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Federalism of Personal Finance: State & Federal Retirement Plans

William Birdthistle

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INTRODUCTION

The critical time horizon for most American lay-investors is the length of their career. Today's America is one in which workers are losing significant financial assistance from pensions or Social Security, and so they must save—and invest those savings—in their own retirement accounts. The challenges of this project are enormous. As a population, Americans save too little and invest what little they do save unwisely. The explanations for these shortcomings are numerous: our educational system offers little coherent financial education to investors, and the task of saving is not one at which people can easily become experts on their own. As Richard Thaler has noted, wryly, humans do not have many ways to improve at this project because "when it comes to saving for retirement, barring reincarnation we do that exactly once."[1]

Though not every financial observer believes the United States will soon face problematic shortfalls in our system of saving,[2] a great many do.[3] Data on the income and assets of America's retirees reveal a complex picture of a heterogeneous population. Today, older Americans are, in

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* Professor of Law, Chicago-Kent College of Law. For their helpful questions and comments, I thank the participants of the Public Law & Legal Theory Workshop at the University of Chicago Law School and the participants of the 2017 Law and Entrepreneurship Association Retreat at Berkeley Law School.

1. RICHARD H. THALER, MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS 50 (2016).

2. *See, e.g.*, Andrew G. Biggs, *New Evidence on the Phony "Retirement Crisis*,*"* WALL ST. J. (Jan. 4, 2016, 7:10 PM), https://www.wsj.com/articles/new-evidence-on-the-phony-retirement-crisis-1451952646 (arguing that data released by the Congressional Budget Office in December 2015 suggest that Social Security's "promised benefit levels are far more adequate than is often portrayed").

3. *See, e.g.*, CHARLES ELLIS, ALICIA MUNNELL & ANDREW ESCHTRUTH, FALLING SHORT: THE COMING RETIREMENT CRISIS AND WHAT TO DO ABOUT IT (2014); Saul Levmore, *Inequality and the Elderly Poor*, *in* AGING THOUGHTFULLY: CONVERSATIONS ABOUT RETIREMENT, ROMANCE, WRINKLES, AND REGRET 182, 182–94 (Oxford Univ. Press 2017) (proposing "a bold expansion of Social Security" to "make a great majority of Americans, including the elderly poor of the future, much better off").

aggregate, a wealthy cohort, flush with a lifetime of savings and buoyed by a felicitous rise in real estate values. Yet, four million elderly Americans are individually poor.

The circumstances of the impending ten-year cohort of workers preparing to retire, those aged fifty-five to sixty-four, however, is clearer: they enjoy a lower incidence of defined benefit pensions and markedly fewer personal savings. They and those who will follow them—many with no savings whatsoever—are headed for more serious financial difficulties. Large numbers of people will have to work many more years than expected, often in difficult jobs, while enduring impoverished retirements.

Possible solutions to this problem generally fall into three broad categories: (1) expand defined benefits, such as by buttressing or expanding Social Security[4] or by introducing "guaranteed retirement accounts";[5] (2) increase personal savings by using behavioral techniques to enroll workers automatically in 401(k) accounts, to contribute automatically to those accounts, and to select default investments other than cash;[6] and (3) do nothing out of indifference or disagreement with the existence or magnitude of the problem.

My focus is upon the second approach: increasing personal savings by improving our current system of defined contribution accounts. Existing behavioral work on enhancing accumulation through automatic enrollment and automatic escalation is insightful, effective, and already comprehensive. Yet, even if we successfully implement these proposals and amass greater savings, the resulting investments and their future earning potential may nevertheless be squandered due to shortcomings within existing defined contribution plans and our inexpert use of them.

In this Article, I consider possible approaches that attempt to improve the plans through which millions of Americans tend to their life savings. I begin by considering the inadequacies of our current system of defined contribution accounts and then address two possible alternatives: the first being a federal account universally available to Americans based largely on the model of the Thrift Savings Plan; the second being a system of state-based retirement accounts like those that have already been developed in a handful of states. Though I conclude that a single, federal plan would be

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4. *See, e.g.*, Levmore, *supra* note 3, at 182–85.

5. *See* TERESA GHILDARDUCCI & HAMILTON JAMES, A COMPREHENSIVE PLAN TO CONFRONT THE RETIREMENT SAVINGS CRISIS 6 (2016), http://www.economicpolicyresearch.org/images/Retirement_Project/Retirement_Security_Guaranteed_digital.pdf [https://perma.cc/C2NC-5LEH].

6. *See, e.g.*, RICHARD H. THALER & CASS SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 108–10 (2009).

superior, either alternative approach would be an improvement over our current system.

I. PROBLEMS WITH DEFINED CONTRIBUTION ACCOUNTS

Like the complaint of Woody Allen's two elderly women talking about the food at a Catskill mountain resort, a significant problem with 401(k) plans is that they may be both "really terrible" and available in "such small portions."[7] That is, while many 401(k) plans suffer from a litany of shortcomings, over 68 million Americans work for employers who offer no retirement plan whatsoever (and thus enjoy no access to valuable tax savings).[8]

Both academic work by scholars, such as Ian Ayres and Quinn Curtis, and recent litigation by firms, such as Schlichter Bogard & Denton, have identified a variety of problems in defined contribution plans. In their 2015 study, Ayres and Curtis argued that fees and menu offerings in many 401(k) plans "lead to a cost of seventy-eight basis points in excess of index funds."[9] "Fees are so high" in sixteen percent of the plans Ayres and Curtis analyzed "they consume[d] the tax benefits of investing in a 401(k) for a young employee."[10]

Similarly, Schlichter Bogard has alleged a suite of other problems with employer contribution plans in lawsuits against Lockheed Martin, Boeing, and John Deere, and more recently against major universities, such as Massachusetts Institute of Technology, New York University, and Yale University.[11] Specifically, Schlichter Bogard alleged excessive administrative costs, the inclusion of unnecessarily expensive share classes of mutual funds, too many fund choices, and selections of conflicted investment advisors.[12] If these allegations are true, the administrators of the employers' plans certainly have made poor—and easily avoidable—choices on behalf of their employees.

Certainly, the state of defined contribution plans in the United States could be improved. Indeed, even if one does not believe there is a current

7. ANNIE HALL (United Artists 1977), http://www.dailyscript.com/scripts/annie_hall.html [https://perma.cc/8UAL-XAQK].

8. U.S. DEP'T OF LABOR, FACT SHEET: STATE SAVINGS PROGRAMS FOR NON-GOVERNMENT EMPLOYEES 1 (Nov. 16, 2015), https://www.dol.gov/sites/default/files/ebsa/about-ebsa/ouractivities/resource-center/fact-sheets/state-savings-programs-for-non-government-employees.pdf [https://perma.cc/Z2RJ-2SAE].

9. Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L.J. 1476, 1481 (2015).

10. *Id.*

11. *See* Tara Siegel Bernard, *M.I.T., N.Y.U. and Yale Are Sued Over Retirement Plan Fees*, N.Y. TIMES, Aug. 10, 2016, at B1; *see, e.g.*, Hecker v. Deere, 556 F.3d 575 (7th Cir. 2009).

12. *See* Bernard, *supra* note 11.

or impending retirement crisis, improvements to our system of saving could—costs and benefits permitting—be a welcome boon to millions of Americans.

II. PROPOSAL I: CREATE A NATIONAL THRIFT SAVINGS PLAN

An ideal defined contribution plan would be one managed by an experienced investment advisor offering a limited selection of high-quality investments at low fees. Happily, such a plan already exists: the Thrift Savings Plan (TSP).[13]

The TSP is the defined contribution plan for federal employees; 4.9 million[14] of whom use it to invest an aggregate of $495 billion.[15] The plan is managed by the world's largest private asset manager, BlackRock, which offers ten prudent investment options and charges an average fee of just 3.8 basis points.[16] For comparison, the average 401(k) fee that private sector employees currently pay is sixty-seven basis points.[17]

I reiterate my proposal that we allow all American workers to invest in the TSP.[18] Or, if current TSP participants object to the rise in fees that such an influx of participants would inevitably cause, then I propose we create another federal plan just like it (which we can call TSP-II).

A. Implementation

To implement this proposal, Congress could use its constitutional power to regulate interstate commerce to amend the Employee Retirement Income Security Act of 1974 with the addition of a few salient provisions.

First, employers of more than a *de minimis* number of employees—say, five—would be required to enroll their employees automatically in TSP-II accounts unless those employees opt out of the plan. Accordingly, the universe of covered employers could be either just those who do not

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13. THRIFT SAVINGS FUND, FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015 (2017), https://www.tsp.gov/PDF/formspubs/financial-stmt.pdf [https://perma.cc/TY4S-SF83].

14. *Id.* at 6.

15. *Id.* at 4.

16. *See* WILLIAM A. BIRDTHISTLE, EMPIRE OF THE FUND: THE WAY WE SAVE NOW 214 (2016); Stephen Foley, *BlackRock Assets Under Management Hit $5.4tn on Record ETF Inflows*, FIN. TIMES (Apr. 19, 2017), https://www.ft.com/content/adeae206-2502-11e7-8691-d5f7e0cd0a16 (noting that BlackRock is "[t]he world's largest asset manager, with $5.42tn under management at the end of March [2017]"); THRIFT SAVINGS FUND, *supra* note 13.

17. *See* Liam Pleven, *401(k) Fees: What is Reasonable?*, WALL ST. J. (Feb. 20, 2015, 4:52 PM), https://blogs.wsj.com/totalreturn/2015/02/20/401k-fees-what-is-reasonable/.

18. *See generally* BIRDTHISTLE, *supra* note 16, at 212–18.

offer their own retirement plan (who, again, employ 68 million workers)[19] or all employers (with 124 million full-time and 27 million part-time employees).[20] Alternatively, TSP-II implementation could begin with a narrower category of employers and, if successful, subsequently expand to the broader one.

After enrollment, covered employers would submit, together with their usual tax withholdings, regular default contributions of three percent of each employee's salary to TSP-II. Like the TSP, employers would be permitted—but not required—to match contributions in line with existing limits. As a default, funds in each employee's TSP-II account would be invested in a target-date fund keyed to their projected retirement date. Over time, the employees' contributions would automatically and incrementally escalate from the initial three percent figure until they reach a cap of ten percent. Employees could, of course, decline to participate in TSP-II or change each of these settings.

Unemployed or self-employed workers who wish to participate could enroll directly in TSP-II and link their bank accounts to deposit contributions automatically in their TSP-II account. On issues of tax deferment and withdrawals, TSP-II savings would be treated in the same manner as all assets in 401(k) plans. Should employees lose or change jobs, they would maintain their existing TSP-II account.

The new plan would be overseen by the Federal Retirement Thrift Investment Board, which currently administers the existing TSP.[21] Or, if that board objected to these additional duties, a new body could be constituted with oversight of TSP-II, following the TSP model. Investment management and administrative services (such as furnishing account statements, maintaining websites, staffing toll-free telephone numbers, and providing the usual complement of tasks required by individual accounts) could, as is the case with the TSP, be outsourced to private vendors.[22]

B. Potential Benefits

1. Prudent Investment Options

For at least two possible reasons, many defined contribution plans offer participants a menu with poor investment options—options that are

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19. *See* Carol Hymowitz, *The 401(k) Crisis is Getting Worse*, BLOOMBERG (Oct. 21, 2015, 7:32 AM), https://www.bloomberg.com/news/articles/2015-10-21/bad-math-68-million-americans-no-401-k-epic-savings-crisis.

20. *Economic News Release: Table A-9. Selected Employment Indicators*, BUREAU LAB. STAT., https://www.bls.gov/news.release/empsit.t09.htm [https://perma.cc/5MG4-TZ2Y].

21. *See generally* THRIFT SAVINGS FUND, *supra* note 13.

22. *See generally id.*

unsuitable for the project of long-term investing, unnecessarily expensive, or simply too numerous. The first reason is simply a lack of sophistication on the part of the employer. A company may not internally possess the investment expertise necessary to make good choices for their plans or to evaluate the choices proposed by third-party vendors.

The second reason is that an employer may receive compensation from vendors in exchange for the inclusion of inferior investment options. If, for instance, an employer agrees to hire, say, Fidelity to administer the company's 401(k) plan, and Fidelity includes a number of expensive Fidelity funds in the plan's menu, Fidelity might then agree to share a portion of the revenue it earns as the advisor of those funds with the employer. Such arrangements exist and have been litigated.[23]

Highly specialized, undiversified, and expensive funds are, one hopes, self-evidently bad choices for workers attempting to save prudently over a several-decade time horizon. Perhaps less obviously, the inclusion of too many choices on a 401(k) menu is also imprudent. Studies have demonstrated that offering too many options to consumers—including investors—can have a stultifying effect on the purported beneficiaries.[24] One analysis has found that for every ten additional choices included on a 401(k) menu, participation in the plan drops by 1.5%–2%.[25] According to the study, the average plan with thirty options yielded a participation rate of seventy percent, but when those options were increased to fifty-six, participation fell to sixty-one percent.[26]

The TSP offers just ten investment options: five target-date funds, four broad-based index funds, and one fund invested exclusively in Treasury securities.[27] Hewing to that model, TSP-II would provide access to such a prudent array of choices for a massive number of Americans. Indeed, a universal TSP-II would allow employees to reject their employer's plan menu, if it were inferior, in favor of these choices.

2. Professional & Monitored Management

While the TSP may be easily derided or dismissed as simply "a government plan" (with all the stigma that appellation carries in certain quarters) management of the TSP's investments is decidedly not "government work." BlackRock, the firm that currently serves as the TSP

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23. *See, e.g.*, Hecker v. Deere, 556 F.3d 575 (7th Cir. 2009).

24. *See, e.g.*, Sheena S. Iyengar, Wei Jiang & Gur Huberman, *How Much Choice is Too Much? Contributions to 401(k) Retirement Plans*, *in* PENSION DESIGN AND STRUCTURE: NEW LESSONS FROM BEHAVIORAL FINANCE 83 (Olivia S. Mitchell & Stephen P. Utkus eds., 2004).

25. *See id.*

26. *See id.*

27. *See* THRIFT SAVINGS FUND, *supra* note 13.

advisor, professionally manages over five trillion dollars[28] and enjoys a sterling reputation in the private sector investing community. Should the performance of TSP-II's funds ever lapse, the plan's oversight board could replace BlackRock with an alternative top-flight private asset manager. And since the plan's ten funds are uncomplicated and, in several cases, just simple index funds, each fund's performance is readily comparable to other such funds offered by other large advisors, such as Vanguard and Fidelity.

Moreover, because TSP-II would include millions of participants and have a high public profile, the performance of its manager would be subject to close public scrutiny. Beneath the gaze of thousands or millions of interested participants, managers have a harder time getting away with shoddy work. That scrutiny would extend beyond the simple performance of the funds and into less obvious management behavior, such as whether the advisor is churning fund assets to accumulate private gains with the brokers executing such trades; overweighting equity holdings in target-date funds to earn the higher fees associated with underlying equity (rather than fixed income) investments; overvaluing any illiquid assets in the funds' portfolios to inflate the fees it receives as a percentage of assets under management; or selectively disclosing the funds' future trades to preferred outside clients with intentions of front-running TSP-II's trades.[29]

In contrast, our current system—comprising thousands of private defined contribution plans—gives participants fewer incentives, less information, and weaker market power to police such unfaithful behavior by investment managers.

3. Low Fees

Perhaps the most obvious and significant benefit of a TSP-II would be the enormous potential savings that millions of investors could enjoy from dramatically lower fees.

Would TSP-II achieve fees as low as the 3.8 basis points in TSP?[30] Perhaps not. The low fees TSP boasts are a function of several factors that are unique to the TSP and may not exist in a TSP-II, at least not immediately. First, the TSP boasts huge economies of scale,[31] and while a

28. *See* Foley, *supra* note 16.

29. *See* BIRDTHISTLE, *supra* note 16 (discussing these potential problems in funds and self-dealing behavior by investment advisors).

30. *Expense Ratios*, THRIFT SAVINGS PLAN, https://www.tsp.gov/InvestmentFunds/FundsOverview/expenseRatio.html [https://perma.cc/PKS3-AAF5].

31. *See generally* INV. CO. INST., THE FEDERAL THRIFT SAVINGS PLAN: CAN IT BE DUPLICATED? (2015) [hereinafter THE FEDERAL THRIFT SAVINGS PLAN], https://www.ici.org/pdf/ppr_tsp.pdf [https://perma.cc/C9FQ-H68Z].

TSP-II could grow to encompass a far greater number of participants and assets over time, it would not do so immediately. One should expect low average balances in the accounts of a TSP-II in its initial years until participants accumulate more substantial savings. Also, the members of TSP are all, by definition, federal employees (many of whom enjoy comparatively healthy salaries[32]) while a substantial percentage of TSP-II participants might be underemployed or low-salaried workers. Another relative advantage of TSP is the administrative efficiency that comes from its participants all working for a single employer with standardized policies, standardized procedures, and a common infrastructure,[33] an advantage that would not be true in a TSP-II involving many different employers. Finally, and perhaps most saliently, significant TSP administrative duties are performed by employees on the federal payroll and thus are not borne by the plan itself,[34] an arrangement that also might not be true in a TSP-II.

On the other hand, TSP-II would cover a universe of possible participants far larger than the 4.8 million in TSP. But if we assume TSP-II included only the unemployed, the self-employed, or employees of employers without plans, their average income—and thus the plan's per capita account size—might always remain lower than TSP and thus less efficient. Over time, however, the significantly larger number of participants would be likely to accumulate larger aggregate savings. And, if TSP-II were instead available to all Americans, the plan would surely grow far larger than TSP. So, perhaps a TSP-II could someday enjoy fees even lower than 3.8 basis points. Consider also that investment advisors such as Vanguard already offer exchange-traded funds and mutual funds to retail investors and modestly sized institutions at rates not much higher than 3.8 basis points.[35] Indeed, were America's defined contribution plans to make far wider use of such investment offerings, the need for changes to our retirement system would be far lower. Unfortunately, they do not.

In any event, the relevant comparison is to the fees employees currently pay in the plans of private employers, which are vastly higher[36] than TSP and, in any fair forecast, the TSP-II.

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32. *Plan Participation*, THRIFT SAVINGS PLAN, https://www.tsp.gov/PlanParticipation/index.html [https://perma.cc/N3LC-N5YJ].

33. THE FEDERAL THRIFT SAVINGS PLAN, *supra* note 31, at 1.

34. *Id.* at 2.

35. *See Vanguard Mutual Funds*, VANGUARD GROUP (Sept. 30, 2017), https://investor.vanguard.com/mutual-funds/list#/mutual-funds/asset-class/month-end-returns [https://perma.cc/94ND-VPRV].

36. INV. CO. INST., 2017 INVESTMENT COMPANY FACT BOOK: A REVIEW OF TRENDS AND ACTIVITIES IN THE INVESTMENT COMPANY INDUSTRY 89 fig. 5.1 (2017), https://www.ici.org/pdf/2017_factbook.pdf [https://perma.cc/2MEY-MA82].

4. Proof of Concept & Political Feasibility

The success of TSP is widely admired, and it serves as a successful proof of concept for TSP-II. Certainly, TSP-II would be more complicated by the inclusion of participants from so many different employers or from no employers at all. Yet, enrollment and participation in our current, heterogeneous landscape of private sector-defined contribution plans is easily managed electronically through websites and smartphone applications. With the preparation of enrollment and management websites, one can easily envision how the implementation of TSP-II could take place throughout the United States.

This plan is also more politically feasible in the short term—particularly under unified Republican control of the federal government—than any other plans to boost retirement accounts, particularly by increasing Social Security benefits. Indeed, the only presidential candidate to propose any retirement plan similar to this idea was a Republican: Marco Rubio.[37] Other similar proposals have come from the Center for American Progress Action Fund[38] and U.S. Senator Jeff Merkley (D-OR),[39] which suggests that a TSP-II could conceivably enjoy bipartisan support.

5. TSP-II as Public Infrastructure

A federal retirement plan could serve as a public good with benefits for private citizens and businesses like highways, railroads, public education, and other governmental infrastructure. If TSP-II became a reality, many American employers might choose to reduce corporate expenditures by dropping their own retirement plans and opting to participate in TSP-II.

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37. Josh Hicks, *Rubio, Retirement Benefits and a Thrift Savings Plan for All Americans*, WASH. POST (May 14, 2014), https://www.washingtonpost.com/news/federal-eye/wp/2014/05/14/rubio-retirement-benefits-and-a-thrift-savings-plan-for-all-americans/?utm_term=.1f3eb6b2b0b8 [https://perma.cc/8PA7-LFKU].

38. David Madland, Alex Rowell,& Rowland Davis, *Improving Americans' Retirement Outcomes Through the National Savings Plan*, CTR. FOR AM. PROGRESS ACTION FUND (Jan. 28, 2016), https://www.americanprogressaction.org/issues/economy/reports/2016/01/28/128146/improving-americans-retirement-outcomes-through-the-national-savings-plan/ [https://perma.cc/AB83-B6TN].

39. Press Release, Office of Senator Jeff Merkley, Merkley Introduces Major New Retirement Security Legislation to Give Every Worker Access to a Retirement Savings Plan (Jan. 28, 2016), https://www.merkley.senate.gov/news/press-releases/merkley-introduces-major-new-retirement-security-legislation-to-give-every-worker-access-to-a-retirement-savings-plan [https://perma.cc/8EVT-6428]. The Merkley proposal is also supported by U.S. Representatives Suzanne Bonamici (D-OR) and Jared Huffman (D-CA). *See* Kellie Lunney, *Members of Congress Really Seem to Like the TSP*, GOV'T EXECUTIVE (June 28, 2016), http://www.govexec.com/pay-benefits/2016/06/members-congress-really-seem-tsp/129465/ [https://perma.cc/W5MW-C9WD].

To the extent that employers wish to compete more aggressively in the labor market, they could, of course, offer their own, more generous plans. Or they could choose an interim position, in which they offer no plan of their own but match a portion of their employees' contributions to TSP-II. So, though there would be costs with automatically enrolling employees in the plan, those costs would likely be lower than managing a private plan for the employer and could be paid for out of plan assets.

6. Data

A large-scale retirement plan operated for the public good could also produce a tremendous flow of data that could be used to help citizens save more effectively for their retirement. For instance, if TSP-II engaged in A/B testing of its electronic interfaces, it might learn which presentations of information lead to greater rates of participation, contribution, and overall saving. Like Facebook, Amazon, Google, and the most effective private sector companies, TSP-II's high volume of users would generate an enormous and important amount of testable information.

TSP-II could use that data to improve services for its own participants, of course. And, as a public program, it could also provide those findings freely to private sector plan administrators or, indeed, to other government agencies (such as the Securities and Exchange Commission or the Consumer Financial Protection Bureau), which could, in turn, consider mandating the implementation of successful approaches.

Using and collecting this data is both possible and feasible because firms like Vanguard currently enjoy huge volumes of investors and assets and possess the ability to produce and process massive amounts of useful investment data.[40] But, as private enterprises, their incentive is more likely to find ways of maximizing their profits, which may not be consistent with better retirement savings by the public at large. A firm that discovered ways to encourage investors to trade frequently might, for instance, generate profits sufficient to offset the reduced performance in those investors' accounts. TSP-II, and indeed TSP, should and could compile and analyze its data for more publicly beneficial lessons.

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40. *See, e.g.*, VANGUARD, HOW AMERICA SAVES 2017 (2017), https://pressroom.vanguard.com/nonindexed/How-America-Saves-2017.pdf [https://perma.cc/K64A-M3U3] (encompassing a 110-page annual report based on Vanguard's defined contribution data).

C. Potential Drawbacks

1. Monopsony

If a government plan such as TSP-II were to suck up billions or trillions of dollars in retirement savings and deliver them into the hands of BlackRock, or any single asset manager, the broader investment industry could suffer competitively. The TSP-II manager, with its incredible concentration of assets, might dominate and possibly drive out competition. Indeed, the industry's fear of this outcome—and their lobbying efforts to prevent it[41]—might explain the conspicuous absence of a TSP-II, even after thirty years of TSP success. Of course, the investing public might also worry that, as with any monopsony, should competition in the investing industry wither or disappear, the fees in a captured TSP-II could then rise dramatically in the future.

This concern could be alleviated with a few adjustments. First, the manager of TSP-II could be rotated every few years, as the Sarbanes–Oxley Act requires of corporate accountants.[42] New managers could participate in an auction for the right to manage the plan for two or three years and then relinquish the role to another firm. Such substitutions might, however, inflict transition costs, investor confusion, or simple uncertainty. Nevertheless, the benefits of rotating the administrator to prevent complacent abuse of the position could outweigh the transition costs.

Alternatively, a more efficient and feasible option would be for the overall manager to retain the services of numerous sub-advisors for several of the plan's funds. This sub-advisory structure is common in the private sector, with major fund families such as Vanguard holding auctions amongst other investment advisors for the financially rewarding privilege of advising massive Vanguard funds.[43] The system allows the overall manager to operate with low costs since bidders, eager for the business opportunity, routinely offer to manage the funds at rates far lower than standard retail or institutional levels.[44] It also allows the manager to assemble a "best-of-breed" array of funds, in which sub-advisors with particular expertise in, say, equities manage the equity fund, while another

41. *See, e.g.*, Letter from Paul Schott Stevens, President & CEO, Inv. Co. Inst., to The Honorable Edmund G. Brown, Jr., Governor of Cal. (Aug. 8, 2016), https://www.ici.org/pdf/16_ici_ca_secure_choice.pdf [https://perma.cc/6NC7-ZBRU].

42. 15 U.S.C. § 78j-1 (2012).

43. *See generally* DANIEL WALLICK ET AL., VANGUARD, THE CASE FOR VANGUARD ACTIVE MANAGEMENT: SOLVING THE LOW-COST/TOP-TALENT PARADOX? (2013), https://www.vanguard.com/pdf/s356.pdf [https://perma.cc/DJ3E-XHMP].

44. *Id.*

shop particularly knowledgeable about bonds manages the fixed-income fund.

Of course, many trillions of dollars in the United States and around the world are invested completely outside of the 401(k) system.[45] So, even were TSP-II to enjoy great success, that success would be confined to retirement savings alone; conversely, any substantial harm to the broader investment industry due to centralized TSP-II management would be only marginal.

2. Governmental Endorsement

Any government plan—particularly one controlling trillions of private dollars—is likely to be resisted by many simply because of the stigma of the "public" label among libertarians and other groups skeptical of governmental involvement. Of course, the governmental nature of this plan does raise substantive issues, apart from political squeamishness. Those issues come in at least two flavors, each the opposite of the other.

The first, and perhaps most salient fear is that any public savings plan carries an implicit promise by the government to not allow the investments to fail. Government bailouts of entirely private businesses are still a fresh memory in this country, so perhaps politicians would feel even greater pressure to prop up the savings in TSP-II should they suffer in an acute economic downturn. The laws and charter governing a federal plan could be drafted to make clear that such a backstop is impermissible, though such assurances can prove very hard to enforce. So perhaps the simplest and most effective rebuttal to this concern is the experience of the original TSP. In the three decades of its existence, which includes several notable market collapses, its funds have never been bailed out or augmented by the government.

The second, opposite fear is that a public savings plan may be raided by the government. Should the government need access to funds, the temptation to raid a multi-trillion-dollar plan might be irresistible. Again, the experience of the TSP is instructive: it has never been touched in its lifetime. The reason for that impermeability may be that its funds are held in distinct, separate accounts by each of its participants, all of whom could see clearly whether and to what extent their personal funds had been reduced. The distributed and disaggregated nature of defined contribution accounts might be their best protection against an avaricious government.

45. *See* 2017 INVESTMENT COMPANY FACT BOOK, *supra* note 36, at 2016 Facts at a Glance.

3. Excessive Passive Investment

Another concern about the success of a possible TSP-II would be the acceleration of the broader trend of passive investing, inasmuch as the plan would direct savings into indexed mutual funds. In recent years, passive index funds have grown dramatically and now hold substantial investment positions in many public corporations.[46] The effects of this concentration of holdings in largely automated investments are not yet clear. But one can—and several law professors do—readily speculate about possible malign consequences to the governance or competitive behavior of operating companies in our economy.

One initial study suggests that large blocks of airlines stocks concentrated in the hands of a small group of mutual funds has led to anticompetitive behavior in that industry.[47] Widespread passive investment—such as through massive TSP-II funds—would ensure that the stocks of S&P 500 issuers will always find a ready, indeed an unthinkingly automatic, buyer. Managers of those firms may thus feel less market discipline in their role as fiduciaries and entrepreneurs.[48] On the other hand, index investors also hold large positions in all the clients of any uncompetitive firms,[49] none of whom would benefit from paying inflated prices. So, the extent to which passive investing creates an uncompetitive landscape is far from settled.

Of course, passive investing is already on the rise,[50] even in the absence of TSP-II. And there is little reason to believe that, without a TSP-II, passive investing will not continue to grow just as dramatically. Individual investors and disparate defined contribution plans are already avid consumers of S&P 500 index funds, ETFs, and other passive funds.[51]

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46. *See id.* at 94–99; *see also* Chris Dieterich & Corrie Driebusch, *Wall Street's Newest Puzzle: What Passive Buying and Selling Means for Individual Stocks*, WALL ST. J. (Sept. 21, 2017), https://www.wsj.com/articles/wall-streets-newest-puzzle-what-passive-buying-and-selling-means-for-individual-stocks-1505986202.

47. José Azar, Martin C. Schmalz & Isabel Tecu, *Anti-Competitive Effects of Common Ownership* (Ross Sch. of Bus., Working Paper No. 1235, 2015), https://ssrn.com/abstract=2427345 2427345 (discussed in Eric Posner & E. Glen Weyl, *Mutual Funds' Dark Side*, SLATE (Apr. 16, 2015, 9:46 AM), http://www.slate.com/articles/news_and_politics/view_from_chicago/2015/04/mutual_funds_make_air_travel_more_expensive_institutional_investors_reduce.html [https://perma.cc/F62E-6DEB]).

48. This phenomenon has most histrionically been discussed in a report by the investment firm Sanford C. Bernstein, entitled "The Silent Road to Serfdom: Why Passive Investing Is Worse than Marxism." SANFORD C. BERNSTEIN, THE SILENT ROAD TO SERFDOM: WHY PASSIVE INVESTING IS WORSE THAN MARXISM (2016), https://www.scribd.com/document/323564709/Bernstein-Passive-Investing-Serfdom-Aug-2016.

49. Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. (forthcoming 2017) (manuscript at 30), https://ssrn.com/abstract=2992046.

50. *Id.* at 13–18.

51. *Id.* at 14–15.

So, to the extent that a massively indexed investing landscape lies in our future, the marginal growth of that phenomenon attributable to a federal retirement plan like TSP-II should not be overstated.

In an investment industry still dominated by actively managed funds, the growth of passive investing appears to be more a positive development than a pathological one. Of the 8,066 mutual funds currently offered, 7,645 are actively managed, and they impose far higher fees than their indexed counterparts.[52] Indeed, the latest developments in the exchange-traded funds involve efforts to register and promote actively managed ETFs, an oxymoronic and expensive solution to an unknown problem.

Even if index investing is "eating the world,"[53] it has a lot of its meal to finish—and it will do so with or without the presence of TSP-II.

III. PROPOSAL II: STATE RETIREMENT PLANS

For those persuaded that improvements to defined contribution plans are a good idea, at least three alternatives to TSP-II exist: multi-employer plans, direct regulation of employers, and state-run retirement plans (using a defined contribution rather than a defined benefit pension structure). The first two of these options suffer significant problems of their own. Multi-employer plans require intricate coordination between disparate—even rival—firms and come with complex regulation. Command regulation requiring employers to establish and mimic a TSP-II in their own defined contribution plans would involve uncomfortably heavy-handed federal interference in private operations, and would almost certainly forfeit the chief advantage of large economies of scale. Accordingly, I will focus on the state plan alternative.

As it happens, a certain amount of ferment already exists at the state level—perhaps too much. Approximately half a dozen states are considering or have already enacted legislation authorizing a TSP-like defined contribution plan at the state level. One of them, California, is the Union's largest economy and is also furthest along this path. Governor Brown recently signed a law establishing a plan entitled California Secure Choice (CSC), which went into effect on January 1, 2017.[54]

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52. 2017 INVESTMENT COMPANY FACT BOOK, *supra* note 36, at 95 fig. 5.6 (reporting 421 index mutual funds in 2016), 96 fig. 5.7 (reporting average fees of 0.82% and 0.58% for actively managed equity and bond mutual funds respectively, compared to average fees of 0.09% and 0.07% for index equity and bond mutual funds, respectively), 170 tbl. 1 (reporting 8,066 total funds).

53. Jason Zweig, *Are Index Funds Eating the World?*, WALL ST. J. (Aug. 26, 2016, 11:46 AM), https://blogs.wsj.com/moneybeat/2016/08/26/are-index-funds-eating-the-world/.

54. *See* Sophia Bollag & Samantha Masunaga, *Nearly 7 Million Californians Will Be Automatically Enrolled in State-Run Retirement Savings Plan Under New Law*, L.A. TIMES (Sept. 29, 2016, 2:10 PM), http://www.latimes.com/business/la-fi-retirement-program-20160929-snap-

The new law requires California employers with more than five employees and no retirement plans of their own to enroll that population of 7.5 million employees automatically in CSC.[55] Those employers were originally scheduled, beginning in 2018, to contribute three percent of covered employees' salaries automatically to CSC, with automatic annual escalations of one percent to a maximum of eight percent.[56] The details of some of these provisions have come into doubt, however, because of recent federal legislation that curtails the ability of state retirement plans to use automatic enrollment.[57] Nevertheless, legislators in California and other states have announced their intention to proceed regardless of the new federal impediment.[58]

Employers are not obliged to match employee contributions, and employees can opt out or alter these default settings.[59] Their CSC accounts will follow them to any future jobs they hold, at least within California. Like TSP, the plan will be overseen by a state board of officials, while investment and administrative services will be outsourced to private vendors.[60] In effect, CSC is quite true to the TSP, just at a state level. The largest difference is that the enacting legislation contemplates that CSC assets will be invested only in Treasury securities, not mutual funds.[61]

Other states, including Connecticut, Illinois, Maryland, Massachusetts, New Jersey, Oregon, and Washington, are contemplating

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story.html. For coverage of Maryland's plan, see Noah Weiland, *Nest Eggs for Job Hoppers*, N.Y. TIMES, Mar. 5, 2017, at F2.

55. California Secure Choice Retirement Savings Trust Act, 2012 Cal. Stat. ch. 734 (codified as amended at CAL. GOV'T CODE §§ 100000–100044 (West 2016)); OFFICE STATE TREASURER CAL., CALIFORNIA SECURE CHOICE FACT SHEET, http://treasurer.ca.gov/scib/fact.pdf [https://perma.cc/ES7Z-K4WX].

56. California Secure Choice Retirement Savings Trust Act, 2012 Cal. Stat. ch. 734 (codified as amended at CAL. GOV'T CODE §§ 100000–100044 (West 2016)); OFFICE STATE TREASURER CAL., *supra* note 55.

57. In March 2017, "[b]y a single vote, the Senate gave final approval . . . to a measure to block cities and counties from organizing retirement savings accounts for workers who have no access to employer-sponsored plans," which it did "using the 1996 Congressional Review Act, which had hardly been used in the two decades before Mr. Trump's inauguration." Noah Weiland, *Senate Narrowly Passes Rollback of Obama-Era 'Auto-I.R.A.' Rule*, N.Y. TIMES (Mar. 30, 2017), https://www.nytimes.com/2017/03/30/business/labor-department-retirement-savings-account.html (discussing federal repeal legislation, H.R.J. Res. 66, 115th Cong. (2017) and H.R.J. Res. 67, 115th Cong. (2017)).

58. Kathleen Pender, *California Fights to Keep State-Run Retirement Option*, S.F. CHRON. (Feb. 16, 2017), http://www.sfchronicle.com/business/networth/article/California-fights-to-keep-state-run-retirement-10939150.php [https://perma.cc/75A5-NLCM].

59. *Id.*

60. CAL. GOV'T CODE § 100046 (West 2017).

61. *Id.*

variants of similar plans.[62] So would a federalism of finance work better than a national TSP-II?

A. Potential Benefits

1. Immediacy

As the passage and schedule of CSC demonstrates, one benefit of pursuing a state approach is the possible immediacy of enactment. The coordination problems and general sclerosis of our federal political apparatus—at least in recent years—suggest that a federal approach may be many years distant. A Trump administration, with a compliant Senate and House, might possibly follow Senator Rubio's initiative and endorse such a plan more quickly.[63] But early evidence suggests that the one-party rule has not made the passage of legislation much easier. Also, retirement security was featured very little as a topic of policy in the recent presidential campaign and, even if attractive to the new administration, it does not yet seem to be a top priority. So, speed of enactment and implementation certainly is an advantage of pursuing this idea at the state level.

2. Experimentation

Of course, the classic chestnut of federalism—that the state petri dishes permit experimentation—is as true on this subject as it so often is. With states varying their offerings, as their initial legislation suggests they are doing, we could study the effects of large versus small menus of offerings, aggressive versus conservative investment choices, and ETFs versus mutual funds, as well as the comparative performance of a wide range of asset managers. Indeed, a federalist approach could nurture a far broader population of plan managers—and certainly not pose anything like the winner-take-all monopsony risks present with a single, national TSP-II.

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62. Richard H. Thaler, *State I.R.A. Plans Are Ready, if Congress Doesn't Interfere*, N.Y. TIMES (Mar. 3, 2017), https://www.nytimes.com/2017/03/03/upshot/state-ira-plans-are-ready-if-congress-doesnt-interfere.html; PENSION RIGHTS CENTER, State-Based Retirement Plans for the Private Sector, http://www.pensionrights.org/issues/legislation/state-based-retirement-plans-private-sector [https://perma.cc/2A2F-ZTNW]. *See* Ashlea Ebeling, *Small Business Retirement Plan Mandates Coming In 2017*, FORBES (Sept. 13, 2016 8:22 AM), https://www.forbes.com/sites/ashleaebeling/2016/09/13/when-will-new-state-retirement-plans-start-enrollment/#50e9b5287e0f [https://perma.cc/NS7E-ZYSC].

63. Hicks, *supra* note 37.

B. Possible Drawbacks

1. Lesser Economies of Scale & Higher Fees

One of the largest problems with a state system is the dramatic drop in possible economies of scale. Dividing the assets of eligible employees into fifty different buckets will ensure that each bucket is significantly smaller than a federal cistern. Implementation and administrative costs, duplicated fifty different times, will represent a far greater aggregate expense in a multi-state system. Nevertheless, some states, such as California, may possess sufficient numbers of participants and assets to yield far better investment options than their citizens currently enjoy. So, on the question of financial benefit alone, state plans are likely not to be as compelling as a single federal plan but are still likely to be a significant improvement over the status quo.

2. Balkanization & Lock-In

A second, perhaps more intractable, problem with a state approach is the barriers it would impose on the mobility of citizens within the United States. California, after all, can compel only Californian employers to participate in its Secure Choice plan. So, a worker interested in leaving California would need to establish a new account in a different state for future contributions while maintaining the CSC account. A balkanized patchwork of savings plans would increase friction upon employee mobility. Employees would have to research and consider the relative merits of different retirement regimes in each of the different states they consider for employment. Economies and individuals rarely benefit in the midst of such frictions.[64]

One possible solution might be for states to agree to reciprocally transfer savings between their plans when citizens move across borders. But, as we have already seen in the initial handful of state proposals, these plans might have incommensurate attributes that would highly complicate such transfers. The Massachusetts plan, for instance, proposes to cover

64. Some critics believe the proliferation of state-based regimes for 529 savings plans for education expenses suffer from a similar problem. With each state offering its own variation of a 529 plan, parents of future college matriculants must navigate among dozens of possible options to find an investment solution. *See, e.g.*, Austan Goolsbee, *The "529" Rip-Off*, SLATE (Aug. 23, 2002, 5:16 PM), http://www.slate.com/articles/business/moneybox/2002/08/the_529_ripoff.html; Howard Isenstein, *As College Plans Proliferate, It Pays to Shop Around*, N.Y. TIMES (June 20, 2004), http://www.nytimes.com/2004/06/20/business/sunday-money-saving-as-college-plans-proliferate-it-pays-to-shop-around.html.

only employees of non-profit corporations.[65] The California plan, as we saw, invests only in Treasury bills,[66] while others will almost certainly include broader arrays of choice. Even in the unlikely circumstance involving perfectly identical state plans, legislators or officials of the state must engage in bargaining to arrive at a compromise, or the federal government might be required, once again, to legislate recognition of the full faith and credit of state plans.

3. Complexity

With experimentation, of course, comes added complexity. And, to negotiate a state-based system, citizens will need to learn the varying details of many ostensibly similar but substantively disparate plans. Many systems—regulatory and tax, for example—impose such complexity already, but the existence of some is not an argument for adding more (particularly not when a federal alternative exists). Indeed, calls by both industry groups and consumers in various settings for federal preemption of state regimes might be predictably echoed here.

4. Local Naïveté & Pay-to-Play

State-based plans may also be afflicted by local operatives who are either too naïve or too canny. As is often the case with the human resources departments of smaller corporations, the state officials in charge of administering defined contribution plans may simply lack the expertise to decide or oversee critical components of their plans. Consider, for instance, one element of CSC: the plan imposes a cap of one percent on administrative costs.[67] To a layperson, one percent may seem like a very low fee. Within the investing industry, however, fees of one percent or 100 basis points are exorbitant, particularly in the context of very large pools of assets such as these. And, California is sure to be one of the most sophisticated and powerful states in this field. One might reasonably fear that some state plans will be taken advantage of by, for instance, investment advisors that invest expensively or charge inordinate administrative costs. Indeed, many such firms have spent many of the past few years defending lawsuits alleging precisely such behavior in the defined contribution plans of employers—and, on occasion, in their own plans.

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65. An Act Providing Retirement Options for Nonprofit Organizations, 2012 Mass. Acts 100–02 (codified at MASS. GEN. LAWS ch. 29, § 64E (2013)).

66. CAL. GOV'T CODE § 100002(e)(1)(A) (West 2017).

67. *Id.* § (d).

Conversely, state officials have at times been all-too-cute regarding the management of public savings. In New York, for instance, and most prominently, officials have been prosecuted for pay-to-play schemes with public pension funds.[68] Officials have solicited bribes in exchange for the appointment of friendly asset managers—often woefully inexperienced, inexpert, or prone to charge too much—to the lucrative position of managing state pension funds. With as many as fifty different plans to monitor, it may be hard for public watchdogs to police this behavior throughout the nation. And even with close scrutiny, politicians will surely feel some pressure to appoint politically supportive financial firms to manage what are sure to be large pools of savings.

CONCLUSION

The merits of a federal savings plan outweigh those of a state-based system, and the presence of any system is certainly superior to none. The actions by California and other states may, alas, interfere with the impetus of federal actors to pursue a national plan. To date, the greatest impediment to states moving forward with their plans has been federal legislation just introduced by Republican congressional representatives opposed to state plans.[69] If there is a legislative lull, perhaps the state initiatives will, more optimistically, serve as a goad to federal actors to move quickly to forestall a spreading patchwork of plans. Perhaps the poorest outcome is the status quo, in which pensions have been eliminated from the U.S. private sector and in which we now impede meaningful efforts by workers to combine their bargaining power to improve the health of their retirement savings.

68. *See, e.g.*, Steven Davidoff Solomon, *After Scandals, Evaluating Pension Funds' Middleman*, N.Y. TIMES (May 12, 2015), https://www.nytimes.com/2015/05/13/business/dealbook/after-pay-to-play-scandals-evaluating-pension-funds-middleman.html?mcubz=1.

69. *See* Reid Wilson, *Congress Takes Aim at State Retirement Accounts*, HILL (Feb. 15, 2017, 1:13 PM), http://thehill.com/homenews/state-watch/319686-congress-takes-aim-at-state-retirement-accounts [https://perma.cc/MVU4-SVT3]; *see also* Editorial Board, *Repealing Labor's Double Standard*, WALL ST. J. (Feb. 27, 2017), https://www.wsj.com/articles/repealing-labors-double-standard-1488241102.