers a retirement plan, it may nevertheless be the case that an employer offers a plan that, from an employee's perspective, is suboptimally designed. Employers offer retirement plans in order to recruit and retain valued workers. Retirement plans help recruit and retain workers when workers find them to be a positive addition to their compensation package. Employers should therefore structure their retirement plans in a way that employees find attractive.[27] In other words, we would expect employers to be effective agents for their employees when they design their retirement plans.[28] Employees, however, are unlikely to be familiar with all of the features of their retirement plan, and are likely, when evaluating an employer plan, to focus on only a few features that are highly salient to employees.[29] For example, it seems plausible that employees would focus on whether a plan is offered at all, and the amount and structure of any employer contributions to the plan, such as matching or profit sharing contributions. Most employees, when deciding whether to accept or retain an offer of employment from a firm, probably do not examine plan details such as plan defaults, the quality of plan investments, investment fees, or forms of distribution. If employers believe or discover that employees focus only on a handful of highly salient features, employers are likely to respond by structuring their plans only around those features and otherwise acting to minimize their costs. For example, an employer might offer a 401(k) plan with a matching

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[25] *See, e.g.*, Michael Chernew et al., *Quality and Employers' Choice of Health Plans*, 23 J. HEALTH ECON. 471, 472 (2004).

[26] *See* Amy B. Monahan & Daniel Schwarcz, *Saving Small-Employer Health Insurance*, 98 IOWA L. REV. 1935, 1944 (2013).

[27] For an overview of pension theories, see GHILARDUCCI, *supra* note 19, at 1–7.

[28] *See* Chernew et al., *supra* note 24, at 472.

[29] *See* James R. Bettman et al., *Constructive Consumer Choice Processes*, 25 J. CONSUMER RES. 187, 199 (1998) (discussing that increased numbers of alternatives facing the consumer when choosing retirement products lead to a greater use of non-compensatory strategies which eliminate alternatives).

contribution that equals or exceeds that offered by its competitor firms, but in order to reduce its costs associated with the plan might select a plan provider that offers high fee investments, defaults that do not address participants' likely cognitive biases, and distribution forms that do not help participants manage income in retirement. The end result may be that even where employers offer plans, they offer plans that are not designed to maximize participants' retirement security.

Again, much the same dynamic is at play in how employers approach health plan design. Employees are likely to focus only on highly salient features when evaluating a health plan – in this case on premium levels, copays, and whether their current doctor is in-network.[30] And employers are likely to respond to this employee focus by designing plans around the highly salient features, potentially at the expense of other important plan design features such as the quality of the plan or providers.[31]

If this hypothesis regarding employer plan design is correct, the implications for retirement and health security are significant. In the retirement plan context, it would mean that even if every employer made a 401(k) plan available to its workers, the problem of insufficient retirement savings would not be solved. While we know relatively little regarding how employer plan design decisions are made and the factors that motivate those design decisions, data regarding plan features provide support for the hypothesis that the majority of employers do not offer plans that are optimally designed. Plans often have defaults that work against retirement savings. Individuals that desire to participate must take active steps to enroll in the plan, instead of being defaulted into participation.[32] Even where participants are automatically enrolled in a plan, default contribution

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[30] See Amy B. Monahan, *Why Tax High-Cost Employer Health Plans?*, 65 TAX L. REV. 749, 764–765 (2012).

[31] See Russell Korobkin, *The Efficiency of Managed Care "Patient Protection" Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1, 58–59 (1999) (explaining how health insurance companies are likely to structure health plans given consumers' focus on only a handful of highly salient features).

[32] *See* Alicia H. Munnell, *401(k) Plans in 2010: An Update from the SCF*, ISSUE IN BRIEF (Ctr. for Ret. Research at Bos. C., Boston, MA), July 2012, at 1, 4, *available at* http://crr.bc.edu/wp-content/uploads/2012/07/IB_12-13-508.pdf (finding that fewer than half of all 401(k) plans offered automatic enrollment in 2010).

rates are often too low to provide adequate savings.[33] Many plans allow easy access to savings prior to retirement,[34] and nearly all have a lump sum distribution as either the default or the only form of distribution available.[35]

In addition, plans sometimes work against participants' savings goals by offering poor investment choices and little investment advice.[36] As we have seen through countless class action lawsuits, many employers allegedly offer a menu of investments that charge excessive fees.[37]

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[33] *See id*. *See also* DELOITTE, ANNUAL 401(K) BENCHMARKING SURVEY 9 (2012), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Consulting/us_cons_hc_401ksbecnchmarkingsurvey2012.pdf (finding that the average default contribution rate was 3%, an amount unlikely "to support a comfortable retirement").

[34] For example, approximately 90% of 401(k) plan participants participate in a plan that offers plan loans. John Beshears et al., *The Availability and Utilization of 401(k) Loans* 2 (John. F. Kennedy Sch. of Gov't, Working Paper No. 11-023, 2011), *available at* https://research.hks.harvard.edu/publications/getFile.aspx?Id=693. Sixty-six percent of all 401(k) plans permit participants to take hardship distributions prior to retirement. INTERNAL REVENUE SERV., SECTION 401(K) COMPLIANCE CHECK QUESTIONNAIRE FINAL REPORT 6 (2013), *available at* http://www.irs.gov/pub/irs-tege/401k_final_report.pdf. Studies are, however, mixed on the extent to which such pre-retirement access threatens retirement security. *See generally* sources cited *infra* note 64.

[35] *See* INTERNAL REVENUE SERV., *supra* note 34, at 59 (finding that 99% of 401(k) plans offer a lump sum distribution, while only 19% offer a qualified joint and survivor annuity). *See also* HEWITT ASSOC., TRENDS AND EXPERIENCES IN 401(K) PLANS 7 (2009) *available at* http://www.retirementmadesimpler.org/Library/Hewitt_Research_Trends_in_401k_Highlights.pdf (finding that all 401(k) plans offered a lump sum option, while 14% offered annuities).

[36] *See, e.g.,* James Kwak, *Improving Retirement Savings Options for Employees*, 15 U. PA. J. BUS. L. 483, 511–12 (2013) (examining the weaknesses of 401(k) investment options); Karen Blumenthal, *Thanks but No Thanks on 401(k) Advice*, WALL ST. J., Nov. 7, 2011, http://online.wsj.com/news/articles/SB10001424052970204346104576638933476020932 (finding that while a majority of 401(k) plans offer investment advice, only around a quarter of participants offered some form of investment advice utilize the service).

[37] For a detailed examination of this litigation and its effects, see Mercer Bullard, *The Social Costs of Choice, Free Market Ideology and the Empirical Consequences of the 401(k) Plan Large Menu Defense*, 20 CONN. INS. L.J. 335 (2014) and Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans* 13-20 (Feb. 21, 2014 (unpublished manuscript) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399531. *See also* Kelly

Employers often offer employer stock as an investment option, even though in many cases it is unwise for a participant who depends on an employer for her current income to invest in that employer's stock for her long-term savings.[38] And finally, plans are permitted to, and often do, pass along to participants nearly all of the administrative costs of running the plan, further reducing participants' rate of return.[39]

There has been one area of plan design that has improved significantly over the last decade. Beginning in the 1990s, several 401(k) plan sponsors began experimenting with automatic enrollment provisions, which provide that an eligible participant will automatically participate in the employer's plan unless he or she takes affirmative action to opt out.[40] The number of employers utilizing automatic enrollment grew following the passage of the Pension Protection Act of 2006, which offered employers various incentives for putting such procedures in place. However, a well-known potential weakness of automatic enrollment provisions is that plan sponsors can choose default contribution levels and investment options that are too low and too conservative to produce adequate retirement savings. When automatic enrollment provisions first gained traction in the late 1990s and early 2000s, default investment options were primarily conservative, capital-preserving investments.[41] However, a recent survey found that 82% of plans with automatic enrollment now had as their default investment option a lifecycle or target-date fund, designed to invest appropriately given the participant's years to

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Greene, *Letters About 401(k) Plan Costs Stir Tempest*, WALL ST. J., July 24, 2013, http://online.wsj.com/news/articles/SB10001424127887323971204578626103409341648 (describing Yale Law Professor Ian Ayres' letter writing campaign to 401(k) plan sponsors regarding their fee levels, and the reaction such letters have provoked).

[38] *See generally* Ning Tang et al., *The Efficiency of Sponsor and Participant Portfolio Choices in 401(k) Plans*, 94 J. PUB. ECON. 1073 (2010).

[39] *See* DELOITTE, *supra* note 33, at 19 (finding that 51% of plans paid all administrative and recordkeeping fees through investment revenue).

[40] *See* Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, 318 EMP. BENEFIT RES. INST. ISSUE BRIEF 1, 4 (2008), *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_06-20087.pdf.

[41] *See* PROFIT SHARING/401(K) COUNCIL OF AMERICA, AUTOMATIC ENROLLMENT 2001: A STUDY OF AUTOMATIC ENROLLMENT PRACTICES IN 401(K) PLANS *available at* http://www.pcsa.org/data/autoenroll2001.asp (finding that among plans with automatic enrollment, 66% had a conservative default investment option such as a stable value or money market fund).

retirement.[42] Note, however, that this change was likely brought about by a change in Department of Labor regulations that protected plan fiduciaries from liability where they offered a "qualified investment" as the default investment option.[43] This change does not appear to have been the result of employers independently making a decision to improve the quality of the plan's default investment option. As a result, this improvement does not provide significant evidence against the hypothesis that employers often lack motivation to design optimal retirement plans. Indeed, when the state of 401(k) plan design is viewed as a whole, it seems reasonable to conclude that even when participants are lucky enough to be offered an employer-sponsored retirement plan, that plan in many cases will not be designed to maximize retirement security.

III. THE ACA MODEL

While there is reason to be less than confident in our current retirement savings system, the structure of federal health care reform provides an interesting model of how dependence on employers can be reduced, and portions of its structure might successfully be borrowed to improve retirement savings. As noted above, there are important similarities between employer-sponsored health and retirement plans. Both types of plans depend on employer decision-making for their success. An employer must decide to offer a plan if an employee is to have access to the benefit at all, since neither type of plan can be duplicated outside of the employment context.[44] And the quality of the benefit provided depends in large part on how employers decide to structure the benefit plan. If an employer makes suboptimal choices in a health plan, an individual's health

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[42] *See* DELOITTE, *supra* note 33, at 11.

[43] Default Investment Alternatives Under Participant Directed Individual Account Plans, 29 C.F.R. § 2550.404c-5 (2008). Each of the three qualified default investment options is diversified in order to minimize the risk of large losses but also to provide long-term growth potential.

[44] Health plans, like retirement plans, depend on employer sponsorship for the individual to receive the most favorable tax treatment. If an employee buys health insurance on her own, she must pay for the coverage with after-tax dollars, whereas an employee who participates in an employer plan may pay premiums with pre-tax dollars. This tax advantage did not change with the passage of the ACA. In addition, purchasing coverage through an employer gives the employee access to group coverage, which tends to be more affordable than individual coverage. *See* Monahan & Schwarcz, *supra* note 26, at 1942–44.

security can be jeopardized, much the same way an individual's retirement security can be compromised if an employer designs a suboptimal retirement plan.

For health plans, however, this should begin to change as the major reforms of the ACA take effect.[45] Once the ACA's provisions are fully effective, individuals who are not offered health coverage through an employer, or are offered a plan that does not satisfy their preferences, should have a meaningful coverage alternative. Such individuals can freely purchase any individual coverage available on their state's health insurance exchange[46] and, assuming these markets function well post-reform, should have a broad variety of plan designs and premium levels from which to choose.[47] The ACA requires all plans sold on the state exchanges (referred to as "qualified health plans") to satisfy various plan design, content and quality requirements in order to ensure that the options available meet minimum standards.[48] In other words, one underappreciated function of the ACA is to act as a backstop for *employer* choices that might be suboptimal from an employee's perspective. While not perfect (an employee purchasing health insurance on an exchange would have to purchase coverage with after-tax instead of pre-tax dollars), the ACA should give an individual a much greater ability to secure desired health care coverage without regard to his or her employer's choices.[49] For example, if an employee is offered health insurance coverage by her employer that has a deductible too high for the employee to afford, or that fails to offer a broad network of providers, that employee is no longer effectively stuck with what the employer offers, but will instead have the option of going to her state's health insurance exchange and buying coverage that satisfies her preferences.

The ACA's provision of a universal option available to all individuals without regard to employment status or employer decision-making provides an interesting model that might be of use in improving retirement security in the United States. Part IV below explores ways in

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[45] Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 42 U.S.C.).

[46] *See* 42 U.S.C. 18031(b) (Supp. V 2012).

[47] *See* 42 U.S.C. 18022 (Supp. V 2012).

[48] *See id*.

[49] For a discussion of some of the implications of these choices, see Brendan S. Maher, *Some Thoughts on Health Care Exchanges: Choice, Defaults, and the Unconnected*, 44 CONN. L. REV. 1099 (2012).

which both the federal and state governments could borrow from the ACA to provide a meaningful alternative to suboptimal employer-sponsored retirement plans.

IV. A UNIVERSAL BACKSTOP RETIREMENT PLAN

Both the federal and state governments have the ability to use law to improve retirement security for many Americans. This Part begins by exploring the use of a universal "backstop" retirement plan, similar to the concept of a qualified health plan under the ACA, which could help to address the problem of flawed employer decision-making. It then discusses the possibilities and impediments associated with establishing such a backstop at either the federal or state level.

A. BACKSTOP RETIREMENT PLAN DESIGN

There are myriad problems in our current retirement savings system. Employer plans provide the greatest tax benefit for retirement savings, but are far from universal.[50] Even when employer plans are available, they are often not designed to address the well-documented mistakes that individuals make in their retirement savings decisions.[51] While there are Individual Retirement Accounts universally available, these savings vehicles have much lower contribution limits than employer-sponsored plans,[52] involve even more complex participant decision-making

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[50] *See* EMP. BENEFIT RESEARCH INST. & MATHEW GREENWALD & ASSOCS., 2013 RCS FACT SHEET #3, at 5 (2013), *available at* http://ebri.org/pdf/surveys/rcs/2013/Final-FS.RCS-13.FS_3.Saving.FINAL.pdf. (reporting that only 72% of workers are offered a retirement plan by their employer); *See* Emp. Benefit Research Inst., *Pension Plan Participation,* FAST FACTS (Emp. Benefit Research Inst., Washington, D.C.), March 28, 2013, *available at* http://www.ebri.org/pdf/FF.225.DB-DC.28Mar13.pdf. (finding that in 2011, 3% of private sector workers participated in a defined benefit plan, 11% participated in both a defined benefit and defined contribution plan, and 31% participated only in a defined contribution plan).

[51] *See supra* Part II.B.2.

[52] *See* I.R.S. Notice 2012-67, 2012-50 I.R.B. 671 (stating that in 2013, individuals can contribute $17,500 to an employer-sponsored 401(k) plan, but can contribute only $5,500 to an IRA).

than employer plans,[53] and are not designed to counteract cognitive biases in retirement savings decisions.[54]

There are many ways to address the perceived shortcomings of our current system. We could reform Social Security so that it provided more complete income replacement in retirement. We could implement a government-sponsored, universal pension plan. We could raise contribution limits on IRAs. The proposal offered in this article is an incremental reform that is based on the premise that 401(k) plans, and defined contribution retirement plans in general, are here to stay and that a wholesale shift away from either defined contribution plans or employer-provided plans is unlikely to be politically viable. Instead, the universal backstop retirement plan is designed to work within the existing employer-based system to ensure that all individuals have access to a quality retirement plan designed to maximize the likelihood that a participant will have adequate income in retirement. The goal is, as best we can, to minimize both suboptimal participant-level decisions regarding saving and investing *and* suboptimal employer-level decisions regarding plan design.

As the ACA will do for health plans, the idea of a backstop retirement plan is to have a plan available to all individuals, regardless of whether they are employed or have access to other retirement plans through an employer. It is offering a new option, not supplanting the existing system. One significant advantage of this type of reform is that it lets the backstop plan compete against employer offerings. It lets participants choose the plan that best meets their needs. In this way, a backstop retirement plan is superior to direct regulation of employer plan offerings. Employers remain free to design a plan that best meets the needs of their

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[53] The decision-making process to establish and fund an IRA is more complicated than participation in a 401(k) plan because there are a greater number of options. An IRA can be established with numerous investment firms, in contrast to an employer that would offer only a single plan. And once an IRA provider is selected, an individual can essentially invest her contributions in any publicly traded security – making the investment decision more complex compared with a 401(k) plan that often offers a limited menu of investment options.

[54] Because IRAs must be initiated and established by an individual, design features such as automatic enrollment, automatically increasing contribution rates, and default investment options typically cannot be utilized. This could change if the law required the establishment of so-called payroll IRAs or automatic IRAs, recently proposed by President Obama. *See Retirement Security for American Families*, WHITEHOUSE.GOV 3, http://www.whitehouse.gov/assets/documents/Retirement_Savings_Fact_Sheet.pdf (last visited Feb. 16, 2014).

employees, or even forgo a plan, but employees will not bear any ill consequences of the employer's decision. In fact, the backstop retirement plan may incent some employers to improve their plan offerings. It is possible, of course, that employers may drop their retirement plans if a backstop retirement plan becomes available. It is important to note that this is not necessarily a bad outcome, if the backstop plan is appropriately designed. Employers dropping retirement plans is only problematic if their doing so leaves employees worse off with respect to retirement savings. An appropriately designed backstop plan, as discussed in more detail below, should prevent such an outcome.

While in reality designing a backstop plan would be a difficult process relying on input from many experts and stakeholders, I offer here some initial thoughts on basic approaches to the backstop plan and issues to be considered. Some of the design features mentioned would require changes to either federal or state law, an issue I discuss in the next subpart.

The first issue to tackle would be designing the plan to encourage participation. The evidence seems clear that automatic participation, with the ability to opt-out, would be preferable to requiring affirmative action to begin saving.[55] But given that this is a backstop plan, and not merely the plan of a single employer, implementing automatic enrollment is complicated. We have three potential categories of participants: employees who have access to an employer-sponsored plan, employees without an employer plan, and self-employed individuals. It would be easiest to implement automatic enrollment for employed individuals without access to an employer plan. Those individuals could simply be defaulted into the backstop plan through required payroll deduction. For those employees who are offered an employer plan, the question becomes *which* plan they should be automatically enrolled in – the backstop plan or the employer plan? The best approach for an employee would depend on how the employer plan compares to the backstop plan, so that is of little help in determining the default. One simple solution would be to default the employee into the backstop plan only if the employer plan does not provide for automatic enrollment. For self-employed individuals, automatic

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[55] *See, e.g.,* Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164, S169 (2004); John Beshears et al., *The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States*, *in* SOCIAL SECURITY POLICY IN A CHANGING ENVIRONMENT 167–95 (Jeffrey Brown et al. eds., 2009).

enrollment is impossible to implement because payroll deduction is not practical. But there are other methods to encourage participation. Self-employed individuals could face a small fee for failing to participate in the plan (or an equivalent retirement savings vehicle), or they could be required to state when filing their federal tax return whether they wish to participate in the plan, and be given the ability to direct any tax refund to the backstop plan. These are not ideal, of course, but illustrations of how participation can be encouraged without the ease of payroll deduction.

After tackling the issue of getting individuals into the backstop plan, the next design issue is contributions, both participant and employer. Ideally, the default contribution level for participants would be a percentage of wages which, if contributed over an average working life, and taking into account an appropriate investment return assumption, would result in a level of income replacement at retirement that would be sufficient to provide seventy to eighty percent of pre-retirement income for the average life expectancy.[56] Obviously, such a contribution level would not be ideal for everyone, and in fact may be so large as to result in participants either dropping out of the plan entirely or lowering their contribution rate.[57] Further study would be necessary to select a contribution rate that would maximize plan participation and contribution rates. One possibility would be to adjust the contribution rate based on a

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[56] Financial planners often suggest that, for most individuals, retirement savings should aim to replace 70% to 80% of pre-retirement income, although this is at best a rough guide. *See, e.g.*, Jason Jenkins, *The New Rule of Thumb for Retirement Savings*, INVESTMENT U (2012), *available at* http://www.investmentu.com/2012/October/new-rule-of-thumb-for-retirement-savings.html. For a more sophisticated analysis of retirement savings needs, see Jonathan Skinner, *Are You Sure You're Saving Enough for Retirement?* (Nat'l Bureau Econ. Research, Working Paper No. 12981, 2007), *available at* http://www.nber.org/papers/w12981.pdf?new_window=1.

[57] *See* Thaler & Benartzi, *supra* note 55, at S169–72 (citing behavioral analysis which indicates that many individuals who perceive themselves as unable to meet current expenditures will not be interested in increasing their participation in savings plans if a rate above their perceived ability to save is suggested); *See* Beshears et al., *supra* note 55, at 171 (noting that employers often set automatic enrollment contribution levels low due to the commonly held belief that high contribution levels will encourage employees to opt out).

participant's income.[58] Another well-tested plan design would be to start participants at a low initial contribution rate, and increase that contribution rate automatically at specified intervals to gradually bring a participant to an adequate savings level.[59]

It is important that employers be able to contribute to an employee's account in the backstop plan. It is easy to imagine that many employers would, if a backstop retirement plan were in place, no longer sponsor their own 401(k) plan. But without the ability of employers to contribute directly to their employees' retirement, an important source of savings would be lost. Therefore, making it easy (and tax advantaged) for an employer to contribute to an employee's retirement savings, whether through an employer-sponsored plan or the backstop plan, would be an important design feature.

Assuming that participation is encouraged at an adequate savings rate, the next design issue, and potentially the most difficult one, is to determine both the default and alternative investment options. The ideal default investment is likely a passive fund that offers the appropriate mix of risk and return characteristics appropriate for the individual's savings horizon.[60] Target date funds, which are designed to automatically shift the fund's asset allocation as the target retirement date nears, are attractive because they are designed around the participant's investment time horizon, and they offer one-stop shopping.[61] Theoretically, a participant could put all of their savings in a single target date fund. These funds are not without risks,[62] but they may provide a better default option than others readily available.[63]

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[58] Varying contribution rates by income level may be more palatable to low-income individuals, and could also be designed to reflect the fact that social security replaces a larger percentage of income for low-income individuals.

[59] A plan design with automatically increasing contribution rates was pioneered by economists Richard Thaler and Shlomo Benartzi. *See* Thaler & Benartzi, *supra* note 55.

[60] *See* Kwak, *supra* note 36.

[61] Julie R. Agnew et al., *What People Know About Target-Date Funds: Survey and Focus Group Evidence* 4 (Fin. Sec. Project at B.C., Working Paper 2011-2), *available at* http://crr.bc.edu/wp-content/uploads/2011/05/FSP-WP-2011-2.pdf.

[62] *See* Zvi Bodie et al., *Unsafe at Any Speed? The Designed-in Risks of Target-Date Glide Paths*, J. FIN. PLAN. (March 15, 2010), *available at* http://www.fpanet.org/journal/CurrentIssue/TableofContents/UnsafeatAnySpeed/.

[63] Zvi Bodie et al., *Life Cycle Finance and the Design of Pension Plans*, 1 ANN. REV. OF FIN. ECON. 249, *available at* http://papers.ssrn.com/sol3/papers.cfm?

An important issue worth considering is whether the backstop plan should *not* have participant-directed investment, but should instead operate as a cash balance plan, where participants are guaranteed a rate of return on their contributions.[64] If a cash balance approach is taken, participants would not face significant investment risk, a distinct advantage over current 401(k) plans.[65] The price, of course, is that such plans typically have conservative rates of return, which may be insufficient to provide adequate retirement income given reasonable contribution rates.[66] Another option would be to default participants into the cash balance plan and allow individuals to opt out of the cash balance plan and into a participant-directed 401(k) plan if desired. Doing so would allow more sophisticated investors to seek higher rates of return than the cash balance plan offers, while still offering unsophisticated or risk-adverse investors a guaranteed rate of return.

Another approach to participant investments would be to invest contributions in deferred life annuities, similar to a recent proposal by Senator Hatch for public pension plans.[67] Investing contributions in annuities would both protect employees against investment risk and provide them with a guaranteed income stream at retirement. However, like the cash balance option described above, such a structure would not necessarily guarantee that the amount of the income stream would be adequate.

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abstract_id=1396835. For an interesting example of an investment option that utilizes both target date funds and annuities that provide a guaranteed level of lifetime income, see Tara Seigel Bernard, *A 401(k) That Promises Never to Run Dry: [Your Money]*, N.Y. TIMES Nov. 14, 2012, at F.4, *available at* http://www.nytimes.com/ 2012/11/14/your-money/a-401-k-that-promises-income-for-life.html?r=0.

[64] Kevin E. Cahill & Mauricio Soto, *How Do Cash Balance Plans Affect the Pension Landscape?*, AN ISSUE IN BRIEF (Ctr. For Ret. Research. Bos. Coll., Boston, MA), Dec. 2003, at 1, 1.

[65] *See id*. at 3; Richard W. Johnson & Cori E. Uccello, *Cash Balance Plans: What Do They Mean For Retirement Security?*, 57 NAT'L TAX J. 315, 316–18 (2004).

[66] *See* Cahill & Soto, *supra* note 64 at 3 (noting that cash balance plans on average offer a 5.6% rate of return, compared to a market-average rate of return of 7.6%).

[67] *See* The Secure Annuities for Employees Retirement Act, S. 1270, 113th Cong. (2013).

The final major design decision concerns plan distributions, both before and during retirement. Allowing easy access to retirement savings prior to retirement may significantly endanger retirement security.[68] However, individuals may be more likely to participate in the first place if they know that they can access their savings in the event of a financial hardship.[69] To balance these competing concerns, the plan could offer pre-retirement distributions only for specific financial hardships,[70] instead of offering relatively unrestricted pre-retirement access as many employer 401(k) plans do currently.[71] Consideration should be given to whether pre-retirement access should only be the form of plan loans,[72] or whether an outright distribution will be permitted, and in what circumstances.

The other major design decision with respect to distributions will be the form of retirement distributions. Most participants in 401(k) plans receive lump sum distributions.[73] However, what most individuals require

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[68] *See* Alicia H. Munnell & Annika Sundén, *401(k) Plans Are Still Coming Up Short*, ISSUE IN BRIEF (Ctr. for Ret. Research Bos. C., Boston, MA), Mar. 2006, at 1, 5, *available at* http://crr.bc.edu/wp-content/uploads/2006/03/ib_43.pdf.

[69] The evidence regarding whether or to what extent access to funds pre-retirement increases participation are mixed. *Compare* Alicia H. Munnell et al., *What Determines 401(k) Participation and Contributions?* 16 (Ctr. for Ret. Research Bos. Coll., Working Paper No. 2000-12, 2000), *available at* http://crr.bc.edu/wp-content/uploads/2000/12/wp_2000-12.pdf ("the ability to borrow increases the contribution rate by about 1 percentage point"), *with* U.S. GEN. ACCOUNTING OFFICE, 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME 5 (1997), *available at* http://www.gao.gov/archive/1998/he98005.pdf ("[p]articipation rates in plans with loan provisions are about 6 percentage points higher than plans with no loan provisions").

[70] The IRS publishes a list of "safe harbor" reasons for hardship distributions, which could be used in the loan context as well. *See* Treas. Reg. § 1.401(k)-1(d)(3)(iii) (2011).

[71] PROFIT SHARING/401(K) COUNCIL OF AM., PLAN LOAN RESTRICTION STUDY (1999), *available at* http://www.psca.org/RESEARCHDATA/PlanLoanRestrictionStudy/tabid/176/Default.aspx (reporting that 82% of plans did not place restrictions on the purposes for which a plan loan would be granted).

[72] Loans have the advantage of allowing the participant to return the retirement savings to the plan with interest, but loan repayment may not be possible in some financial circumstances.

[73] *See* U.S. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, BULL. NO. 2749, NATIONAL COMPENSATION SURVEY: HEALTH AND RETIREMENT PLAN PROVISIONS IN PRIVATE INDUSTRY IN THE UNITED STATES, 2009, at 125 (2010),

in retirement is lifetime *income*.[74] For this reason, having a life annuity as the default form of retirement distribution likely makes the most sense, with notice and consent required for other forms of distributions such as lump sum or installments.[75]

1. A Federal Backstop?

With the design basics in place, the next issue to consider is whether a backstop plan is best offered at the federal or state level. A backstop retirement plan created at the federal level has some advantages over state-based plans. Assuming there is political will to put such a plan in place, the federal government could easily pass a law establishing the backstop plan that has the basic design features described above. States, on the other hand, would have to work around existing federal law to put such a plan in place, as is discussed in more detail below. A federal plan may also make sense given that retirement savings goals and related plan design likely do not vary significantly by state, as some other types of programs might, and there are also likely to be economies of scale associated with a single backstop plan, versus fifty individual plans.

The biggest impediment to establishing a federal backstop plan, in addition to political will, is the cost. Assuming that the backstop plan would involve extending the tax benefits of employer-sponsored plans to

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available at http://www.bls.gov/ncs/ebs/detailedprovisions/2009/ebbl0045.pdf (finding that 90% of plan participants had a lump sum distribution option, while 27% were offered installments and 15% were offered an annuity); VANGUARD, DISTRIBUTION DECISIONS AMONG RETIREMENT-AGE DEFINED CONTRIBUTION PLAN PARTICIPANTS 6 (2010), *available at* https://institutional.vanguard.com/iam/pdf/CRRDDP.pdf (finding that only 2% of retirement-aged participants elected installments, whereas 47% took a lump sum distribution and the remainder left their account in the plan).

[74] *See* Lawrence A. Frolik, *Protecting Our Aging Retirees: Converting 401(k) Accounts into Federally Guaranteed Lifetime Annuities*, 47 SAN DIEGO L. REV. 277, 285–86 (2010) (explaining the process of managing retirement wealth to produce an income stream in retirement).

[75] While legislative action to require annuities does not seem imminent, the Department of Labor has recently proposed regulations that would require defined contribution plans to provide on participant's benefit statements an estimated lifetime income stream based on current retirement savings. Pension Benefit Statements, 78 Fed. Reg. 26727, 26737–38 (proposed May 8, 2013) (to be codified at 29 C.F.R. pt. 2520).

the backstop plan, the cost of an already expensive tax expenditure would increase.[76] Given our current fiscal realities, it may be difficult to persuade Congress to spend money now in order to save money on supporting retirees in the future.

One potentially revenue-neutral way to expand tax benefits to the backstop plan would be to lower the current 401(k) deferral limits. In other words, to shift some of the current tax benefits available exclusively to employer-provided plans to a wider population. While there are sound equity-based arguments for lowering the tax benefit but extending it to a wider population, objections might be raised that doing so would have the perverse effect of lowering existing rates of retirement savings by those in employer plans. Further study would be necessary to better understand the effects of shifting the tax benefit. The maximum salary deferral in 2014 is $17,500, but historical data shows that few participants contribute the maximum amount.[77] Not surprisingly, the number of participants contributing the maximum amount to a 401(k) plan is closely correlated to income level.[78] While twenty-eight percent of those earning $100,000 or more contribute the maximum amount to a 401(k) plan, only one percent of those earning between $40,000 and $60,000 do so.[79] On average, participants contribute between 7.5 and 8% of their income.[80] These data suggest that the maximum pre-tax deferral to 401(k) plans could be lowered without adversely affecting the majority of participants, and the minority that would be affected would be relatively high-income

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[76] The tax expenditure for employer-sponsored defined contribution plans is estimated to be $57 billion in 2013. JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017, at 39 (Comm. Print 2013), *available at* https://www.jct.gov/publications.html?func=startdown&id=4503.

[77] *See* Munnell, *supra* note 32, at 5.

[78] *Id.*

[79] *Id.*

[80] *See* Craig Copeland, *401(k)-Type Plans and Individual Retirement Accounts (IRAs)*, EBRI NOTES (Emp. Benefit Research Inst., Washington, D.C.), Oct. 2007, at 1, 6, *available at* http://www.ebri.org/pdf/EBRI_Notes_10a-2007.pdf (reporting average deferral rate of 7.5%); *Fidelity Average 401(k) Balance Climbs to Record High at End of 2012*, FIDELITY.COM (Feb. 14, 2013), http://www.fidelity.com/inside-fidelity/employer-services/fidelity-analysis-finds-record-high-average-401k-balance (reporting 8% average annual deferral rate among Fidelity 401(k) plan participants).

participants (who are likely to save for retirement even in the absence of a tax benefit).[81]

Another way to address the tax issue would be to structure the plan as an after-tax plan. One way to do so, which would require no change to tax laws, would be to have contributions to the plan be made on an after-tax basis and have participants subject to capital gains taxation when gains or losses are realized.[82] Another option would be for Congress to make the plan operate like a Roth IRA, where contributions are after-tax, but distributions are tax-free.[83]

2. A State Backstop?

Theoretically, states could take legislative action to do much the same thing as the federal solutions described above. States could create their own state-based retirement plan available to all workers, designed to produce adequate income replacement for the average worker. But implementing a state-based solution is difficult because of current federal limitations. First, the federal Employee Retirement Income Security Act of 1974 (ERISA), preempts any state law that "relates to" an employee benefit plan.[84] Without getting into the complex details of ERISA preemption, suffice it to say that a state law that required employer participation in a retirement plan or significantly penalized an employer for failing to participate in a retirement plan would be preempted by ERISA.[85] As a

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[81] *See generally* Eric M. Engen et al., *The Illusory Effects of Saving Incentives on Saving*, 10 J. ECON. PERSP. 113 (1996) (examining whether and to what extent tax incentives increase the level of retirement savings).

[82] Depending on the investment strategy pursued, conventional savings accounts without tax deferral can be just as tax efficient as tax-favored accounts that tax gains at ordinary rather than capital gains rates. *See generally*, John B. Shoven & Clemens Sialm, *Asset Location in Tax-Deferred and Conventional Savings Accounts*, 88 J. PUB. ECON. 23 (2003) (describing how locating assets optimally can significantly improve the risk-adjusted performance of retirement saving).

[83] For an overview of the relative tax advantages of Roth IRAs, see Leonard E. Burman et al., *The Taxation of Retirement Saving: Choosing Between Front-Loaded and Back-Loaded Options*, 54 NAT'L TAX J. 689 (2001).

[84] 29 U.S.C. § 1144(a) (2006).

[85] For a more detailed overview of ERISA preemption in this context, see Edward A. Zelinsky. *California Dreaming: The California Secure Choice Retirement Savings Trust Act*, 20 CONN. INS. L.J. 547 (2014).

result, states would be unable to require employer contributions to a state retirement plan, although they should be able to require employers to facilitate payroll deduction contributions to a state retirement plan.

In addition, the federal tax code currently grants tax benefits for retirement savings in limited circumstances – either when an employer plan is utilized, or when a qualified individual retirement account is used. As a result, if a state were to adopt a state-based retirement plan, it may not be able to take advantage of federal income tax preferences. A state backstop retirement plan would not be an employer-provided plan, and therefore would be ineligible for existing federal tax benefits for employer plans. And while the state plan might be able to qualify as an IRA, structuring the plan in such a way would likely prohibit the use of a cash balance design,[86] and would only provide the lower tax benefits available to IRA holders.[87]

Still, there is some reason to believe that this is an area where states may be more interested and nimble than the federal government. Indeed, California has passed a law requiring employers to either sponsor a retirement plan or participate in a state-based retirement plan.[88] That law, however, is effectively on hold until the state can get favorable ruling from the federal government on the tax and ERISA issues noted briefly above and described in more detail in Professor Zelinsky's article in this issue.[89]

States could, of course, design a plan that avoids ERISA preemption and does not depend on federal tax benefits for its success. As mentioned in the previous section regarding a federal backstop plan, a state plan could allow individuals to invest on a post-tax basis, with any gains then being taxed at capital gains rates when realized. Alternatively, the state could offer state-tax benefits to attempt to offset, at least in part, the absent federal tax benefits. For example, a state could exempt from its income tax retirement savings contributions regardless of whether such contributions were made to an employer-based or state-based plan.[90] While this would help improve the tax advantage of the state plan, it would not

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[86] *See id.*

[87] *See* I.R.S. Notice 2012-67, 2012-50 I.R.B. 671.

[88] *See* CAL. GOV'T CODE § 20139 (2013).

[89] See generally Zelinsky, supra note 85.

[90] While states often adhere to the federal definition of income for tax purposes, they are of course free to define income for state income tax purposes in any manner they see fit. For an in-depth discussion of federal-state tax conformity, see Ruth Mason, *Delegating Up: State Conformity to the Federal Tax Base*, 62 DUKE L.J. 1267 (2013).

put participants in the same tax position they would be in if they participated in an employer plan. A state could, however, offer a state matching contribution equal to the estimated value of the federal income tax benefit if the contribution had been made to an employer-plan. Doing so could put the individual in the same position as she would have been in if federal income tax law treated employer and individual retirement savings equally, but it would obviously do so at a cost to state governments. If a state were to expend money on a retirement plan through the use of state tax benefits it would likely want to address how to treat participants in the state plan who move to a different state either before or during retirement. One possibility would be to have a claw back provision that would require repayment of the tax benefit upon losing state residency. On the whole, while states may be good laboratories for experiments in this area, existing federal law may make it difficult for states to meaningfully pursue retirement savings improvements.

3. Which Plan Provider?

Regardless of whether the backstop retirement plan was established at the federal or state level, thought would need to be given to which entity would most appropriately administer the plan and any investment options. One approach would be to designate either a governmental agency or an independent agency to administer the plan. For example, the California law establishing a state retirement plan for all workers allows the state to designate CALPERS (the California Public Employee Retirement System) as the plan administrator.[91] Another approach would be to take a free market approach, and allow any licensed investment firm to offer a retirement plan structured around legal design and investment requirements. Providers could also be made subject to basic fiduciary duties with respect to participants' accounts. While this option involves less direct government action than the first proposal, it would also be in many ways harder to implement, and may cost participants more if fees are not very closely regulated. If there were numerous providers for these plans, it would be difficult to auto-enroll participants, unless some entity wanted to take responsibility of assigning individuals to certain providers. In addition, it would complicate payroll deduction significantly, given that employers would be responsible for transferring contributions to many different providers instead of a single entity.

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[91] See CAL. GOV'T CODE Sec. 20139 (2013).

B. CONGRESSIONAL ACTION TO ALLOW STATE INNOVATION

There may not be political will at the federal level to implement a backstop retirement plan, and states may be hampered in their reform efforts by existing federal laws that constrain their options. One available compromise would be for Congress to amend ERISA to allow state governments to require automatic enrollment in state retirement plans and allow employer contributions to such plans without triggering ERISA preemption. Doing so would significantly broaden states' reform options. If this reform is perused, careful thought should be given to whether ERISA should apply to such state plans and, if so, whether any of its requirements should be modified.[92]

In addition to addressing the ERISA barriers to state action, Congress could also amend the tax code to provide tax benefits for state-based plans that are equivalent to those afforded to private-employer plans. There would again be the issue of increased cost, but perhaps Congress would be willing to do so in order to see the results of state-based retirement plan experiments.

V. CONCLUSION

The system of retirement savings on which many Americans currently rely does not generate sufficient capital for most individuals to adequately replace their income in retirement. While a widespread shift to 401(k) plans has likely contributed to this outcome, this article has suggested that it is not 401(k) plans per se that are to blame, but rather a bad combination of flawed individual decision-making and poor employer plan design. The federal government could take a lesson from the ACA and create a universally available retirement plan designed to reflect the many lessons learned from behavioral economics about encouraging retirement savings. If it is unwilling to do so, it could at the very least make it possible for states to meaningfully experiment with universal retirement savings options.

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[92] Historically there has been little political interest in subjecting state retirement plans to ERISA regulation. *See* Amy B. Monahan & Renita K. Thukral, *Federal Regulation of State Pension Plans: The Governmental Plan Exemption Revisited*, 28 ABA J. LAB. & EMP. L. 291, 297 (2013).