Covering the Uncovered

Common Ground Recommendations to Expand Retirement Savings for American Workers

Working Report

Conversation on Coverage

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Working Group Two Report

Report on the Conversations and Recommendations of Working Group II

Working Group's Assignment

Answer This Question:
How do we increase coverage and retirement savings by providing new incentives to encourage employees to save for themselves, as well as incentives for employers to contribute increased amounts for employees in low tax brackets?

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Executive Summary

The proportion of workers who participate in workplace retirement plans has remained at or near 50 percent for many years, despite a number of efforts by Congress and successive Administrations to adopt policies intended to expand coverage. One of the goals of Working Group II was to look for ways to expand participation to include substantially more of the uncovered half of the workforce and to increase the level of saving by those who do participate. The group was especially focused on low and moderate income workers – those who are most likely to lack coverage by a workplace retirement plan.

The group set out to expand coverage and saving by offering to support proposals that are intended to do the following:

- Prompt more employers to offer access to retirement savings plans.
- Expand the number of workers who are eligible to participate in an existing employer-sponsored retirement plan.
- Increase the overall level of saving by workers in workplace retirement savings plans, especially among those who save the least – low and moderate income workers.

The group began as a collection of members with a great deal of expertise on the key issues before them, but with very diverse and strongly-held views. Over the course of more than half a dozen meetings of the entire group and additional subgroup meetings, the members hammered out a consensus in areas where members held common ground, often exceeding the expectations of its members concerning the degree to which agreement could be reached.

> "Think about the dramatic change we could make in the lives of people right now, who only have a modest income, if we could get them saving for retirement. That would give people peace of mind in their retirement years."
>
> Representative Rob Portman (R-OH) from his address at the Conversation's National Policy Forum, July 22, 2004.

The Retirement Investment Account Plan

The group's chief accomplishment was to reach general agreement on the broad outlines of a new centralized broadly-based savings account, the Retirement Investment Account Plan or RIA. This plan is targeted toward workers at companies that do not currently have a retirement plan, as well as workers at firms where there is a retirement plan, but where some workers are not eligible to participate. Further, the vehicle is designed to provide an additional source of retirement income on top of the benefits provided by the Social Security system

Members of the group supported the RIA because it was believed that this approach offers great promise in providing access to retirement saving for a substantial portion of uncovered workers. One of the reasons the proposed plan will be helpful is because it removes most of the administrative burden of sponsoring a plan, a key concern of employers who do not currently sponsor a plan. By giving employees access to a workplace retirement system, it is also likely to dramatically increase the chances that workers will contribute toward retirement savings and enhance their retirement income beyond the Social Security benefit.

As this report will show, much work was put into the details of a potential RIA plan and much progress was made on many building blocks of the system. Even where there was not general agreement on the details, there was often agreement on the framework in which the details could be resolved.

The group generally agreed on the following broad outlines of the RIA plan:

- **Accounts Will Be Managed By a Central Clearinghouse.** The RIA plan will be offered through a government-authorized central clearinghouse that would be run by the private sector.
- **Contributions Can Be Made Through Payroll Deductions.** The system would be set up to receive contributions from employees through payroll deductions by the employer of amounts indicated by employees. The system would also be able to receive contributions by employers.
- **How the Infrastructure Will Work.** The employer will send the employee and employer contributions to the U.S. Treasury, and the Treasury, in turn, will forward contributions to the central clearinghouse.
- **Participant Contributions Made in a Default Investment.** Contributions to the RIA plan will be placed in a default investment pool that will be a balanced, diversified fund, which could also be a lifestyle or life cycle fund.
- **Participants Can Select From Simplified Investment Choices.** Participants who wish to choose investments beyond the default choice will have a simplified choice of investment options chosen by the clearinghouse.

Policies to Expand Coverage in All Retirement Savings Plans

The members of the group also supported a number of initiatives they felt would increase the level of participation and the retirement saving by and for workers at companies where there is already a workplace retirement plan. These include:

- **Automatic Enrollment.** The group generally supported continuing the policy whereby employers voluntarily offer automatic enrollment to new hires as a way to prompt workers to contribute regularly to their accounts in the plan.
- **Automatic Rollovers.** The group generally supported designating the Thrift Savings Plan – an employer-sponsored saving plan for federal government employees – as a central national receptacle for rollovers for accounts with balances from $1,000 to $5,000 for employees who leave a firm. This policy would make it easier for many employers to roll over such sums and would likely preserve retirement savings for more workers.
- **Default Investment Mix.** The group generally agreed to support a change in federal pension law to provide a safe harbor that would allow employers to voluntarily offer employees a default investment option which would automatically place their contributions in a balanced, diversified fund that could be a lifestyle or life cycle fund.
- **Saver's Credit.** The members generally agreed to support an extension and expansion of the Saver's Credit, which provides 10 to 50 percent government matches for individual contributions of low and moderate income workers. The program is slated to sunset in 2007.
- **Financial Education.** The group generally supported a proposal to encourage high schools and colleges to provide basic financial education, including education on retirement saving and health care finances.

The Mission

The mission of Working Group II was to review and discuss proposals to increase the portion of the work force that participates in a workplace retirement saving plan, as well as to increase the level of overall retirement savings in plans. The group was also asked to review and discuss incentives for employers to contribute increased amounts for employees in lower tax brackets.

Principles and Standards

Members of the Working Group generally agreed on a list of principles and standards by which it would evaluate proposals. The principles include:

- The effort would be collaborative while inviting diverse thinking. It would focus on workers with incomes below the median, especially low-income workers, and it would consider the unintended consequences of proposals.

- Proposals should be efficient to administer and simple to communicate to workers and have a nationally consistent set of rules.
- Proposals should be judged on whether they are economically efficient and feasible, both in the short-term and the long-term, as well as whether or not they involve minimal interference in economic, investment and labor markets.
- Proposals should be judged on whether or not they offer flexible terms and rules for both employees and employers.
- Proposals should be politically viable, both in the short-term and the long-term.
- Proposals should be judged on whether or not they enhance retirement income security for all U.S. citizens.
- Proposals, when considered in total, should be equitable in their benefits and contributions. They should be equitable 'horizontally' (meaning that it affects people the same whether or not they have access to an employer-sponsored plan), as well as when viewed 'vertically' (meaning across all income levels).

Background

The goal of providing a retirement plan for all workers is an ambitious one. In 2004, for example, only about 59 percent of American workers had access to a retirement plan sponsored by their employer, according to the Bureau of Labor Statistics. A majority of these workers – about 50 percent – have access to a defined contribution retirement savings plan, such as the 401(k) plan. [1]

Employees participating in a defined contribution plan often save by determining what portion of their wages is to be taken from their regular pay and contributed to their plan. Employers often match those contributions. Workers who participate in defined contribution plans usually have the responsibility of determining how much they expect they will need to save for retirement and how much they would like to contribute out of each pay period. Workers also are often given choices among several investment options within a plan. When they retire, workers with defined contribution plans received lump sum distributions and, therefore, have to decide how to manage the accumulated savings to provide income across their retirement years.

Some of the areas where improvements can be made in coverage can be found in some of the details of the employer surveys of coverage in different segments of the workplace population. Medium and large businesses (100 employees or more) had a participation rate of 67 percent, while small businesses (99 or fewer workers) had a participation rate of 37 percent.[2] Further, the participation rate for all full-time workers of all private sector businesses was 60 percent, significantly higher than the 20 percent for all part-time workers.[3]

Expanding participation in workplace plans is important for other reasons. It appears to be the best way to increase retirement saving. If one looks at federal income tax return data, the proportion of filers who claim an IRA or Keogh deduction has been both fairly modest and steadily declining over time. From a peak of 16.2 percent in 1986, it fell to 3.5 percent in 2000 and 2001.[4] In contrast, the participation rate in workplace plans is 66.2 percent of those eligible for 401(k) plans (a population of workers that represents 32.6 percent of the private sector workforce).[5]

Increasingly, important decisions that will affect retirement income tend to fall on the shoulders of individual workers. If more workers are to be able to save for retirement, more of them need to have access to and participate in a workplace retirement savings plan. Potential opportunities to increase the proportion of the workforce with access to a retirement saving, and potential opportunities to increase participation by those already covered can be created in several ways, include the following:

- Employers who have plans can make it easier for more workers to participate in those plans.
- Employers who do not have retirement plans, which are predominantly in the small business sector, can sponsor plans. (Working Group III has focused its efforts on developing a proposal for the small business sector).
- Incentives, such as tax credits for employees and/or employers, as well as government contributions into accounts, can increase the level of overall saving in existing retirement plans.
- Beyond this, the government can create new saving vehicles that will be more attractive to smaller employers, as well as self-employed and contract workers.

- Employers who do not have retirement plans can facilitate access for its employees to new kinds of centralized savings vehicles that might be created.
- Government can also devise programs and incentives that target lower-income workers.
- Finally, efforts can be made to provide opportunities for financial education in high school and college so that more workers better understand the need to save for retirement and health care expenses, and also to be better prepared to plan for their future needs.

How the Working Group Went About Its Assignment

To meet the challenges set out above, Working Group II decided initially to focus on ways to increase overall saving in existing plans, and ways to expand access to employer-sponsored retirement saving plans to more workers. The group also looked at tax-based incentives, including tax credits and tax deductions.

The group looked at the existing Saver Credit program to see how it might be expanded and made permanent. It also looked at a range of incentives and ideas for improving coverage and saving – including automatic enrollment, default investment choices, and financial education – and reached agreement on a number of them. This is discussed in Section II of this report.

Working Group II also examined ideas for setting up a new type of savings account program that would be patterned after the 401(k) plan, but would be more widely available to workers and even non-workers. The group devoted considerable time to developing general agreement on the broad outline for a new individual account system named the Retirement Investment Account or RIA. The group examined how government credits and contributions might play a role in promoting retirement saving by low and moderate income workers, especially those who presently are not enrolled in an employer-sponsored plan.

Members were invited to express their opinions about the incentives and proposals to increase saving and coverage, as well as the broad outline of the RIA. The group sought to reach consensus on as many points as they could. At times, the group was unanimous or nearly-unanimous in supporting or rejecting a given point. In this instance, the group was said to have "generally agreed" or "generally disagreed" on that point. At other times, the group found substantial agreement, while there was minor opposition. At other times, the opposition might be strong. When the group disagreed on a point or provision, members were invited to offer different options that might address that particular issue. Members of the group were assured that strong opposition would be noted in the report.

SECTION I: The Retirement Investment Account Plan

Working Group II's primary accomplishment was its success in reaching general agreement on many of the broad outlines of a proposed new retirement vehicle, which the group named the Retirement Investment Account or RIA.

The Retirement Investment Account Plan at a Glance

The group generally agreed that the Retirement Investment Account would be offered through a new privately-run, centralized infrastructure overseen by the federal government. This system is designed to expand pension coverage and provide a benefit above and beyond the Social Security benefit. The areas of general agreement are described below.

The RIA and the new infrastructure are designed to make it possible to have a savings account vehicle potentially available to all workers, whether full-time, part-time, self-employed or contingent workers. Importantly, the RIA could potentially provide coverage to workers who are not currently covered by a retirement savings plan. The potential for a broadly-based centralized system to boost retirement savings has long been a hope for those who would like to see the United States create a means whereby all working Americans could participate in a payroll-withholding retirement scheme.

In the interest of a harmonious outcome, the majority of the group supported making the program voluntary, although a number of members strongly favored making it mandatory. There was also support for providing a means for workers to contribute directly to the central clearinghouse without going through payroll deduction. This could include making contributions when filing annual income tax returns.

The elemenets of the plan include:

Central Clearinghouse. A government-authorized central clearinghouse will handle contributions from employees into accounts in the RIA plan. The members generally agreed that the government will contract some or all of the services provided by the central clearinghouse to the private sector.

Employer Facilitates Contributions. Employers will voluntarily help facilitate contributions from employees to the RIA plan, but do not have to become involved as plan sponsors; i.e., sponsors of the RIA retirement plan. Thus, they do not have to assume the responsibilities, fiduciary liabilities, and other burdens of being a plan sponsor for the RIA plan.

Employee Contributions. Employees will indicate the level or amount of contributions they would like to have deducted from their wages on a regular basis on a revised W-4 form. The employer will transfer to the U.S. Treasury the amount that an employee has elected to contribute to the RIA plan when the employer submits regular tax payments. Treasury, in turn, will forward contributions as soon as possible to the clearinghouse.

Employer Contributions. Employers can also make contributions and matches of employee contributions[6] to the RIA. The employer contributions, too, are sent along to the U.S. Treasury and forwarded as soon as possible to the clearinghouse.

Default Investment Mix. Contributions to the RIA system will automatically be placed into a default investment in a balanced, diversified fund which could also be a lifestyle or life cycle fund.

Investment Choices. For participants who wish to make a choice other than the default investment mix, there will be a simplified offering of investment options chosen by the clearinghouse.

Government Credits and Matches. The RIA plan is set up in a way that would make it possible to offer government contributions and matches of employee contributions, as well as government tax credits. The group, however, while supporting government matches and tax credits in a general way, did not agree on a specific program.

Offered in Conjunction With Other Plans. Employers at firms that already sponsor 401(k) and other retirement saving plans can also offer their employees access to the RIA plans. The target group, however, consists of workers who are not covered by or are ineligible to participate in an employer-sponsored plan.

Contribution Limits. The group set limits on participant and employer contributions and matches at levels that are designed to prevent the RIA plan from undermining the success and appeal of the 401(k) plan, the SIMPLE,[7] and other defined contribution plans.

Members of the group looked at initiatives that members felt would be beneficial without consideration for their budgetary impact and acknowledge that whatever program that might be proposed would be dependent on the federal budget available at the time.

The Design Elements of the RIA Plan

The group devoted many hours to discussing the details of how the RIA plan would work and how it would fit into the array of existing retirement plans without detracting from any of them. The group was able to reach some agreement on some of the design elements, but was divided on other elements, sometimes strongly divided. Each of the broad design elements of the RIA plan are presented below, along with the outcome of the group's discussions.

The Infrastructure for the RIA Plan

The group discussed what type of infrastructure would work best to make the RIA plan accessible to employees, while reducing the potential burden on employers. The group also examined what would be needed in the infrastructure to implement potential government matches and tax credits for individuals.

Areas of General Agreement:

The RIA Will Be Run Through a Central Clearinghouse. The group generally agreed that contributions from employees and employers to the RIA plan will flow into a government-authorized central clearinghouse. This infrastructure would allow employees to have a portable plan, to the extent that a future employer also participates in the RIA plan, and to the extent other flexible methods are found for employees to contribute directly.

The Central Clearinghouse Will Be Privately Run. The group generally agreed that the government-authorized central clearinghouse would be run by the private sector. This approach was taken so that the RIA plan would not be seen by critics as creating a big government bureaucracy.

Employees Will Indicate Contributions on W-4 Forms. The group generally agreed that employees would indicate what amount of their regular pay and compensation would be earmarked as a contribution to the RIA plan.

Employer Will Remit Contributions to U.S. Treasury. The group agreed that employers will remit the employee-designated contributions to the U.S. Treasury. The group agreed that the employer also will send employer contributions to U.S. Treasury and will not remit directly to the clearinghouse.

The U.S. Treasury Will Transfer Contributions to the Central Clearinghouse. The group generally agreed that the U.S. Treasury will forward contributions remitted by the employer to the central clearinghouse. The group deferred any decisions on how this should be done or how quickly it should occur, but generally favored an approach that transferred the funds in a timely manner.

The Clearinghouse Will Credit Contributions Received from the U.S. Treasury. The group generally agreed that the clearinghouse will credit employee and employer contributions in designated individual accounts, as funds are sent to it by the U.S. Treasury.

Areas Where Views Differed:

Government Oversight Agency. The group discussed which agency would oversee the clearinghouse, but members decided that the proposal for the RIA plan should not get detailed.

Who Is Eligible to Participate?

The group discussed whether or not to include several groups of workers: those under the age of 21, part-time workers, contingent workers, contract workers, the self-employed, household workers, and non-working spouses. Currently, workers from these groups are often excluded from required coverage for most retirement savings plans sponsored by employers. Excluding them helps employers meet nondiscrimination requirements. Self-employed workers do have access to existing tax-preferred retirement savings plans, such as the SEP, Keogh, IRA, and SIMPLE IRA and SIMPLE 401(k).[8]

Areas of General Agreement:

All Wage Earners Eligible to Contribute. The group generally agreed that the RIA plan should be open to all Americans who earn an income. There were some, however, who did not agree. Some members preferred to limit access to the RIA plan to workers earning at least $5,000 a year. Some opposed to opening the RIA plan to all workers said they were concerned that it might set up a system that would collapse from having to administer millions of tiny accounts.

Self-Employed Can Participate in RIA plan. The group generally agreed that the participation of the self-employed would not be affected by whether or not employers are required to make the system accessible to employees through payroll deductions. The reason is that the self-employed could include their contribution into the RIA plan when they send the IRS their quarterly income taxes. One member suggested that participation of the self-employed be limited to those who earn at least $1,250 a quarter, which would maintain the $5,000 a year minimum income level for participation.

Areas Where Views Differed:

Direct Contributions By Employees. The group discussed how individuals might contribute to the RIA plan if they are not able to contribute through payroll deductions arranged by their employer. The group failed to reach agreement on how this might be done. However, there were several suggestions that were offered.

One member of the group suggested that an alternative method of contributing should be set up that would allow workers to make contributions to the clearinghouse when they file their income taxes every year. Another member suggested that workers be allowed to designate a portion or all of their refund as a contribution into the RIA plan.

Non-Working Spouses. The group could not reach agreement on whether or not non-working spouses should be allowed to contribute to a RIA plan, as is now allowed with IRA's.

Some in the group maintained that non-working spouses already have access to IRAs and that allowing them to participate in the RIA plan would make the system unnecessarily complicated. One member suggested, and others agreed, that the proposal remain silent about spouses but provide that it will be open to all citizens with earned income, which arguably would include what is allowed for contributions to IRA's by default. When spouses contribute to IRA's they are deemed to be self-employed with no reported income. Others in the group contended that explicitly offering the RIA to unemployed spouses would assist them in preparing for retirement.

Investment Options

The group discussed whether or not participants could be automatically enrolled in the plan, whether there might be a default investment choice, and whether there might be additional investment options in the plan.

Areas of General Agreement:

Automatic Enrollment. The group agreed that employers would be allowed to provide automatic enrollment. With this approach, a new employee would have to choose not to enroll. Otherwise he or she would be enrolled in the RIA plan.

Automatic Investment in Default Balanced Fund. The group generally agreed that if employees do not elect to choose an investment option(s), their contributions to the RIA plan would automatically go to a balanced,[9] diversified fund, which could be a lifestyle-oriented fund.[10] A balanced fund is a common name for an investment fund that invests significant portions of its assets in each of the major investment asset classes: shares or equities, real property, fixed interest investments and cash. Lifestyle funds are one type of balanced fund that allocates funds between different classes of investments based on the participant's age and risk tolerance, and which sometimes automatically adjusts the allocation as a person ages, becoming more conservative over time.

The group's recommendation regarding the default choice reflects a growing trend in the 401(k) system in favor of a default choice of a balance fund or lifestyle fund. When a default option is offered, a member said, about 75 percent of workers usually accept the default investment.

Clearinghouse Will Select Simplified Investment Options. The group generally agreed participants could elect to make a choice among one or more of a simplified offering of fund options. The group also generally agreed to let the choice of investment options to be determined by the clearinghouse.

One member suggested that the range of choices should be limited to the types of choices offered in the Thrift Savings Plan.[11] Another member suggested even fewer options: a balanced fund, an equity fund, and a short-term interest fund. One member suggested that some people may want a safer investment, such as Treasury bills or bonds. One member supported keeping contributions in the default investment in a balanced fund until the balance had reached a minimum level, which was not specified.

Employee and Employer Contribution Limits

All defined contribution plans, including the 401(k), have contribution limits that affect how much employees and employers can contribute. Such limits are put in place partly to reduce the drain on government revenues and partly to assure that owners and high wage earners do not take too great a portion of the overall tax benefits provided to retirement savings plans.

Over the years Congress has developed a range of simpler defined contribution plans with different sets of contribution limits than the popular 401(k). As new types of plans have been introduced, lawmakers have consciously tried to design them so that they do not work to undermine the success of existing plan designs.

Areas of General Agreement:

Why the RIA Has Contribution Limits. The group agreed that the RIA plan should have contribution limits for employee and employer contributions. The contribution limits would accomplish two things:

Limits could help assure that higher-paid employees and business owners do not disproportionally benefit from the RIA plan.

The limits could be kept low enough to prevent the proposed RIA plan from prompting employers to terminate their existing defined contribution plan, such as a 401(k) plan. The group supported the view that the RIA plan should not undermine existing plans or prompt them to be terminated. Plans like the 401(k) are seen to be helpful in increasing overall saving because they often feature employer-matching contributions to encourage workers to contribute. This feature, in turn, prompts workers to save who might not be inclined to save in a system without matches, supporters of the 401(k) plan contend. If an employer terminates a 401(k) plan because the RIA has similar contribution limits (which means the employer gets the same outcome in terms of benefit), it might reduce overall saving for retirement by the rank and file, according to supporters of the 401(k) plan.

Contribution Limits Should Be Lower Than Those For the 401(k) Plan. The group agreed that the contribution limits should be set lower than those for the 401(k).

One member explained his support for lower limits as follows: If new savings vehicles are set with limits that are too high, it would be a disincentive for small business owners to offer an employer-sponsored plan. Employers would instead offer workers access to the RIA plan. One member said that his business would drop its 401(k) plans "in a heartbeat" if the RIA plan were created with the same contribution limits as a 401(k). The reason is that the employer would no longer have to sponsor a retirement plan, educate workers about saving and offer matching contributions to get more of the lower-paid workers to contribute so that the plan could pass nondiscrimination tests.

Participant contributions to 401(k) plans are called elective deferrals in the Tax Code. For 2005, the limit was raised from $13,000 to $14,000. Similarly, the limit on the salary deferrals[12] was raised from $13,000 to $14,000 for 457 plans[13] of state and local governments and tax-exempt organizations. For SIMPLE plans, either SIMPLE IRAs or SIMPLE 401(k) s, the limit was increased from $9,000 to $10,000. IRA contribution limits for 2005, by comparison, rose from $3,000 to $4,000.

Participant Contribution Limits Set at $5,000 to $6,500. The group generally agreed that participant contribution limits should be limited to somewhere between $5,000 and $6,500. This contribution limit level would position the RIA plan in a niche below the 401(k) plan ($14,000 limit) and the SIMPLE ($10,000 limits), but above the IRA ($4,000 limit).

Employer Contribution Limit Set at $4,000. The group generally agreed that voluntary employer contributions could be allowed to the RIA plan and that such contributions should be limited to $4,000 a year. The RIA contribution limit would position the plan in a niche below the 401(k)'s $14,000 limit and also below the SIMPLE's $10,000 limit.

Employers Can Choose a Nondiscrimination Safe Harbor for Contributions. The group generally agreed to support a nondiscrimination safe harbor from having to conduct nondiscrimination tests. The safe harbor can be achieved in one of two ways:

- The employer contributes two percent of pay into the RIA accounts of all workers.
- The employer contributes a match of $1 for each $1 contributed by an employee into a RIA account for the first two percent of pay, followed by an employer match of 50 cents for each $1 contributed by an employee for the next two percent of pay.

Withdrawals and Distributions from Accounts in the RIA Plan

The group discussed when rules should apply for pre-retirement withdrawals for either loans or hardship, when changing jobs, when withdrawals can begin without penalty, and what rules would govern those withdrawals.

Areas of General Agreement:

Plan Allows Hardship Withdrawals, Does Not Allow Pre-Retirement Loans. The group generally agreed that the RIA plan would not allow loans on balances in the plan, but would allow for hardship withdrawals under tight rules. By contrast, in 401(k) plans, participants can take out loans against their balances and can have hardship withdrawals.

Loans were opposed because they would add to the administrative burden of the plan for the central clearinghouse. Further, some argued that it may be difficult to get the loan prepaid because the RIA plan is not an employer-sponsored plan where the employer can arrange for payroll deductions to repay the loan. Finally, it was argued that loans would add difficult complications to implementing potential government tax credits. One member, however, strongly opposed a prohibition against loans, stating that the RIA plan should not be inferior to a 401(k) plan. This member further contended that loans could be repaid through payroll deductions.

Those in support of allowing hardship withdrawals under rules at least as stringent as those for 401(k) plans, noted that it was important for low and moderate income savers to know that they could have access to their savings if they had an emergency. Otherwise, some would not contribute to the RIA plan or might contribute less if no pre-retirement hardship withdrawals were allowed.

No Need to Withdraw Funds When Employees Change Jobs. The group generally agreed there was no need for employees to withdraw funds due to a plan termination by the employer or because an employee changes job, since the RIA plan is associated with a central clearinghouse. Even if an employee's new employer does not participate in the RIA plan, the funds in the account can continue to enjoy gains from its investments. Also, contributions could potentially be continued directly to the government when participants file their annual income tax return.

No Early Withdrawals of Government Contributions. The group generally agreed that government contributions or matches to accounts in the RIA plan could not be withdrawn at all before participants are eligible to withdraw employee and employer contributions without penalty. This prohibition was supported because it would assure that government contributions would go toward supporting participants in retirement and not for pre-retirement living expenses. (See section on Government Contributions)

Withdrawal Rules Made Consistent for Government, Employer, and Employee. The group, while disagreeing on what the retirement age should be, did agree to make the age uniform for all sources of contributions – individual, employer and government – to avoid administrative complications if one source of funds faced special age restrictions.

Roll Over Accounts Will Maintain Restrictions on Government Contributions. The group generally agreed that the prohibition against early withdrawal of government contributions would apply to funds from an account in the RIA plan that are rolled over to another retirement saving plan. (See discussion on Government Contributions).

Areas Where Views Differed:

Age When Withdrawals Can Be Made Without Penalty. The group was unable to agree on what age a participant could begin to withdraw funds from an account in the RIA plan without a penalty for early withdrawal. While the group was agreed that the age should be the same for all contributions – individual, employer and government – the group was divided into two groups about when the retirement age should be set for withdrawals. Some members preferred setting the age at 59½, which is the age when participants can begin to withdraw from a 401(k) plan without penalty. Other members, however, preferred setting the retirement age the same as those for Social Security, where retirees can begin to collect a reduced benefit at age 62, and those born in 1940 can collect the full retirement age benefit at 65 and 6 months in 2005 (although the age will increase gradually for later birth cohorts until it reaches 67 in 2027 for those born in 1960).

Those who favored withdrawals without penalties at age 59½ said that the RIA plan should not be designed to be inferior to the 401(k) plan. The members preferring a later retirement age argued that it would preserve the government contribution until retirement age. Group members favoring a higher uniform age argued

> "I think the Conversation has really been quite extraordinary . . . it has brought together a broad array of interests. Really most every expert that I've come across in my years of work in this business appears to be involved in this common endeavor."
>
> Representative Earl Pomeroy (D-ND) from his address at the Conversation's National Policy Forum, July 22, 2004.

that a higher age for withdrawals without penalty could still allow for early withdrawals without a penalty due to disability, using the disability rules as defined by the Social Security Administration.

Rollover Rules. The group left unresolved the question of whether or not age restrictions set for the RIA plan might apply to funds that were rolled over from a RIA plan to another retirement savings plan. While the group did support the idea that government funds could not be withdrawn until retirement age as defined in the RIA plan, it was not decided whether or not the age at which funds can be withdrawn without penalty, if different, would be transferred to the rollover account in another retirement plan.

Tax Credits, Including Government Matching Deposits

The group discussed ways to encourage employees to contribute to RIA accounts by using an array of tax credit approaches. A tax credit is a direct reduction in the tax payment that would otherwise be required from a taxpayer. There were three kinds of tax credits that the Working Group thought merited discussion and which could prompt employees to contribute more to the RIA plan:

1. Refundable tax credit: An income tax credit is "refundable" if it is designed so that it could result in a refund (i.e., a payment from the Treasury to the taxpayer). The refund payment can take the form of either a check from the Treasury to the taxpayer or a direct deposit by the Treasury to the taxpayer's bank account. Whether paid by check or direct deposit, the refund can be used any way the taxpayer wishes; the taxpayer could choose to spend it or save it.

A refundable tax credit first reduces or eliminates the amount of income tax that the taxpayer might otherwise owe (if any). If the credit exceeds the person's income tax liability, the excess is paid to the person (by check or direct deposit) as a tax refund.

> ***Example:*** Taxpayer owes $200 in income tax and is eligible for a $300 refundable tax credit. The credit first wipes out the $200 tax liability. The remaining $100 of the credit is refunded to the taxpayer.
>
> If, instead of $300, the credit had been only $150, it would have reduced the taxpayer's income tax liability from $200 to $50. In that case, the taxpayer would have paid $50 in tax and would not have received any refund.

2. Nonrefundable tax credit: An income tax credit is "nonrefundable" if it is designed so that it cannot result in a refund. A nonrefundable tax credit reduces or eliminates the amount of income tax that the taxpayer might otherwise owe. But if the nonrefundable credit exceeds (and therefore eliminates) the person's income tax liability, the excess is not refunded to the person. The same result – no refund – also applies if the person never had any income tax liability in the first place. Therefore, a nonrefundable credit is of no value to a low-income person who owes no income tax.

The Saver's Credit (discussed in detail on pages 55-56) is an example of a nonrefundable credit. If someone whose income is $50,000 or less (in the case of a married couple; $25,000 for a single person) contributes to a 401(k), another employer plan, or an IRA, then they get a tax credit equal to a percentage of their contribution, but only up to the amount of their tax liability (which is what makes it nonrefundable). The percentage of the contribution that generates a credit may be 10%, 20%, or 50%, depending on the taxpayer's income. The amount of the credit is limited to $1,000 for individuals, $2,000 for married couples.

Because the Saver's Credit is nonrefundable, it fails to reach some 50 million households who would otherwise qualify for it because their income is low enough but who receive nothing from the program because they have no income tax liability. The group discussed expanding the Saver's Credit by making it refundable in order to make it valuable to most of the lower-income households that it was designed to benefit.

> ***Example:*** taxpayer owes $200 in income tax and is eligible for a $300 nonrefundable tax credit. The credit wipes out the $200 tax liability. The remaining $100 of the credit is not refunded to the taxpayer; it simply disappears (or perhaps, if the rules governing the credit permit, the excess might be carried forward or back to reduce the taxpayer's income tax liability in a later or earlier year).

3. Direct government deposit of refundable tax credit: A refundable tax credit could be designed so that any refund is deposited directly into the taxpayer's RIA account in order to ensure that it is saved (rather than the refund being paid to the taxpayer as a check or direct deposit to their bank account, which, in either case, could be spent for any purpose instead of being saved). The group had various questions about this approach, as discussed below.

Areas of General Agreement:

Employers Might Be Allowed to Contribute to RIA Accounts. The group discussed whether employers (not merely employees or other individuals) should be allowed to contribute to the RIA. Most members favored this, although some raised concerns about whether this would ultimately threaten the viability of employer-sponsored plans and complicate the application of nondiscrimination standards. The group also generally agreed that, if employers contributed to the RIA, the government could match those contributions by contributing additional amounts to the RIA. (Costs were not part of the discussion in this round of the Conversation.)

Start-Up Subsidy for the RIA System. The group generally supported providing a start-up tax subsidy to get the infrastructure of the RIA plan up and running and able to sustain itself. (Again, costs were not factored yet into the discussion).

Areas Where Views Differed:

Government Can Offer Refundable Tax Credits. There was strong support, but not general agreement for the government to strengthen the RIA by offering tax credits that could be spent by individuals – as opposed to limiting government credits to only direct *contributions* into individual accounts within the RIA plan. Supporters of this approach noted that workers might be more inclined to put money into an RIA if they know that, in return, they will get a government match in the form of a check from the Treasury as cash. One member strongly supported the view that tax credits paid out in cash refunds (by check) to individuals would be more likely to increase overall saving for retirement. However, some members objected to this approach because they felt that if government matches went directly into RIA accounts instead of into the hands of employees, it would better serve the goal of promoting retirement savings. By this, they mean that the total amount of saving would be higher if the refund, too, went into the RIA account and was not paid out.

Government Credits and Matches Deposited Only in RIA Accounts. There was considerable support, but not general agreement, for depositing into the RIA plan account all government contributions and matches of employee contributions made to either the RIA or 401(k). Some of those who supported this approach said it would avoid administrative complications for the 401(k) system, such as trying to track down a former employee a year later when a government contribution arrived. Government matches, likely to be based on income levels, could not be made until an individual has filed an annual income tax return. Some members strongly opposed having government funds go only to the RIA plan, claiming it would undermine the 401(k) system. Another member favored having government matches deposited in either the 401(k) or the RIA.

Government Can Offer Matches and Tax Credits. Some members of the group supported a policy of both government contributions into individual RIAs, as well as tax credits that could be spent by individuals. The group as a whole, however, did not generally agree to support this approach. Members supporting an approach that would combine both a match and a tax credit, also recommended making it more attractive to choose the government match to be deposited into a RIA, rather than receive a check from the government that can be spent any way individuals wish. For example, a participant could choose between two options: (1) the government could deposit $500 into an account for a participant who contributed $1,000 to a RIA; or, (2) an employee who contributed $1,000 to a RIA could receive a $250 tax credit to be spent any way an individual chooses.

Can Employers Count Government Contributions for 401(k) Nondiscrimination Testing? The group did not support a suggestion to allow employers to take into account government contributions to RIAs for their employees when they conduct nondiscrimination tests for their 401(k) Plans. One member who objected to this approach said it would lead to fewer employer contributions to 401(k) plans, and recommended instead a tax credit for employers who make contributions to low-income workers that are above the level required under nondiscrimination rules.

Government Seed Money and Super Matches. Most of the members agreed that tax incentives, such as small contributions for some or all RIA accounts in the system, would be helpful. However, supporters of tax incentives did not agree on which incentives to support. Some members favored direct contributions to RIAs for workers making less than $40,000. Other members favored a super match for initial contributions that would benefit lower income workers, such as offering a supermatch for the first $5,000 of lifetime savings. Members of the group recognized that these types of programs could be relatively costly, and acknowledged that whatever program that might be proposed, would be affected by budgetary constraints.

Tax Credits for Employers. There was some support for a suggestion to provide tax credits for employers who made contributions or matches that are above and beyond the levels employers are required to contribute to meet nondiscrimination rules and tests. However, the group deferred discussion on this point and was unable to address the subject again due to time constraints. Similarly, the group failed to reach agreement on supporting a tax credit for employers who contributed a higher percentage of pay to low paid workers than is contributed on behalf of all workers.

Members of the group acknowledge that much more discussion is necessary to flesh out the options under government matches and tax credits. The group, as well, acknowledged that in the next stage of the Conversation, it would be helpful to have research to provide the costs of any of these proposals to the Treasury. The group generally decided that whatever tax credits would apply to the RIA should also apply to other employer-sponsored plans to ensure that there are not lopsided incentives favoring the RIA over employer-sponsored plans.

Should Employers Be Required to Provide Access to the RIA Plan?

The working group discussed whether or not to recommend that employers be *required* to transfer contributions from employees who wanted to participate in the RIA plan. Members of the group were asked whether or not they supported making the RIA plan mandatory in any or all of the following instances: (1) for workers at companies that do not offer employer-sponsored retirement plans, (2) for workers at companies that do sponsor plans who are *not* eligible to participate in those plans, and (3) for workers at companies that sponsor plans and who *are* eligible to participate in the plans.

After discussion, the majority supported making access voluntary on the part of the employer to garner business support for the RIA plan. However, there were two members who felt strongly that the RIA plan should be mandatory for all workers, regardless of whether their employer offered a plan, while two other members supported making it mandatory only for workers who do not now have access to a retirement plan. The majority, however, supported making access to the RIA voluntary on the part of the employer. Some members suggested that ways should be found to allow workers to contribute directly to the RIA, such as allow employees to direct tax refunds to be deposited in a RIA plan account.

Those who supported a voluntary RIA plan gave a range of reasons for their views. One member said he was against government mandates because they tend to discourage job formation and generally lead employers to reclassify workers into contract employees. In addition, the member said, mandates place a burden on small businesses. Another member argued that the burden of handling contributions would be far more onerous than some opponents realized. He noted that in his view it was employers, not the government, who do a great deal of the work involved with administering the Social Security system. Likewise, employers are the ones who will make the RIA plan work.

Those who supported making access to the RIA plan required for employers felt strongly about the importance of this proposed provision. One member said that the need to provide retirement savings opportunities to half the workforce without a plan is so great that it would justify making access to it mandatory for employers. If it were required, the member suggested that the next step would be to launch a massive educational program to convince more workers to participate. Another member supporting mandatory access said the burden on business would be trivial. One member said that if the program was not required, it might be better to devote available resources to expanding the Saver's Credit to get more workers participating in a retirement savings plan.

Next Steps: A Pilot RIA

Some members of the group supported a program to introduce the RIA plan on a pilot basis to demonstrate how it can help increase saving and how it can work along side existing employer-sponsored plans. The experience from a pilot, it was suggested, might demonstrate that the RIA plan does not impose an unworkable burden on employers. If this were to be demonstrated, it could lead to support for requiring all employers to offer access to the RIA plan, one member contended. Some members questioned whether it was feasible to do a pilot RIA, claiming it would be difficult to execute a pilot without new legislation and regulatory rules in place. One member was strongly opposed to a pilot, claiming that a pilot plan would be expensive to do, negating the low-cost advantage of the RIA.

SECTION II:
Proposals to Increase Saving in Retirement Plans

The Working Group discussed a number of tax incentives, regulatory changes and other approaches designed to increase the number of workers covered in an already existing defined contribution plan, as well as to increase the amount of money saved and invested through the plan. They also looked at ways to increase coverage among low and moderate income workers who currently are either not in a plan or who save little through the plan in which they are enrolled.

Automatic Enrollment

When workers are hired, some employers automatically enroll them in the 401(k) or other defined contribution plan unless the worker specifically requests on government forms that he or she would not wish to participate in the plan. The group discussed whether or not this should be mandated and whether special incentives should be provided to encourage more companies to adopt automatic enrollment.

The group discussed whether or not employers who have an automatic enrollment program could automatically place employee and employer contributions in a balanced fund, including a lifestyle fund. The group also examined whether special incentives, such as changes in fiduciary rules, should be provided to encourage more companies to place workers in a default investment mix. Many employers who have automatic enrollment presently allocate by default the funds in the account to a money market or other low-risk, fixed income fund. However, some employers also already allocate available funds by default to balanced funds. Others may be reluctant to allocate by default to balanced funds because of concerns about fiduciary liability for the choices of participants in the plan, in a situation when the participant did not chose the investment, except by default.

Areas of General Agreement:

Automatic Enrollment of Workers. The group generally agreed that more employers should be encouraged to voluntarily offer automatic enrollment but that it should *not* be mandated by law. It was suggested that during the implementation phase of the Conversation on Coverage that a study be conducted of incentives to encourage automatic enrollment.

Safe Harbor for Default Investment into a Balanced Fund. The group generally agreed that employers should be given a safe harbor from fiduciary liability[14] when they direct the funds of an employee who has not made a choice among investment options into a balanced, diversified fund, including a lifestyle fund. Some members noted that it might be difficult to get Congress and/or regulators to support a safe harbor for such an approach, since such safe harbors are based on the assumption that the participant chooses the investment.

Automatic Rollovers

The group discussed whether or not employers should automatically place rollover funds of $1,000 to $5,000 from workers who have left the company, in an investment other than a money market fund or low-return investment. When workers leave a company, employers are allowed to pay out employee balances up to $5,000. Balances between $1,000 and $5,000, if paid from the plans, are automatically rolled over into an Individual Retirement Account or IRA unless the employee designates to the contrary.[15] Employees also can elect to take the money out of their retirement accounts.[16]

Areas of General Agreement:

Invest Rollovers for Better Earnings. The group generally agreed that when employees leave a company and are eligible for payouts of sums up to $5,000, it is important that amounts saved be retained for retirement purposes and not be spent on current needs.[17] The group also generally agreed that it is important that rollovers of sums between $1,000 and $5,000 be invested in a way that will earn the best risk-adjusted return for the worker.

Roll Over Small Balances to the Thrift Savings Plan or IRA. The group generally agreed that it would be helpful if there were a single national destination for rollovers that any employer could use to transfer rollovers. This would make it easier for employers to roll over the sums and encourage employees to save the funds for retirement. The employers would no longer have to choose an IRA, if they did not wish to do so, or if they found it to be a burden.

The group discussed whether or not to roll over funds to the Pension Benefit Guaranty Corporation or to the Thrift Savings Plan[18] which is a retirement savings plan for federal government civilian and uniformed workers. Some members of Congress have suggested designating the PBGC as a recipient for rollover funds. However, the group generally agreed that the Thrift Savings Plan would be the preferred destination. In addition, the group generally agreed that employers should be allowed to choose between rolling over small balances to the Thrift Savings Plan and rolling them over to an IRA.

The choice of the TSP as a destination for small balances was seen as helping alleviate concerns by the employer about choosing an IRA for a departing employee who fails to make a choice for the rollover. Some members in the group supported the proposal to roll over small balances to the TSP. Other members of the group, however, preferred to keep the option of allowing employers to roll over the small balances into an IRA. The group reached agreement to allow either one or the other.

Expand Saver's Credit

Currently, low and moderate income workers can receive a Saver's Credit up to $1,000 to encourage saving in a retirement saving plan. Enacted into law[19] in 2001, the Saver's Credit was first available in 2002 and is slated to end in 2007. The Saver's Credit can reduce the federal income tax a worker pays dollar for dollar. The amount of credit that one can receive is based on one's contributions into an IRA, 401(k), and other retirement saving plans.[20]

The amount of credit[21] available ranges from 10 percent to 50 percent, depending on adjusted gross income and filing status. Lower income workers are eligible for a higher credit. For married couples filing jointly, the credit is available on incomes $50,000 and under. For single people and married couples filing separately, the credit is available on incomes up to $25,000. In practice, most of the benefits have been paid out in 10 percent credits for couples filing jointly who earn between $35,000 and $50,000.

The Saver's Credit is not refundable. That is, if someone does not owe any taxes, then they cannot receive the credit in cash. The credit can only go towards reducing an existing tax liability. Although there are 57 million workers within the income brackets covered by the Saver's Credit, only about 20 percent are eligible to receive any benefit.[22] In this group only about 3.5 million have actually received a Saver's Credit by contributing to an eligible savings plan, and most have received only a 10 percent or 20 percent match.[23] Contributions are made to a 401(k) and rarely an IRA.[24] Only about one tenth of one-percent received a 50 percent match on a $2,000 contribution.[25]

The members discussed whether or not the Saver's Credit had increased coverage or saving. Members disagreed on how successful the Saver's Credit has been in promoting either goal. One member estimated that the program cost $10 billion in tax revenues. Members of the group generally agreed that it would be helpful to get detailed information on how the program has worked in its initial implementation, in order to evaluate what changes might improve coverage or saving for retirement.

Areas of General Agreement:

Extend the Saver's Credit Beyond 2007. The group generally agreed that the Saver's Credit program should be extended beyond its sunset in 2007.

Make the Tax Credit Refundable. The group generally agreed that the tax credit should be refundable so that more workers could enjoy the benefits. This means that workers who do not have a tax liability sufficient to cover the tax credit would be eligible to receive a payment for the part not covered by a tax liability. This means that if they owed, say, $200 in taxes and were eligible for a $300 credit, they would receive a payment for $100. Supporters stated that refundable tax credits are desirable because they promote greater saving by more workers. Some of those supporting a refundable credit expressed a preference for depositing the refundable portion into a retirement savings account rather than sending payments to eligible recipients.

There were some objections, too, to a refundable tax credit. One member was concerned about compliance issues, such as possible fraud. One member stated that refundable tax credits are less efficient in promoting saving than government matches. The member noted that $1 match would result in $2 of savings. A $1 tax credit might, however, only prompt $1 of saving if the tax credit is spent. There was also a concern that the government would impose costly complications that might be difficult to administer.[26]

Areas Where Views Differed:

Make the Saver's Program Permanent? The group was unable to agree on making the Saver's program permanent.

Raise the Percentage Match and Income Levels. The group discussed a variety of ways to raise the percentage of the credit available at various income levels. They also supported workers earning higher incomes than allowed currently be eligible for the credit. While the group *did not* generally agree on a new income schedule at which different percentage credits would apply, there was strong support for raising the tax credit to 75 percent for couples filing jointly who earn up to $40,000, with the credit phasing down to 50 percent for couples earning $50,000, and then phasing down to zero for couples earning $60,000. For singles and couples filing separately, the income limits would be half the level for couples filing jointly.[27]

Offer a Government Match for Employee Contributions? The group also discussed a government match for individual and employer contributions. There was support for a government match, but some members were unsure about one would devise a method for determining the match, and how the funds would be transferred into the plan. The issue is complicated by lack of an infrastructure for transferring the funds. It is also complicated by the fact that the government match could not be transferred into an account until after a worker making a contribution filed income taxes, at which time the worker's annual adjusted gross income would be known.

Employer Tax Incentives for Matching Contributions by Employers

Currently, employers are not eligible for tax credits or other tax incentives for making matching contributions to employees. The group discussed whether or not it was better to offer tax credits to employers or employees in order to help increase overall saving. They also discussed whether or not tax credits to employers or employees would offer the greater net gain in saving. Or, to put it another way, which would offer the biggest savings bang for the tax credit buck? The group also discussed whether or not tax credits for employers should be limited to small businesses, and whether credits should be offered only for contributions to the accounts of workers below a certain income level.

Areas Where Views Differed:

Employer Tax Credit. There was strong support, but not general agreement, for a suggestion to provide an employer tax credit that rewarded employer contributions or matches, provided it was tightly targeted at lower-paid workers in both large and small businesses.

There were concerns about how a tax credit would work, even among supporters of tax credits for employers. One member said that contributions would have to be 'high quality,' in the sense that they were provided only for employer contributions that were made almost entirely on behalf of the targeted low-income workers.[28] Some who supported a tax credit in principle worried how it might work in practice. One member who strongly opposed any type of employer tax credit said it is not true that this approach gives a greater bang for the tax credit buck. He claimed that if employees can get an additional tax credit if the employer matches the employee's contribution, it would have a similar affect on net retirement savings as providing a tax credit to the employer.

Members Offer Several Suggestions for Tax Credits. The group discussed several options for designing an employer credit without deciding to generally support any one of them. One member suggested a credit for employer contributions that are above and beyond what was needed to satisfy nondiscrimination tests.[29]

One member suggested a 50 percent tax credit to employers for contributions to non-highly-compensated employees.[30] One alternative was to offer a credit to employers for contributions to workers earning up to $40,000 or $50,000.[31] One member proposed making the employer credit a complementary part of the Saver's Credit, which is directed at employees. In this instance, the credit would be only for contributions above and beyond what an employer makes to the work force generally.[32]

The group discussed whether or not an employer tax credit might be limited because the targeted group of small business includes some companies without a big tax liability. To reach this group, it was suggested that any employer credit also be refundable and spendable.[33]

Intelli-Match Proposal to Benefit Low, Moderate Wage Earners

The group discussed the Intelli-Match proposal[34] that would provide a higher proportionate match or contribution to low and moderate income workers than it provides to workers in general.

Before employers could set up an Intelli-Match proposal, Congress would have to pass legislation to grant employers a safe harbor on nondiscrimination tests, since some workers would receive matching contributions at a higher percentage of pay than others. There are existing safe harbors which would allow employers to do this; however, they also require immediate vesting, which may be inconsistent with the business requirements of some employers. For this reason, the Intelli-Match proposal had a provision that employers would not have to provide for immediate vesting[35] to the employer match. This would reduce the overall cost of an Intelli-Match program for employers.

Areas of General Agreement:

The group generally agreed to support an adjustment in the terms of the safe harbor to make defined contribution plans more flexible for employers in return for a higher targeted match for workers earning up to $50,000.

Areas Where Views Differed:

The group did not agree on the provision in the Intelli-Match proposal that would eliminate immediate vesting, although it supported the broader concept, as noted above, that the employer would be given some additional flexibility in return for a higher match for low and moderate income workers.

Payroll Deduction IRAs

The group discussed ways to expand the availability of payroll deduction IRAs, including requiring employers to offer them at firms that do not have a retirement savings plan, as well as requiring employers who have a retirement plan to offer the payroll deduction IRA to workers who are not eligible to participate in that plan.

Under current law[36] employers are allowed to provide employees with the opportunity for making contributions to an IRA through payroll deductions. In 2005 employees are able to contribute up to $4,000 a year to a payroll deduction IRA, while workers over 50 can contribute an additional $500 directly to the bank.

Areas of General Agreement:

The group generally agreed that it would be desirable to expand payroll deduction IRAs.

Areas Where Views Differed:

The group was divided on this issue and did not agree to require employers to offer the payroll deduction IRA. As an alternative, some members suggested that workers be allowed to contribute part or all of their refund to an IRA when they file their annual tax returns.

Reducing the Risk in Defined Contribution Plans

The group considered several proposals that were designed to reduce the market risk that may occur when investment returns perform below historic averages for an extended period. A period of low returns can be of special concern if this occurs when workers are nearing retirement.

Areas of General Agreement:

Government-Issued Retirement Bonds. The Group generally supported encouraging employers to offer inflation-adjusted retirement savings bonds as an investment option in their plans. The group identified Treasury Inflation-Indexed Securities (TIPS) as a potential candidate for this option.

Areas Where Views Differed:

Government Insurance for Defined Contribution Plans. It was proposed that the government insure the difference between a career average return on investments, and the actual return on investment in a worker's account at the time of their retirement, death or disability. The group did not endorse any form of government insurance for contributions or investments in defined contribution plans.

Combination Defined Contribution/Cash Balance Offset Plan. The group decided against considering a proposal with a defined benefit[37] component, as it was seen to be within the scope of Working Group I on defined benefit plans and not within the scope the assignment set for Working Group II. A proposal had been submitted to recommend adding a cash balance plan to a 401(k) in order to assure that a portion of the retirement saving would have a guaranteed return no matter what happens to the markets.

Raising the 70 Percent Coverage Requirement

Under tax law, 70 percent of employees must participate in a retirement plan in order for the plan to qualify as nondiscriminatory.[38] In addition, plans can exclude from this calculation employees who work less than 1,000 hours a year. Some members suggested that it might be possible to increase the required level of coverage to some level above 70 percent of workers. The group also considered whether or not to recommend that employers be required to include more part-time and contingent workers to the standard required to be nondiscriminatory.

Areas of General Agreement:

The group generally agreed there should be more study of the impact of raising coverage above 70 percent and increasing part-time coverage.

Areas Where Views Differed:

The group was unable to reach agreement on supporting either raising the 70 percent level or increasing the number of part-time and contingent workers. There was strong disagreement over the proposal to increase the number of part-time and contingent workers. Some members said that the group needed data to demonstrate the impact of both approaches to determine which would be more effective, while others were willing to support these approaches without more data.

Other Proposals:

Areas of General Agreement:

Improving Financial Education and Literacy. The group generally agreed to support instruction on financial literacy for high school and college students. However, the group did not recommend making it a requirement for graduation, as one member had suggested.

Tightening Coverage Rules. While not making any specific recommendations, the group generally supported the proposition that coverage rules should be tightened. However, the group also generally agreed that more studies are needed to measure the impact of various proposals before endorsing them.

Endnotes

[1]U.S. Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2004,",November 2004, Table 1, p. 5. From the web site at http://stats.bls.gov/ncs/ebs/sp/ebsm0002.pdf. The survey does not include workers employed by state and local governments, the federal government or the military.

[2]U.S. Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2004,",November 2004, Table 2, p. 6. From the web site at http://stats.bls.gov/ncs/ebs/sp/ebsm0002.pdf. The survey does not include workers employed by state and local governments, the federal government or the military.

[3]Ibid.

[4]U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Bulletin, (Winter 1984-1985, Winter 1986-1987, Winter 1990-1991, Winter 1993-1994, Winter Fall 1995, Winter Spring 1996, Fall 2001, and Winter 2002-2003).

[5]Craig Copeland, "Retirement Plan Participation and Features, and the Standard of Living of Americans 55 or Older," EBRI Issue Brief Number 248 (Washington, D.C.: Employee Benefit Research Institute, August 2002), Figure 2, p. 8.

[6]The W-4 is the form the IRS requires to be filled out by new employees for tracking payroll taxes and deductions.

[7]SIMPLE IRAs and SIMPLE 401(k)s are available to small business with less than 100 employees, as well as self-employed people. SIMPLE stands for Savings Incentive Match Plan for Employees.

[8]SIMPLE IRAs and SIMPLE 401(k)s are available to small business with less than 100 employees, as well as self-employed people. SIMPLE stands for Savings Incentive Match Plan for Employees.

[9]A balanced fund aims to produce high rates of return over the medium to long-term. In terms of risk levels, a balanced fund usually occupies a middle position. It is more volatile than a fund with primarily cash and fixed interest investments. It is less volatile than a fund which invests only in equities and real property.

[10]In a Lifestyle Fund, the choices about how much to put into equities, bonds and cash are based on the risk tolerance of the investors and the investor's goals. Lifestyle Funds allow an investor to put all the assets in a single fund and not have to review or revise those investments. The fund periodically adjusts the allocation and gradually becomes increasingly more conservative as the investor moves toward retirement age.

[11]The Thrift Savings Plan offers only a handful of few investment options, which is generally seen to make it easier for participants to use and make decisions about investing. The TSP offers, for example, the following five choices: a Government Securities Investment (G) Fund, a Fixed Income Index Investment (F) Fund, a Common Stock Index Investment (C) Fund, a Small Capitalization Stock Index Investment (S) Fund, and an International Stock Index Investment (I) Fund.

[12]Some pension plans refer to the contribution made into the plan as a salary deferral because it reduces the amount of income that is counted for taxation purposes, while deferring taxes on that income until it is withdrawn later.

[13]SIMPLE IRAs and SIMPLE 401(k)s are available to small business with less than 100 employees, as well as self-employed people. SIMPLE stands for Savings Incentive Match Plan for Employees.

[14]Internal Revenue Code 404(c) requires a participant to make a choice in order to give employers a safe harbor from fiduciary liability for the participant's choice.

[15]Congress required employers to rollover sums for departing employees who do not make a choice in the Economic Growth and Tax Relief Reconciliation Act of 2001. Implementation of the policy cannot begin until Treasury issues regulations affecting the rollovers.

[16]If employees withdraw their money from a 401(k) account after leaving and job and do not deposit into an IRA or another 401(k) at their next job, they will owe taxes on the withdrawal, including a 10 percent penalty tax on amounts withdrawn before age 55.

[17]Congress required employers to rollover sums by for departing employees who do not make a choice in the Economic Growth and Tax Relief Reconciliation Act of 2001. Implementation of the policy can not begin until Treasury issues regulations affecting the rollovers.

[18]The Thrift Savings Plan offers only a handful of few investment options, which is generally seen to make it easier for participants to use and make decisions about investing. The TSP offers, for example, the following five choices: a Government Securities Investment (G) Fund, a Fixed Income Index Investment (F) Fund, a Common Stock Index Investment (C) Fund, a Small Capitalization Stock Index Investment (S) Fund, and an International Stock Index Investment (I) Fund.

[19]The Saver's Credit was part of the Economic Growth and Tax Relief Reconciliation Act of 2001.

[20]Saver's Credit also available for contributions to 403(b) plans, 457 governmental plans, SIMPLE 401(k) plans or SIMPLE IRA's.

[21]For married couples filing jointly, workers with income up to $30,000 are eligible for a 50 percent Saver's Credit for their contributions into a saving plan. Married couples earning $30,001 to $32,500 are eligible for a 20 percent credit, and married couples filing jointly earning $32,501 to $50,000 are eligible for a 10 percent credit. Those earning over $50,000 are not eligible for a credit. For single people or married people filing separately, the Saver's Credit is available for 50 percent of contributions for workers with incomes up to $15,000. Workers with incomes $15,001 and $16,250 can obtain a 20 percent Saver's Credit. Single workers and married people filing separately who earn between $16,251 and $25,000 can receive a 10 percent Saver's Credit on contributions. Slightly different earnings levels qualify a head of household: (50 percent for incomes up to $22,500; 20 percent for incomes $22,501 to $24,375; and 10 percent of incomes $24,376 to $37,500).

[22]Data provided by former Treasury official Mark Iwry.

[23]Ibid.

[24]Ibid.

[25]Ibid.

[26]A proposal to make the refundable amounts made available by a special savings bond payable on retirement and not through a tax credit has been made by Senator Jeff Bingaman (D-New Mexico.)

[27]For singles and couples filing separately, there was support for raising the credit to 75 percent for those earning up to $20,000. The credit would be gradually phased down to 50 percent for those earning $25,000. It would then be gradually phased out to zero for those earning $30,000.

[28]The member who proposed this suggestion said the definition of 'high quality' would have to be further refined.

[29]Nondiscrimination testing is required under Internal Revenue Service rules to ensure that highly compensated employees do not

derive a much greater benefit from a qualified plan than non-highly compensated employees. There are two broad tests. One is Actual Deferred Percentage (ADP) Test which measures the rate at which employees elect to make contributions. The other is the Actual Contribution Percentage (ACP) Test that measures the rate of employer matching and after-tax contributions.

[30]Non-highly-paid employees are those earn less than $90,000. Highly compensated employees earn $90,000 or more.

[31]In this proposal, employer contributions would have to meet "a certain quality of coverage" standard in order to qualify for the 50 percent tax credit, such as requiring that the first dollar of coverage awarded by employers would reach the target population within a given range. Companies would not qualify if they integrated their benefits into Social Security or if they engaged in cross testing to meet nondiscrimination testing requirements. Credit would be made for matching and automatic contributions. On matching contributions, employers had to provide at least a 20 percent match. On automatic contributions, the level would have to be 1 percent or 2 percent of pay. The credit was capped at 3 percent of pay for the employer contribution. It could also be provided for a 1 percent non-elective, 2 percent match. The target was low-income people, not just small business workers.

[32]The employer credit would be allowed made for employer contributions to workers earning less than $30,000, and be applied to contributions 1 percent or 2 percent of wages above the percentage contribution levels the employer was providing to all employees.

[33]One member described both the refundable and nonrefundable tax credits as "spendable" tax credits to differentiate them from contributions deposited into an account by the government.

[33]One possible Intelli-Match approach would be to provide a 100 percent match for employee contributions up to $2,000 or 4 percent, whichever is greater. A worker earning $100,000 could contribute up to $4,000 and receive a $4,000 match. A worker earning $20,000, however, might contribute $2,000 even though that would represent 10 percent of the worker's salary. Even so, the worker would still get a $2,000 match. The proposal would also provide a tax credit to the employer for the amount of employer match contributed to people making less than $50,000 that is above the percentage match give to owners and highly-compensated employees.

[34]An employee is said to be "vested" in a pension when the employee becomes entitled to the benefits of the plan, including employer contributions to a plan and their earnings.

[35]In 1975 the Department of Labor issue a regulation describing the circumstances under which the use of an employer payroll deduction program for forwarding employee monies to an individual retirement account (IRA) will not constitute an employee pension benefit plan subject to Title I of the Employee Retirement Income Security Act (ERISA) of 1974. Further, as part of the conference report on the Taxpayer Relief Act of 1997, Congress expressed its view that "employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction system to help employees save for retirement by making payroll deduction contributions to their IRAs." (H.R. Rep. No. 220, 10th Congress, 1st Session at 755, 1997).

[36]Defined benefit type plans are retirement plans offered by employers who promise to fund and provide a monthly retirement benefit to each eligible employee based on years of service and earnings.

[37]Internal Revenue Code Section 410(b).

Questions & Answers

Questions and Ideas from the National Policy Forum Working Group II

The Conversation on Coverage sponsored a National Policy Forum on the proposals from three working Groups, including Working Group II, at the National Press Club on July 22, 2004. This section summarizes some of the questions, comments and suggestions addressed during the break-out session for Working Group II.

Many members of the Working Group were present to respond to questions about the Retirement Investment Account (RIA) plan and other recommendations from this report and to take comments for the upcoming refinement and implementation phases of the Conversation on Coverage. Some of the responses below expand on comments made at the break-out session in order to provide background and context.

Questions and Answers

Q. What was the target population for the RIA plan?

A. The Working Group was concerned about individuals who did not have access to a plan either because their employer did not sponsor one or because they were ineligible to participate in an existing plan. In addition, the group targeted its efforts at finding ways to get low- and moderate-income people covered by a plan – either an existing plan type or the proposed RIA plan.

Q. What could be done to prevent the RIA from threatening existing 401(k) plans? And was the Working Group in favor of designing the plan so that it would not undermine the 401(k) plan?

A. The Working Group consciously designed the RIA plan so that it would not undermine existing employer-sponsored plans. For example, it set contribution limits lower than the limits for the 401(k) plan and the SIMPLE plan, but higher than the limits for IRAs. The plan also has fewer investment options and more restrictions on withdrawals than the 401(k) plan to simplify it and make it less expensive to administer. One member, however, supported giving the RIA plan to the same contribution limits as the 401(k) plan.

Q. Would it not be better to improve the 401(k) plan than to add a new type of plan?

A. The Working Group spent a good deal of time looking at ways to improve existing plans so that more workers would be covered, and those suggestions are included in this report. However, members felt that improving the 401(k) plan would not do enough to expand coverage because many workers are at companies without a 401(k) plan while others work for an employer with a 401(k) plan, but are not be eligible to participate.

Q. Did the Working Group discuss spousal protections and what protections would the RIA provide for spouses?

A. The Working Group discussed the idea of allowing spouses to contribute to separate accounts in the RIA plan as they can now do with IRAs, but did not reach agreement to specifically state that the plan would have this provision. However, several members agreed that the group should remain silent about spouses but state that the plan will be open to all citizens with earned income. This approach, it was argued, would include what is now allowed for spousal contributions to IRAs by default. That's because when spouses contribute to IRAs, they are deemed to be self-employed with no reported income. The group did not, however, address the issue of spousal rights to funds in accounts.

Q. Did the Working Group give any thought to which government agency should run the clearing house? And how many entities would be involved?
A. The Working Group agreed during its discussions that the RIA will be offered through a government-authorized clearinghouse that would be administered by the private sector. The details of how it would be operated are to be worked out in the refinement and implementation phase of the Conversation on Coverage.

Q. Can the default investment option in the RIA plan give weight to investments based on the age of the participant?

A. Yes. The default investment is in a balanced fund and the choices can include a life cycle fund, which is one that allocates funds based on the age of the participant.

Q. What sort of research data would be helpful in the next phase?

A. One group member suggested that behavioral economics would be helpful, especially studies that might reveal at what level a refundable tax credit match might prompt the most low income workers to make a contribution to a retirement plan in order to get the match. Another member said he would like to see research that could explain why people who are eligible to participate choose not to participate in employer-sponsored retirement savings plans. A member said she would like a survey of employers to determine whether or not they think it is worth the time to teach employees about finances.

Q. Given its potential appeal, should not employers be required to offer access to the RIA plan?

A. The members of the Working Group discussed at length whether or not employers should be required to offer access to the plan and ultimately, the group did not agree to require it to be mandatory, even though some of its members favored that approach.

One member of the group said during the break-out that he favored making it mandatory to offer access to the RIA plan in order to ensure that everyone is covered and also to make sure the plan is portable. Another member noted that employers have a strong negative reaction to making anything mandatory and this opposition would make it difficult to get Congress to adopt a mandatory plan. One member of the group said during the break-out, that making the RIA mandatory would undermine the existing employer-sponsored defined contribution plan system as employers with 401(k)'s would drop them in favor of an RIA plan.

Suggestions and Responses

Some suggestions do not have a response because none was offered during the break-out session.

Suggestion: Members from all three Working Groups should discuss the differences between their plans and why different approaches were taken to similar policy challenges. For example, the Model T Plan proposal from Working Group III allows for loans on account balances, but does not allow for hardship withdrawals – while the RIA plan from Working Group II allows for hardship withdrawals, but does not allow for loans.

Suggestion: Research should be done on how many people would be covered by the RIA plan and what design options would give it the widest enrollment. There should be a survey of the financial industry to see how much interest there would be in selling the plan once it is set up. There should also be a survey of the legal issues that might be involved with setting up the RIA plan.

Suggestion: The Working Group should give consideration to a more distinctive name than RIA. It is too similar to IRA and, thus, subject to confusion with an IRA.

Suggestion: Consideration should be given to how to help savers and investors allocate their savings for best results without having to learn a lot about economics and finance.

Response: One person suggested that technology could provide a solution to this challenge. A group member said that some of those in attendance might come up with some suggestions in the area of automatically managing investments after reading the details of the report.

Suggestion: Mandate automatic enrollment in 401(k) plans and other defined contribution plans.

Response: The Working Group generally supported the concept of automatic enrollment, but did not reach a consensus that it should be mandated. One group member noted that there are industries with high worker turnover where automatic enrollment would make it very hard for employers to pass nondiscrimination tests.

Working Group Two Members

All Working group members participated as individuals not as representatives of organizations.

The affiliations listed are those during the time that they participated on the Working Group, during the second stage of the Conversation on Coverage, from 2003-2004. Current affiliations (2005) are listed in parentheses.

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