EDUCATION

PODCAST: Updating the Outlook for Fundamental Changes to the US Retirement System

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An update on the legislative and regulatory landscape affecting US retirement plans and policy, with Drew Carrington, Franklin Templeton's Head of Institutional Defined Contribution, and Michael Hadley, a partner at the Washington, DC law firm Davis and Harman.

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Key Takeaways

- We were cautiously optimistic that some retirement legislation would make it through by the end of last year, but unfortunately, like a lot of parts of the government, retirement legislation got stuck with other problems that Congress had in moving things forward.
- Thinking about the retirement regulations that have already passed, those that are likely to be issued in the short to intermediate term and all of the legislative proposals, we are looking at a lot of fundamental changes to the retirement plan landscape, covering really the full gamut of issues.
- When talking about employers that don't offer plans today—that don't offer their employees an opportunity to save—we sort of generalize that to assume that these are all very small employers with very low paid employees and that's not necessarily the case.
- The Retirement Enhancement and Savings Act (RESA) did pass in the House in a bill with other provisions called the "Family Savings Act," but never made it across the finish line. Those ideas seem likely to be resurrected because there are members of Congress interested in improving the retirement system.

Podcast Transcript

Host/Richard Banks: Hello and welcome to Talking Markets with Franklin Templeton Investments: exclusive and unique insights from Franklin Templeton. I'm your host, Richard Banks.

Ahead on this episode, landmark changes to the US retirement system stalled, but perhaps only temporarily. The major factors that slowed momentum, and how it could soon pick back up as a result of some changes in leadership in Washington. Plus, the possibility of saving plans expanding beyond retirement.

Talking about it all is Michael Hadley, a partner at the Washington, DC law firm Davis and Harman, who practices in the area of laws affecting retirement plans. He's joined by Drew Carrington, Head of Institutional Defined Contribution at Franklin Templeton Investments. Drew, take it away.

Drew Carrington: Thanks, Richard. Michael, a lot has changed since we last talked. We have had an election, we have had a [government] shutdown, we thought were going to get some stuff done in the lame duck and it didn't happen. So let's start with the legislative front, what did we think was going to happen and what actually happened?

Michael Hadley: You know, I think when we last talked, we were cautiously optimistic that some sort of retirement legislation would make it through by the end of the year, either before the election or during the lame-duck session. And I don't think it's because there wasn't bipartisan agreement that there are some common-sense ideas to improve the retirement system. It's, unfortunately, like a lot parts of the government, retirement legislation just sort of got stuck with all the other problems that Congress had, kind of moving things forward.

Once the shutdown occurred, there really wasn't room to talk about anything else. We were very hopeful that the Retirement Enhancement and Savings Act or what we call RESA, would pass in some form and it actually did pass in a version in the House in a bill called the Family Savings Act with other provisions, but never made it across the finish line. I don't think those ideas or lots of other ideas that are out there are dead. In fact, I think they are going to be resurrected because there is a lot of evidence that, even after the election, there are folks in Congress that are interested in improving the retirement system, the private retirement system. So, I continue to think that there will be attention on that, and that we will see it in the next two years.

Drew Carrington: So let's talk about those folks who are interested. We have obviously had some changes post-election in the committees that oversee retirement policy and so maybe we start there and talk about who the players are?

Michael Hadley: So in Congress, in the retirement space, there are really four key committees: the Senate Finance Committee, the Senate Health Education, Labor and Pensions Committee, on the House [of Representatives] side the House Education and the Workforce Committee and the House Ways and Means Committee. So you have three chairmen or chairwomen of these committees that have switched.

On the Senate side, Senator Orrin Hatch, longest-serving senator, has left Congress, and his seat as chair of the Senate Finance Committee was taken over by Chuck Grassley. On the House side, you had a flip in control and the House Education and Workforce Committee is now going to be chaired by Bobby Scott who's out of the Norfolk area of Virginia. And most importantly, the House Ways and Means Committee—really the key committee on taxes in the House—is going to be chaired by Richard Neal out of Massachusetts, somebody who has a long history with retirement, long history in trying to get things done on a bipartisan basis, and we know is going to feature retirement prominently in the next two years.

Drew Carrington: Last week, Chairman Neal held a hearing in House Ways and Means on retirement policy, wondering what your thoughts are on that hearing, what do we learn about his legislative plans, if anything in that hearing.

Michael Hadley: The biggest takeaway for me from this hearing, which was the second one held in the Ways and Means Committee under Chairman Neal's leadership, was just the number of members that showed up, which sent a strong signal that this confirmed this is an area of interest for Chairman Neal and for his committee members, many of whom on the democratic side or are brand new to the Ways and Means Committee. Neal was saying his members, this is important and this is an area where we can get things done. It confirms for me, Drew what we've been saying for a long time, that retirement changes to enhance the retirement security system is an area where bipartisanship continues to be possible. There was a lot of talk about RESA and the open MEP idea, which continue to have strong support and in fact, RESA was reintroduced in connection with the hearing on a bipartisan basis in the House.

We expect reintroduction in the Senate fairly soon and the Republican version of RESA, the Family Savings Act was reintroduced as well. I continue to believe that if there is new pension legislation this year, it's likely to include some core ideas from RESA, including open MEPs, enhancements to automatic enrollment and in-lifetime income ideas. Now, if you listen to the entire hearing, one of the things you notice is that while there's bipartisanship and a lot of good ideas for retirement security, the private retirement system for members of Congress, what they hear from their constituents about is the importance of keeping Social Security solvent and addressing the multi-employer funding crisis that had more emotional resonance. It's also an area where it's hard to get bipartisanship, but if you focus solely on the parts that we really worry about, that is enhancing the private retirement system, I continue to believe that the parties are much closer together than they are on other areas. Mr. Neal didn't signal, kind of, his next steps, except he signaled he's going to do something on retirement. So, we will expect that he's going to continue to move towards legislation sometime this year.

Drew Carrington: We have also got a couple of names in the retirement space that have popped back up again. Portman and Cardin have also proposed a new bill. Maybe we can talk a little bit about what their role is in this process also?

Michael Hadley: Portman and Cardin have a long history of working together on retirement. Ben Cardin out of Maryland and Rob Portman out of Ohio, a Democrat and a Republican, respectively. They actually worked together when they were House members many years ago on a bill that many of our listeners may not know the name of, EGTRA [Economic Growth and Tax Reconciliation Act], but they certainly know what it did. It significantly increased contribution limits and created catch-up contributions. Those two gentlemen have always said that they wanted to find another way to work together. They are now both in the Senate, and they introduced a bill late in the last Congress that has a lot of bipartisan commonsense ideas. There are more than 50 provisions in that bill. Lots of ideas to simplify retirement administration to make it easier to save on an institutional basis, to enhance the integration of student loans and retirement plans, make it easier to have lifetime income vehicles, lots and lots of ideas. We expect that, because we have divided Congress, that the only thing that can really pass in the next two years are going to be bills that have bipartisan ideas that are widely supported, and I think in the next two years those are two names we are very likely to hear as retirement legislation moves forward.

Drew Carrington: So we have the RESA bill which has passed Senate, passed in some flavor in the House late last year, we got Portman/Cardin on the Senate side and then we have Neal on the House side. So at least three bills of varying degrees of comprehensiveness. Maybe we could talk a little bit about how these three bills work their way through Congress and maybe talk about which provisions could end up in a single bill or if they go in two bills, what's the process here?

Michael Hadley: Well, it's interesting, we're just finished with the shutdown, so a lot of members of Congress have done nothing other than kind of get organized and sort of staff their committees. Each of the committees, particularly in the House, they are changing membership in the House, many of the Republicans either lost or have been kicked off the committee because the ratios change, and on the Ways and Means Committee there is a number of new Democrats. So, it's only speculating this point, in part, because Congress is just getting started but we have, sort of, this RESA Bill that has a lot of bipartisan support, passed unanimously out of the Senate Finance Committee a couple of years ago. One possible path forward is just to, kind of, pass that, and that is possibly geared up and ready to go. There is no reason that Congress couldn't do that. It's also possible that Mr. Neal, on the House side, will say, no I like those ideas but I have lots of other ideas I like, including some simplification ideas and a bill, that he is very fond of, that is designed to increase coverage by requiring every employer except the very smallest to offer a 401(k) plan.

So the question is how do all the bills we have talked about here kind of work their way to the House floor if there really is bipartisan support. I offer a couple of comments. The first is Chairman Neal has really shown that he is going to put his money where his mouth is. He has already held a hearing on retirement to, sort of, get his members educated on some of the issues that are out there, particularly the new members to the Ways and Means Committee and the second thing is that whatever he decides to do, in terms of, kind of, putting a bill together, it’s going to start by working his way through the committee, where he will give his members a chance to add things and subtract things, and then ultimately the leadership of the House and then of course the Senate will decide what do they want to put on the floor.

My guess would be there is probably only enough floor time for one retirement bill. If I were in charge, I’d try to get as many bipartisan ideas done I can in a single bill, which suggests that this bill would be loaded up with a lot of different ideas.

Drew Carrington: So it might have some of the aspects of Portman-Cardin as well as some of Neal’s and, in effect, folds in the RESA provisions, and then the debate, kind of, ends up at the edges. Obviously, Neal’s bill is more ambitious. Once you start talking about mandating offering plans, that gets both ambitious and starts to implicate scoring because now you are going to have higher levels of coverage, more people participating in plans. So those seem like the most difficult things to get done. Is that kind of how you think the process happens?

Michael Hadley: I think that’s right. Mr. Neal has to make a decision, and I agree with you 100%, very hard to pass in the Senate, a new mandate on employers which is what his bill is, even though it’s probably as reasonable a mandate as we ever going to get on the retirement side. He has to decide, gee, do I try to include that to get that passed, because it’s critical to me and could be important in the presidential election, or do I focus just on the things that I think can get through the Senate. Of course, the Senate colleagues are going to be weighing in with him as well, and as we have already said, it’s what Mr. Portman and Mr. Cardin can do, what they are willing to do together, is going to be pretty critical, because I think, on the Senate Finance Committee, they are really going to be looked to as leaders on the retirement space and Chairman Grassley is likely to defer to those folks in terms of what can be done on the retirement side.

Drew Carrington: So we have got a lot going on the legislative front. You alluded to the focus on student loans, so that employers can encourage the young employees who have student debt to participate in the plan and pay down their student loans at the same time. I think that’s a really interesting phenomenon, in addition to some of the other points that you made, may improve retirement participation and savings among a demographic that is challenged today because of their levels of student loan debt.

Michael Hadley: I think the student loan issue highlights what we’ve tried to talk about here in Washington; that is, in order to increase retirement savings, we have to think holistically about an employee, and there was a private-letter ruling on the interaction between student loans and retirement plans which got a lot of attention, and now it’s getting even more prominence. As I said, the Portman and Cardin Bill includes a provision on this, Senator Ron Wyden, who is the ranking member of the Senate Finance Committee of Oregon, also has a standalone bill. And basically, what’s going on both in Congress and with the regulators is, they are thinking very seriously about, gee, can we expand this so that, number one, we deal with a lot of the thorny technical issues you would have if you set up a program that integrates student loan and the retirement plan; and, might we expand this beyond student loans. If you read the private-letter ruling, the analysis is not limited to connecting student loan repayments and the plan. In fact, at least in theory, you could do the same for the other types of monies that an employee put somewhere else. So, for example, maybe you provide a matching contribution for employees that are repaying their student loan or contributing to a 529 account, or to what’s called an ABLE account for disabled individuals. There’s a lot of talk about expanding that and making it easier for people to both accumulate retirement savings while dealing with some of the other financial issues that they have at different stages of their life.

Drew Carrington: I think this fits with the broader industry trend of talking about more holistic financial wellness, but as you alluded to, there are some tricky technical questions there. You did also raise the question about the regulatory agencies, while the Congress has been stymied in terms of moving legislation forward on the retirement-policy front, the Department of Labor [DOL] in particular, has been pretty active. We saw a couple of advisory opinions and a proposed regulation come out of the DOL in the fourth quarter. The one, I think, that's particularly interesting is their association retirement plan proposed regulation which was issued in October, comments closed on Christmas Eve, so we expect to see something out of the DOL probably in the first quarter on that front. That's kind of the DOL's version of the open multiple employer plan. This is one of the tracks to try and improve coverage and access.

Michael Hadley: Yes, this proposal while it's tagged as being related to the open MEP [Multiple Employer Plan] idea, in a way, it's really not that. In a way, it's really expanding what's considered a closed multiple employer plan. And just a backup for a second, the Department of Labor has taken the position for a long time that unrelated employers cannot join together to offer or to participate in a single plan for ERISA purposes, and that makes it difficult for small employers to get either health coverage or a retirement plan coverage.

The Department of Labor first put out what they call the Association Health Plan proposal which basically, with a bunch of requirements, allow small employers to join together into a single health plan which streamlines administration and provides some relief from some state rules. And they followed that up with what they call the association retirement plan proposal. It doesn't allow any unrelated employer to join together. There are some pretty strict rules around the types of employers that could participate in these association retirement plans. It's just a proposal, but most of the comments were both supportive and asking the Department of Labor to expand. The main thrust of this proposal—it would allow a local Chamber of Commerce or business league or trade association to offer a plan to employers that have some commonality, either they are in the same trade or they are in the same geographic area. That would open up, what's allowed under current law, but not a lot, and the Department of Labor has said, repeatedly, that they feel like, that's as far as they can go without a change in the law, which is why I continue to think there's a good chance that Congress might change the law.

I'm sort of interested Drew in your take on how big you think of a deal this is, that is, the Department of Labor, and if they sort of keep it as strict as they have kept it, whether it will have the impact that they are expecting.

Drew Carrington: Well, I think it will have an impact on access in coverage, and I think it will create an opportunity, particularly, for either small employers that currently offer a plan to band together under a single umbrella, as well as small employers that don't currently offer a plan.

One thing that happens when we talk about employers that don't offer plans today, that don't offer their employees an opportunity to save, we sort of generalize that to assume that these are all very small employers with very low paid employees and that's not necessarily the case. Certainly, if you look out here in Silicon Valley, it's a lot of startups where the business is focused on the business, not on offering a retirement plan. And, if there were a simple way to participate in a retirement plan and enable folks who are compensated at a level high enough to be able to save for retirement, then, I think you can see some traction there. I mean, it would be at the margin. It's not, certainly, the open MEP level of opportunity for improved coverage and access, but it will move the needle at the margin. Importantly, it moves the needle because we know what the metrics are on large plans. We know that large plans can provide lower-cost investment options, more services, so all those kind of holistic financial wellness things that we just talked about earlier. They can have higher participation rates, higher deferral rates, better metrics with regard to diversification of the participant portfolios. If we can move those metrics closer to large plan metrics by banding together small plans under an umbrella that employers are comfortable with, then that's progress. So, with a single stroke of a pen, does it solve the challenges that we face with coverage and access in retirement plans in America? No. Does it improve the landscape that we have? Absolutely.

But the other challenge with the DOL's Association Retirement Plan proposal is, while it does open up the landscape somewhat for unaffiliated employers to participate together in a single plan, we still have the issue which is commonly referred to as the "One Bad Apple" rule, and we need the Treasury or IRS [Internal Revenue Service] to issue guidance on that side.

Michael Hadley: The President ordered Treasury and IRS to look at the problem of what happens if you've got a multiple employer plan, which has a lot of employers that participate, many of which could be very small. Under current law, if any single one of those employers does something that's inconsistent with the plan document or violates the nondiscrimination rules, the whole plan theoretically is disqualified. In practice, that tends not to happen, but it scares away employers from participating, and it makes difficult for the Multiple Employer Plan sponsor to deal with employers that either stop responding, go out of business, or aren't doing what they are supposed to.

Drew Carrington: That's different in a single employer plan, where, if a single employer has some technical issue or fails to file a form or whatever the issue is, the risk of a disqualification is actually relatively low. There's lots of procedures to correct errors that might be made.

Michael Hadley: That's right, that's right. It's just much more difficult to deal with an error of some kind when you've got, call it 100 employers, and one of them seems to have done something wrong. Right now, for example, it's very hard to just say to that employer, "You know what? You are gone. You take your plan, go somewhere else because we don't want you infecting your apple with our bunch." So what the president ordered the Treasury to do is to come up with a solution to that. And they have not issued proposed regulations yet, we don't even have a sense of, kind of, when that's going to happen, but we do think it's going to happen. After all, the president did order the Treasury to work on it. And so, I would expect a proposal this year. That, along with opening up the multiple employer [plan], who can join together, whether it's a change in Congress or moving forward in the association retirement plan. That, with the one bad apple, solves at least two of the issues that we have heard a lot about that limit small businesses from joining these plans and making them more difficult to operate.

Drew Carrington: Anything else on the regulatory front that those of us in the retirement business ought to be thinking about?

Michael Hadley: Yes, let me mention a couple. You talked earlier about issues related to missing participants, and I continue to think that's an area that plan sponsors and their service providers should really think about. What are we doing to help keep track of the participants that change jobs, leave us, how do we prevent their addresses from going bad, how do we get rid of small accounts, how do we deal with that? We know that DOL continues to be focused on that, and I think we will hear more about missing participants and what it means for plan fiduciaries this year.

We are also waiting for some sort of final rule from the SEC [Securities and Exchange Commission] on what we broadly call the "Best Interest Proposal." Although it's really five proposals, it's best interest standard for broker-dealers providing retail investment advice, it's guidance to investment advisers on their duties and then it's three separate additional proposals all related to sort of notices and how you title yourself in your disclosures and that kind of thing.

That is a high priority for SEC Chair Jay Clayton. He has essentially committed to trying to get a vote on that within the SEC this year. He has both of his Republican colleagues now seated. So, at least he theoretically has the votes he needs in order to finalize that proposal, and it's a proposal that is often viewed as very closely related to the now-overturned Department of Labor fiduciary proposal. On the other hand, though, I think the SEC's proposal is pretty widely supported by most folks in the industry—the advice industry if you will, as well as the 401(k) and pension industry. And the reason for that is not because it's perfect. In fact, there are lots of comments that folks have made to try to improve it, but that's also true on the other side. Investor advocates have looked for improvements in the proposal, which suggests to me, that the SEC probably did a good job of sort of getting it right if there are comments going on both sides.

We don’t know what the final rule would look like, but I think it’s very likely that the SEC will publish a final rule this year and the power of that is it brings a best interest standard when people are providing advice which really nobody disagrees with. It’s really about the details about how that advice works, what you can do to compensate somebody for providing advice and ensuring that both the advisor model and the broker-dealer model continue to be viable as a way of delivering services to investors and to retirement plan participants.

Drew Carrington: I think it’s safe to say that, if you think about the regulations that have already passed, the regulations that are likely to be issued in the short to intermediate-term and all of the legislative proposals, we are looking at a lot of fundamental changes to the retirement plan landscape, covering really the full gamut of issues, whether we are talking about access or coverage or disclosures or how people draw their money out of plans, the financial wellness, investment choices, rollovers. It’s really almost radical. Certainly, pretty transformative, in terms of what we are looking at, if even half of what’s proposed out there today gets passed, it’s going to be a really changed environment for us.

Thank you Michael, as always it’s pleasure talking to you I’m looking forward to our next discussion, and a look at what changes we have seen, and what we are likely to see in the future.

Host/Richard Banks: And thank you for joining us for this episode of Talking Markets. We hope you enjoyed the conversation. If you’d like to hear more, visit our archive of previous episodes and subscribe on iTunes, Google Play, or just about any other major podcast provider. So until next time when we uncover more insights from our on the ground investment professionals, goodbye!

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