It's Time to Shift Retirement Plans Away from Employers

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MarketWatch Blog by Alicia H. Munnell

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Breaking the link between employers and retirement may be key to better system.

Lots of proposals have been put forth for a new and better retirement system, but they don't answer the question of how we get from here to there.**[1]** We have a fairly extensive – albeit far from perfect – 401(k) system that people have just begun to understand. In my view, it makes more sense to *transform* 401(k) plans into our ideal rather than to superimpose a new system on top of what we already have. But figuring out just what steps to take is hard. I am beginning to think that the single most important step is to shift the responsibility for sponsoring and administering retirement plans from employers to independent entities.

Interestingly, such a shift is a major component of principles in plan design just released by the American Academy of Actuaries – "Retirement for the AGES: Building Enduring Retirement Income Systems." AGES reflects the four principles of **A**lignment, **G**overnance, **E**fficiency, and **S**ustainability. The focus of this discussion is alignment, which requires aligning the stakeholders' roles with their skills. In the case of individuals, alignment means recognizing that most people lack the financial skills needed for retirement planning and therefore require simple structured choices. In the case of employers, alignment means recognizing that many employers do not have the desire, ability, or resources to administer retirement plans and would benefit from shifting the responsibility to third parties. Such a shift would also have the potential to improve access and portability and to reduce costs through economies of scale.

The proposal to reduce the role of employers in the provision of retirement income did not originate with the American Academy of Actuaries. In fact, the ERISA Industry Committee – a membership organization representing the employee benefit plans of the nation's largest employers – put forth just such a proposal in 2007. This group argued that large employers are burdened by the fiduciary and administrative responsibilities associated with being plan sponsors. Employers cite complex regulations and escalating financial commitments and that plan sponsorship diverts their attention from their business activities just when they need most to focus. The Council's proposal would shift the responsibility of the provision of retiree and health benefits from the employer to "New Benefit Platforms" that would be administered by intermediaries with expertise in designing, delivering, and managing such benefits.

Under both of these proposals, employers would become more of a conduit. Those who want to offer generous benefits to compete for talent could continue to do so through retirement plans and health benefits, but their job would be reduced to transferring money to some type of new platform. That is how the well-respected Australian system works.

Transferring the sponsoring and administration of retirement plans to third parties could solve a lot of problems. One is coverage. Less than half of the private sector workforce is covered by any type of retirement plan. The uncovered could be defaulted into plans run by these third –party entities. The second problem is leakages. 401(k) balances could remain with the third-party administrator when workers change jobs, eliminating the cashing out of balances upon termination. The third problem is costs.   Third-party administration could lead to more standardization in plan design and fee disclosures and offers economies that could bring down costs for small and mid-sized companies.

Proposals to reduce the role of employers seem to hold so much promise for both employers and individuals. And these proposals are not coming from starry-eyed radicals but from sedate business people and actuaries. Could we really do this?

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[1] For examples of proposals, see the **SAFE plan** or the **Guaranteed Retirement Accounts** proposal.