Covering the Uncovered

Common Ground Recommendations to Expand Retirement Savings for American Workers

Working Report

Conversation on Coverage

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Working Group Three Report

Report on the Conversations and Recommendations of Working Group III

Working Group's Assignment

Answer This Question:
How do we increase coverage and retirement savings
through new institutions and structures?

Co-Chairs:

Ian Lanoff
Pamela Perun

Working Group Members:

John Ameriks
Chris Bone
Doug Ell
Cathy Heron
Pat Humphlett
Leslie Kramerich
Robert Nagle
Carol Sears
Javier Silva
Dick Wartman
Christian Weller
Janice Winston

Executive Summary

Working Group III's goal was to explore and consider what role new institutions and structures might play in expanding the portion of the workforce covered by pension plans. After due consideration, the group chose to examine the role that financial institutions could play in increasing coverage, particularly among small businesses. Only about 35 percent of employees at small businesses (those with 99 or fewer workers) participate in a workplace retirement savings plan. The group also wanted to find ways to expand coverage for part-time workers. This group represents an even greater area of need since only 18 percent of part-time workers participate in a workplace retirement savings plan. Further, since small businesses employ more part-time workers, the effort to reach small businesses would potentially expand coverage for part-timers.

The group also recognized that workers are much more likely to save if they have a way to save through their employer. When such plans are offered, participation rates are high across the board, even if there is no employer match. One reason is that savings can be regularly deducted from a worker's pay check. In addition, once a decision to save is made, it continues automatically.

After reviewing a range of proposals aimed at reaching the target group, the Working Group decided to take the bold step of offering its own clean-slate proposal to reach the masses of uncovered workers. Taking a leaf from Henry Ford's highly successful strategy of designing a car for the masses, the group decided to name its plan the Model T. The new Henry Ford's who would put together retirement plans for the masses would be executives at regulated financial institutions: banks, insurance companies, brokerage firms, and mutual funds.

The Model T would have these features:

- All employees – full-time, part-time, contingent workers and even independent contractors [1] – would be eligible to participate if an employer agreed to be part of a plan. This is a striking departure from existing rules that allow employers to limit which employees might be eligible for such plans as the 401(k).
- Regulated financial institutions could be authorized to offer a simplified plan to groups of employers. This could include insurance companies, banks, brokerage companies and mutual funds.

> "Unless we make some significant changes in our retirement system today, three decades from now we will almost certainly have a system where we have a whole new class of impoverished retirees. We will either spend a relatively paltry amount of money now and dramatically reduce the number of retirees with no means of support other than Social Security or we will spend a lot of money later on down the line when we have tens of millions of retirees with nothing but Social Security."
>
> Representative Robert Andrews (D-NJ) from his address at the Conversation's National Policy Forum, July 22, 2004.

- The group generally agreed that there should be only three to five investment options and that they would include model portfolios that would be conservative, moderate and aggressive.
- Employers would be able to automatically enroll workers.
- If workers enrolled in a Model T plan make no choice among investments, the employer could designate that their contributions be invested in a mix of options that would be appropriate for their age and expected date of retirement.

Small businesses would be more likely to offer such plans because two of the chief reasons they say they currently avoid plans would be eliminated. First, the plan would be administered by the financial institution that provides it. Secondly, the employer would no longer be potentially liable as a fiduciary for the investment choices of employees.

Employers would be allowed to contribute to the plan, but would not be required to contribute. This, too, would address a concern by small businesses whose managers and owners worry that the business is too precarious and profits too uncertain to commit to employer contributions.

While tax credits for employer and employee contributions were seen as helpful, they were not deemed to be essential for the plan.

The Working Group supported giving sponsoring institutions flexibility to design plans to be marketed to employers in a specific region or city or even industry. This approach would make the Model T more appealing because it could meet the marketing needs of some financial institutions. For example, a bank in Peoria, Illinois could offer the plan to businesses in the Peoria area. The plan could also be targeted toward business categories, such as a Mississippi insurance company offering a plan for Mississippi construction and building trade groups.

Mission

The broad mandate of Working Group III was to find new institutions and structures to increase the portion of the workforce covered by a retirement saving plan and to raise the level of retirement savings. The members of the group looked at the role that financial institutions could play in providing new approaches that target workers employed by small businesses, where coverage and saving are much lower than in mid-sized and large businesses.

The group generally agreed they should try to develop broad outlines for a new plan they named the Model T plan, which would be a simplified, low-cost multiple employer retirement savings plan that could be sponsored by financial institutions, such as banks, insurance companies, mutual fund companies, and brokerage firms. The group set out to design the elements of the plan that explain how it might work to attract plan providers and employers. In working on the design elements of the plan, the group sought to find agreement on as many areas as possible and, where a consensus could not be developed, to identify areas where more work needed to be done.

Background

According to the Bureau of Labor Statistics, different segments of the workplace population have widely differing participation rates. The participation rate is 67 percent in medium and large businesses (100 employees or more). However, the participation rate was only 37 percent among small businesses (99 or fewer workers).[3] There is an ever sharper divide in participation rates between full-time (60 percent) and part-time workers (20 percent).[4]

Getting small business owners to sponsor plans is difficult, but not impossible. According to the 2003 Small Employer Retirement Survey (SERS) by the Employee Benefit Research Institute, 29 percent said they were likely to start a plan in the next two years.[5] At the same time, 68 percent said they were not likely to start a plan.[6] This represents a sharp decline in the number of small businesses that are likely to start a retirement plan in recent years. In 1998, for example, 42 percent of small business owners said they were likely to start a plan in the next two years, while 56 percent reported they were not likely.

The survey looked at a number of factors that could improve the chances that small businesses would offer a plan. It found that 73 percent of small businesses were more likely to start a plan if it did not require employer contributions, 67 percent were more likely to start a plan if the employer could get tax credits for start-up costs, 57 percent were more likely to start a plan [7] if the plan had reduced administrative requirements, and 55 percent were more likely to start a plan if it offered easy-to-understand information about the plan. Fiduciary responsibility is another stumbling block to employers sponsoring plans.

These data suggest that a plan that has the following attributes would likely prompt a good deal of interest among small business employers: a plan that offers discretionary contributions on the part of the employer, is easy to administer, reduces fiduciary liability for the choices of employees, provides tax credits for start-up costs, and is easy to understand.

Employer-sponsored pension plans still appear to be the best way to motivate workers to save for retirement. The federal income tax return data indicate that 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. [8] By 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). [9]

How the Working Group Went About Its Assignment

Working Group III first examined a range of existing proposals aimed at employees of small businesses. Instead of recommending any of those proposals, the group instead decided to start with a clean slate and design the broad outlines of a new proposal for a simplified multiple employer[10] or group plan that would be offered to small businesses by financial institutions.

In taking this approach, the group was also responding to a recommendation from the first Conversation on Coverage in 2001 to examine new types of model group pension plans that would enable groups of unrelated small employers to pool resources, thereby reducing administrative costs and fiduciary liability. [11]

Taking a leaf from Henry Ford's Model T, which became the symbol of affordable transportation for the masses, the group named its new plan the Model T multiple employer plan. It was the group's hope that it could be an inexpensive and accessible savings vehicle that could provide pensions to tens of thousands of workers in small companies.

Under the Model T plan approach the plan providers – banks, insurance companies, brokerage companies, and mutual fund companies – would assume fiduciary liability for the investment choices in the plan and would shoulder administration duties for the plans. The transfer of these two responsibilities from the employer to the plan provider was seen by the group as a means of addressing two of the key objections by small businesses to starting a new defined contribution plan. In addition, the simplicity of the proposal was seen as addressing another key concern of both small business employers and employees.

The Model T Plan at a Glance

The group generally agreed on the following broad outlines of the Model T plan.

Multiple-Employer Plan. It will be a multiple-employer defined contribution group or pooled plan and not an aggregation of individual retirement accounts.

Workplace Plan. The Model T will be offered by an employer to employees and independent contractors of the firm.

Administration by Third Party Provider. The administration of the plan would be the responsibility of the plan provider – a financial institution – and not the employer.

Financial Institutions Would Offer the Plan. Regulated financial institutions – banks, insurance companies, brokerage firms and mutual fund companies – would be authorized to offer the Model T plan, in much the same way the Internal Revenue Code now authorizes certain types of financial institutions and corporations to offer IRAs. The authorized institutions would market the plan to employers.

Limited Investment Choices. The group generally agreed that Model T plans would be required to offer a limited choice of three to five options that would consist of model portfolios and/or lifestyle funds, with the possibility of a guaranteed return investment option. The choices would be designed to make them easy for the employer and employee to understand.

Fiduciary Liability Transferred to Third Party Provider. The fiduciary responsibility for the investment choices will be transferred from the employer to the plan provider.

Default Investment Mix Option. Plan providers will have the option of offering participants in the plan the choice of selecting a default mix of investments based on a lifestyle fund or a model portfolio. [12]

Employee and Employer Contributions. Once an employer signs up with a plan provider, both the employer and employees will be able to contribute to the plan.

Securities and Exchange Commission Is Lead Regulator. While the Internal Revenue Service and the Department of Labor would play an important role in the regulation of the Model T plan, the Securities and Exchange Commission would take a leading role in the regulation and oversight of fiduciary and investment matters.

The Building Blocks of the Model T Plan

The group discussed in detail how the plan might be structured and what policies would govern the various elements of the plan. In many cases, the Group was able to reach a consensus, but in others there were varying opinions, or dissenting opinions. The outcome of the discussions of the various elements is presented below.

Building Block No. 1: Plan Providers

The group discussed potential plan providers to offer the plan to employers. This included banks, insurance companies, mutual fund companies, brokerage firms, and various financial intermediaries.

Areas of Agreement:

Regulated Financial Institutions Can Offer the Plan. The group generally agreed the regulated financial institutions can sponsor the Model T plan. This would include banks, insurance companies, brokerage firms and mutual fund companies. A number of members indicated they thought that a simplified Model T plan might be attractive to banks, which have not been as active in offering retirement plans as other financial institutions.

Plans Can Target Regions and Groups. The group generally agreed that plan providers could offer plans that are targeted to employers in a specific geographical or regional area or targeted at employers in specific categories of business and industry.

Authorized Providers. The group generally agreed to support a regulatory approach that is similar to the Internal Revenue Code provisions that govern who can offer IRAs. [13] These regulations would set out the procedures for designating which financial institutions would be authorized to provide the plan to employers. They also generally agreed that the process would be open to eligible financial institutions already regulated by a federal or state agency. This would include banks, insurance companies, brokerage firms, and mutual fund companies.

Brokers and Intermediaries. The group discussed whether or not brokers or intermediaries could pool contributions from self-employed individuals and forward them to a regulated financial institution plan provider. The discussion included such potential intermediaries as organizations representing freelance workers. It was generally agreed that an organization could be allowed to facilitate signing up its members in a plan offered by a financial institution.

Areas Where Views Differed:

Authorization Dependent on Target Participation by Low-Income Workers. There was a proposal by one member that the authority of financial institutions to offer the Model T be dependent on the ability of the plan provider to market the plan in such a way that a designated portion of the workers covered by the plan – perhaps 20 percent – would be low-income workers. This would follow the approach taken in the Community Reinvestment Act (CRA) toward regulating depository institutions. The group was divided on whether or not to support a CRA-type approach to licensing. One member who objected said it would increase the cost of the plan by increasing the level of detail in administering it. One member supported the use of the CRA-type approach by institutions offering the Model T but did not want to make it part of the eligibility requirements for a financial institution seeking to offer a plan. One member suggested that a study be made of 529 college saving plans[14] with CRA-type requirements to see if something could be adapted to suit the eligibility requirements for the Model T plan.

Commissions for Brokers and Intermediaries. The group also discussed whether organizations or even brokerage firms could pool contributions from a group of workers or small employers for a commission. The group could not agree, however, on whether organizations could earn fees for their work as facilitators.

Professional Employment Organizations. One member suggested that professional employment organizations or PEOs that lease out employees be authorized to offer the Model T to the employees they lease out to businesses. However, the group did not generally agree to support allowing PEOs to be plan sponsors.

Building Block No. 2: Employee Participation in the Plan

The group discussed which of a given company's employees would be eligible to participate in the plan and whether or not employers should be allowed to automatically enroll workers when they are hired.

Areas of Agreement:

All Employees Eligible to Contribute. The group generally agreed that once an employer agrees to participate in a Model T plan offered by a financial institution, then all employees will be eligible to contribute to the plan. This will include full-time workers, part-time workers, contingent workers and independent contractors. As noted above, there was interest in having organizations facilitate contributions from various groups of workers, including the self-employed.

Automatic Enrollment. The group generally agreed that an employer participating in a Model T plan could adopt the option of automatically enrolling a new hire into the plan unless the employee indicated otherwise.

Areas Where Views Differed:

Limits on Employee Contributions. The group deferred discussion on setting contribution limits for employees and/or employers to the next phase of the Conversation on Coverage, with the assumption that the limits would be in keeping with the limits for other defined contribution plans.

Building Block No. 3: Employer Contributions to the Plan

The group discussed whether or not employers could contribute to the Model T plan and whether, in fact, employers might be required to contribute.

Areas of Agreement:

Employer Contributions Allowed. The group agreed that employers would be able to contribute to the Model T plan.

Areas Where Views Differed:

Mandatory or Voluntary Contributions. The group discussed whether or not employer contributions would be made mandatory, but remained divided on this issue. There was strong opposition to mandatory contributions. One member said that if employer contributions were made mandatory, then it would create a barrier for signing up employers to be part of the Model T plan. Another member noted studies – such as the annual Small Employer Retirement Survey (SERS) by the Employee Benefit Research Institute – that have found that small business employers would be more likely to offer a retirement saving plan if employer contributions were entirely discretionary. [15]

Some members were strongly in favor of mandating employer contributions. One member who supported a mandate said that if there is no mandate for the Model T plan, he did not see how it would differ very much from an IRA. A member who opposed mandatory contributions said that the Model T would still be a different plan because it would allow for employer contributions to the plan. One member suggested as a compromise, a flexible policy rule in which employers would be required to contribute in x years out of five, depending on whether or not there are profits. Another member suggested requiring the employer to contribute one percent of compensation if the employee puts in four percent of compensation. One member suggested that the Model T allow for reverse match contributions, where the employer contributes first and the employee matches the employer contributions.

Building Block No. 4: Investment Options in the Plan

The group discussed how many investment options and what types of investments should be included in the Model T plan.

Areas of Agreement:

Simplified Investment Options. The group generally agreed that the plan should offer at least three investment options, but no more than five options. The members also generally agreed that the choices should include at least three model portfolios or lifestyle funds: conservative, moderate, and aggressive.

Default Investment Mix. The group generally agreed that when employees fail to make choices on their own, plan providers should be allowed to offer participants at firms that join the plan a default mix of investment options based on lifestyle or life cycle funds – or model portfolios representing the basic asset classes.

Areas Where Views Differed:

Additional Investment Options. The group discussed including an investment option that would provide a guaranteed rate of return. Although several in the group strongly supported such an option as key to encouraging low-income workers to participate, the group did not reach agreement that this should be a required investment option.

Government Definitions of Investment Options. The group discussed having the government define what should be in an investment option, but could not reach agreement.

Two Tiers or One? The group discussed whether or not financial institutions might have two models or tiers to offer employers: (1) a simplified incubator model plus (2) a full-fledged plan with more investment options. Those who supported the concept of two-tiered plans argued that employers could begin with the simplified incubator plan and then move on to a traditional qualified plan offered by the institution offering the incubator plan – or any other institution – when they were ready. The suggestion was made out of concern that the simplified plan might not be profitable for plan providers and, thus, might fail to enlist their enthusiastic marketing of the plan. Members explained that the Model T might not be as profitable in the beginning because it would consist of a lot of accounts, each with very small balances.

The group was divided on this proposal. Some supported an approach with two plan options, a simplified incubator and a full-fledged plan, while others supported a single, simplified Model T plan. Members supporting a single Model T plan argued that while the Model T might not prove to be as profitable initially as the financial institution might wish, account balances would grow over time, increasing the plan's profitability. Further, employers could mature into one of the whole range of existing single employer plans when they are ready for more investment options and more bells and whistles in their plan.

Government Sponsored Start-Up Plan. The group discussed whether or not the government should sponsor a Model T plan for those employers with many small accounts – clients whose business would not be profitable for financial institutions that provide Model T plans. The group was divided on whether or not there should be a government start-up plan. A member who opposed a government plan said it would be difficult for the government to start up a plan. Furthermore, it was suggested that the financial institutions interested in sponsoring Model T plans would be opposed to it. Members supporting a government start-up plan, how-

> “It’s great to see people coming together to set aside their specific differences in the interest of the common good. And the common good is expanding retirement savings, which is good for the economy and good for the worker.”
>
> Representative Rob Portman (R-OH) from his address at the Conversation’s National Policy Forum, July 22, 2004.

ever, continued to strongly support this approach. One asked why financial institutions would be opposed, since the government plan would be only for unprofitable accounts. A member opposing a government plan said it would “get tricky” to devise a way for employers to move from the government plan to a private sector plan.

Building Block No. 5: Regulation and Oversight

Since the Model T plan would transfer administration and fiduciary liability from the employer to the plan provider, it raised a number of questions about what regulatory regime would work best to keep the plan costs low while protecting participants.

The group also looked at the question of who would have fiduciary liability for the investment choices in the plan or in the case of malfeasance or fraud that might occur. The group generally agreed that the employer would be relieved of fiduciary liability for the choice of investment options in the plan.

Areas of Agreement:

SEC is the Lead Regulator. The group discussed what regulatory roles would be played by the Department of Labor, the Internal Revenue Service, and the Securities and Exchange Commission. The group discussed whether the SEC should enhance its role as fiduciary regulator over Model T plans, above the level of scrutiny it applies for the non-pension related oversight that constitutes its regulatory focus. They also discussed whether or not the SEC should be the lead fiduciary regulator instead of the Department of Labor or IRS. The group generally agreed that the SEC should take the lead role in fiduciary regulation for the Model T. They also agreed that at the same time the IRS should be the guardian for tax rules while the Department of Labor would regulate the employer/employee relationship. The exact nature of the DoL’s regulatory role was deferred for future consideration.

SEC Will Regulate Model T Plans Offered By Banks and Insurance Companies. The group discussed whether or not the SEC oversight would apply beyond brokerage firms and mutual funds to include banks and insurance companies, which are chiefly regulated by federal banking authorities, as well as state banking and insurance authorities. One member noted that the SEC currently already regulates mutual funds offered by banks and variable annuities offered by insurance companies. Thus, the member explained, it is not a departure for the

SEC to also regulate Model T retirement saving plans provided by banks and insurance companies. The group generally agreed that the SEC could be the fiduciary regulator for all providers of Model T plans.

Paying for Plan Administration Costs. The group discussed how administration costs would be paid. The group generally agreed that the sponsoring financial institutions could charge a fee for administration (in addition to the fee for investment management). They also generally agreed that, as an option, the fee could be borne by participants as a charge against earnings.

Fees Should Be Low. The group generally agreed that internal fees charged to manage funds, as well as administrative fees to manage plans, should be low. Many in the group supported an approach that would keep fees below 100 basis points.[16]

Areas Where Views Differed:

SEC Will Regulate Fees. Many in the group supported the view that the SEC would be responsible for regulating fees and determining what a reasonable fee might be. The SEC would also be responsible for determining whether or not there should be a cap on fees. This approach would expand the powers of the SEC, which currently oversees mutual funds, but does not regulate fees in mutual funds. However, the group did not generally agree to this approach. One member strongly objected to having the SEC set rates or caps for funds, and further stated that putting this suggestion in the proposal would "seriously derail" any effort to get support for the Model T plan. The member objecting also noted that if the Model T plan had caps, it would reduce the number of players in the market; whereas, if there is no cap, it would increase competition, a development which would, in turn, help keep fees lower.

Enhanced SEC Fiduciary Authority. The group was divided over whether or not the SEC should enhance its fiduciary oversight for Model T plans. Some favored the current level of fiduciary scrutiny applied to brokerage firms and mutual funds as a way of streamlining regulation and keeping down costs. Others, however, felt that since the SEC was the lead regulator, it would have to take on some of the duties associated with the Department of Labor and some of the more extensive list of prohibited transaction rules under ERISA.[17]

Study to Address Unresolved Fiduciary Issues. The group generally agreed that a study should be undertaken to develop an outline for a regulatory regime for the Model T. For starters, the study could flesh out the duties of the various regulatory bodies, and address what enhanced fiduciary regulatory authority the SEC might have over Model T plans.

One unresolved issue concerns whether or not any fiduciary liability would remain with the employer. Some suggested that the employer would retain fiduciary liability for choosing a Model T provider, even if the employer transfers to the plan provider the fiduciary liability for the investment choices offered in the plan. Some suggested that employers should face restrictions on who they might choose so "they could not hire their brother-in-law down the street," as one member put it.

There was also discussion about whether or not the plan provider might escape fiduciary liability for the choices in the plan, if the provider follows the required list of investment offerings. The group, however, did not reach agreement on a suggestion to remove fiduciary liability for plan providers who chose the recommended investment options. One member explained that a plan provider could simply offer the investment options of a business colleague or a relative rather than provide investment options based on the sole interest of the plan participants.

Building Block No. 6: Withdrawals and Distributions

The group discussed under what terms and conditions employees could make pre-retirement withdrawals for hardship or a loan. They also discussed the rules that would apply when employees leave an employer, as well as the rules which would govern distributions of assets when a participant reaches retirement age.

Areas of Agreement:

Hardship Withdrawals Not Allowed. The group generally agreed to disallow hardship withdrawals. This approach was taken partly because it would be difficult for plan providers to be able to determine if there was a genuine hardship. In addition, barring hardship withdrawals was seen as simplifying the overall plan design, making the Model T less expensive. It was also seen as setting a policy that would encourage workers to retain their accumulated balances until they are old enough to be eligible to take distributions.

Loans Allowed Up to 50 Percent of Assets. The group generally agreed that participants would be able to withdraw loans from their accumulated balances for amounts up to 50 percent of the value of the assets in their plan. They also generally agreed that if a participant defaulted, the loan would be treated as income and would be taxed. This approach was taken to provide some type of pre-retirement access to the assets in the plan. This approach was taken on the assumption that workers tend to contribute more and save more if they know they can withdraw some of the funds for an emergency. Loans were seen as preferable to hardship withdrawals, for the reasons noted above.

Lump Sum Withdrawals at Age 59½. The group generally agreed that participants could withdraw up to 50 percent of the value of the assets in the Model T plan beginning at age 59½, conforming to the age set generally for withdrawals from defined contribution plans, including 401(k) plans. If a participant has taken out loans and not repaid them, these loans would count toward the 50 percent maximum limit that could be withdrawn as a lump sum.

Required Annuity on 50 Percent of Account Balance. The group generally agreed that at least 50 percent of the account balance in the plan should be converted to an annuity or be subject to the current joint and survivor annuity rules. In addition, employees could elect at retirement to take out the entire balance as an annuity, with spousal consent.

Rollover Rules. The group generally agreed that a participant who leaves an employer can withdraw up to 50 percent of the balance or roll over the account into another Model T plan where he or she is eligible to contribute. A participant who leaves a company can also leave the remaining 50 percent in the account until age 59½. A participant would have to either leave the 50 percent balance designated for a future annuity in the plan or roll it over to a new Model T plan.

No Maximum Age or Minimum Withdrawals. The group generally agreed that there would be no maximum age at which time withdrawals would have to begin and no schedule of minimum annual withdrawals after that designated age. In 401(k) plans, for example, withdrawals must begin by age 70½ unless the employee is still working. If retired, annual withdrawals beginning at age 70½ are based on the life expectancy [18] of the participant – or the participant and his or her spouse, if married.

Joint and Survivor Annuities. The group generally agreed to apply existing law governing joint and survivor benefits to the Model T plan. That means the annuity would be issued jointly to the plan participant and spouse. It would also mean that the spouse would continue to receive the annuity should the plan participant die before the spouse dies. Plans would be able to decide whether or not they would allow the individual to take up to one-half of the balance at age 59½. If a participant decided he or she wanted to take 50 percent of the accumulated balance as a lump sum when it is offered, current law governing joint and survivor annuities would apply to the remaining amount in the plan.[19]

Areas Where Views Differed:

Other Types of Payment Schedules. Some members suggested that for the annuity half of the benefit, participants should have the option of setting up a regular withdrawal schedule timed to life expectancy. This was seem by some as problematical since participants could outlive the assumed time span for a chosen schedule of payments, while annuities would make regular payments as long as a participant lived – or as long as a surviving spouse lived, in the case of joint and survivor annuities.

Government Managed Annuities. One member suggested that balances dedicated to annuities be transferred to the Social Security Administration and that SSA could then issue the annuities. Or, alternatively, the Pension Benefit Guaranty Corporation could assume control of the balances dedicated to annuities and pay out the annuities beginning at retirement age. The group, however, declined to support this approach.

Building Block No. 7: Tax Incentives and Provisions

The group discussed whether or not there should be tax credits for employers, employees and plan providers, as well as tax subsidies for employers and providers. The group also discussed how contributions, gains on assets and distributions of funds from the plan would be treated for tax purposes.

Areas of Agreement:

Special Tax Treatment Not Essential. The group generally agreed that while special additional tax benefits for contributions by employees and employers might be helpful, it was not essential for the Model T plan.

Current Tax Preferences Favored. The group generally agreed that the Model T should follow existing tax policy in key issues affecting contributions, earnings, capital gains, and distributions. Employee contributions would be excluded from income and, thus, income taxes. Employer contributions would be considered an expense against corporate income. Earnings, dividends and capital gains within the Model T plan would accumulate tax-free. Distributions and withdrawals from the plan would be taxed as part of ordinary income. Distributions at the time an employee separates from service upon termination of employment would be subject to the current withholding rules and would also be subject to a possible penalty if not rolled over to an IRA or another plan. Distributions that result from failure to repay a loan could be subject to the current early withdrawal penalty if made before age 59.

No Tax Subsidy for Plan Providers. The group agreed that the Model T plan should not provide a start-up tax credit or subsidy for financial institutions that offer the plan to employers.

Areas Where Views Differed:

Tax Credits for Employer Contributions. The group also discussed whether or not there should be tax credits for employers as an incentive for them to contribute to the plan or to match employee contributions. While members generally agreed the tax credits for employers would be helpful, the group did not reach agreement on what types of credits would be appropriate. One member said it would be more difficult to get Congress to enact a law to set up the Model T, if it included tax credits for employer contributions. Another member, however, said that the plan should call for a tax credit, noting that one could not get a subsidy if one did not ask. The member also suggested allowing third parties to offer to match employee contributions for low-income workers.

Super Deductions for Employers. The group discussed a suggestion to give employers a super deduction, such as 110 percent, for employer contributions to the Model T plan. While some members supported this approach, the group did not reach general agreement on recommending this policy.

Start-Up Tax Credit for Employer. The group discussed whether or not small businesses should get tax credits for costs associated with starting up the plan, but could not agree on a recommended policy. Some members noted that the plan was provided by a third party, so start-up costs would be minimal. Other members noted, however, that there would be some costs associated with setting up the plan and some members supported a credit for the first few years of the plan as an inducement to get small businesses to sign up with a plan provider. One member suggested a limited start-up credit.

Tax Credits for Employees. The group discussed whether or not to recommend refundable tax credits for employees to encourage contributions, expanding on the nonrefundable tax credits available through the Saver's Credit.[20] The group, however, did not generally agree to support this approach, although some members strongly favored it.

Building Block No. 8: Marketing Considerations

The group discussed how the plan might be marketed to assure that small businesses would decide to participate.

Areas of Agreement:

Description of How the Model T Plan Differs. The group generally supported providing a description of how the Model T differs from other retirement and saving plan types as a way to interest financial institutions in offering the plan. The comparison of the provisions of Model T with other available plans could also serve as a way to draw attention to the plan for employers who might wish to offer it to their employees.

Demonstration Project. The group generally supported exploring the possibility of a demonstration project to generate interest in the Model T plan. Such an effort could be modeled after such successful campaigns as "Cleveland Saves," which enlisted the Mayor and local banks in a public education campaign to encourage people to save. The Model T demonstration project could market a demonstration plan to small businesses and their employees in a given community.

Areas Where Views Differed:

Government Education Campaign. There was discussion about having the government mount a public education campaign on the Model T plan so that financial institutions which offer them will not have to advertise them. Instead, individuals and small businesses would approach potential providers. This strategy was seen as a way to reduce the cost of the plans and prompt financial institutions to offer them. The group, however, did not reach general agreement on supporting this approach.

Endnotes

[1]Independent contractors in this context refers to contract employees and freelancers, but does not include the employees of professional firms, such as lawyers and accountants, who advise or take on specific projects for companies.

[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]Ibid.

[5]Small businesses reported as follows: 7 percent were very likely to start a plan in the next two years, while 22 percent were somewhat likely. Source: Employee Benefit Research Institute, "The 2003 Small Employer Retirement Survey (SERS) Summary of Findings" (Washington, D.C.: EBRI, June, 2003), p. 2.

[6] Small businesses reported as follows: 25 percent were not too likely to start a plan in the next two years, while 43 percent were not at all likely. Source: Ibid.

[7] Ibid.

[8] U.S. Department of the Treasury, Internal Revenue Service, S*tatistics 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).

[9] 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.

[10]Multiple employer plans (MEPPs) are controlled by a single plan document (for this reason they are technically classified as a type of single employer plan) and do not involve a collective bargaining agreement. The employers usually have some kind of connection short of common ownership ("controlled group" status), and the (typically employer) contributions are pooled in a single trust. Fiona Wright, "Working Paper on Pooled Multiple Employer Pension Plans", mimeo, May 2003.

[11]Leslie B. Kramerich, "Confronting the Pension Coverage Challenge," A Report on the Conversation on Coverage Convened by the Pension Rights Center, July 24-25, 2001, p. 42. From the web site at http://www.pensioncoverage.net/pdfs/whitepaper.pdf. The report discussed recommendations for pooled arrangements noting that these would be appealing to small businesses while also being a good vehicle for covering part-time and contingency workers.

[12] 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.

[13]The Internal Revenue Code's Section 408(a)(2) designates what institutions can offer an IRA (banks, credit unions and state corporations chartered by the commissioner of banking, and 401(n) defines what a bank is. Some non-bank financial organizations that offer IRA's often have affiliates that meet the definition of a bank. In addition, the trustee of an IRA can also be "a person other than a bank," but such a person or entity has to apply to the Commissioner of the Internal Revenue Service to demonstrate that it can "act within the acceptable rules of fiduciary conduct." The particulars for this requirements are spelled out in Treasury Regulations § 1.408-2(e)(6).

[14] So-called 529 plans are college savings programs established and administered by the states. They are named 529 Plans after the IRS code section that outlines the details of the plans.

[15] The 2003 Small Employer Retirement Survey found that 73 percent of small business would be more likely to start a plan if it did not require employer contributions.

[16]A basis point is one one-hundredth of a percentage point. Thus, 100 basis points equal one percentage point.

[17]The group did not explore in any detail what sort of prohibited transactions might be required in a fiduciary regime. The Employee Retirement Income Security Act (ERISA) of 1974, for example, sets forth a list of prohibited transactions to which employee benefit plans are subject. The Investment Company Act, which governs mutual funds and brokerage firms, also has a list of prohibited transactions, but not as extensive as ERISA.

[18]Withdrawals at age 70 ? are based on life expectancy under a uniform IRS table or the joint life expectancy of the participant and his or her spouse if the spouse is more than 10 years younger than the participant.

[19]Since the Model T is a defined contribution plan, it follows current law applicable to such plans, but only on the portion that can be withdrawn as a lump sum, and only then if the plan does not offer an annuity on that portion. This policy is based on that fact that defined contribution plans are not required to offer an annuity provided the spouse receives 100 percent of the account balance if the employee dies while covered by the plan. However, current law also states that if the plan does not offer an annuity and the employee does not die while covered by the plan, the employee can withdraw the account balance as a lump sum or other non-annuity payment without spousal consent when the employee leaves the plan. Thus, if the plan offered an annuity on only 50 percent of the balance, then the lump sum could be taken out without spousal consent. However, if the plan offered an annuity on the entire balance, with the option of a lump sum on 50 percent, it would require spousal consent to take the benefit as a lump sum. Some members suggested that the process of obtaining consent for the annuity portion should be streamlined to reduce administrative costs, while others insisted that the current form of consent – a signature on paper – must be obtained to protect spousal rights.

[20]Enacted into law 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. The Saver's Credit is part of the Economic Growth and Tax Relief Reconciliation Act of 2001. The Saver's Credit is also available for contributions to 403(b) plans, 457 governmental plans, SIMPLE 401(k) plans or SIMPLE IRA's. The Saver's Credit works as follows: 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 between $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).

Questions & Answers

Questions and Ideas from the National Policy Forum Working Group III

The Conversation on Coverage sponsored a National Policy Forum on the proposals from three working Groups, including Working Group III, 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 III.

Many members of the Working Group were present to respond to questions about the Model T Plan as proposed in 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. A good deal of the time was spent explaining in more detail the building blocks that make up the plan and how the group arrived at its agreement on key provisions.

Questions and Answers

Q. What is going to be done to assure that people would have equal access to the plans? Would there be sanctions against employers who failed to make the plan available to all employees? The person raising this question pointed out the SEPs are marketed to a lot of employers who only use them for themselves instead of making them available to all employees.

A. The Working Group generally agreed that all workers would be eligible to participate in the plan. Members did not address of just how employers are supposed to make information about the opportunity to participate to all of its employees. The group also did not discuss whether or not to recommend sanctions for employers who failed to notify workers that they were eligible to participate. The group did, however, indicate that the design of the Model T Plan was intended to transfer most of the administration costs to the financial institutions that would offer the plan.

Q. Would people be drawn to the Model T Plan at the expense of better coverage in an existing plan – for example, moving from a 401(k) to a Model T? The person asking this question stated that, as designed, the plan allows employers to contribute $13,000 or more on their behalf, while not requiring that any money be contributed on behalf of non-full-time employees.

A. During their conversations, the Working Group discussed requiring employers to contribute to all employees a minimum amount in order to be eligible to sponsor in this plan, but did not reach agreement on this point. The current proposal has not yet developed contribution limits or determined how nondiscrimination rules might apply. Those issues can be addressed in the refinement and implementation phase. During their meetings, the Working Group discussed requiring the financial institution offering the plan market and administer it in such a way that a minimum percentage of those contributing would be low and moderate-income workers. The members of the group, however, did not generally agree to this approach.

Q. Why does the proposal for the Model T from Working Group III allow loans but not hardships, while the Retirement Investment Account proposal from Working Group II allows hardship withdrawals and not loans?

A. In both instances, the prohibitions were aimed at preventing leakage. In the case of Working Group II, it was felt that it would be difficult to arrange a repayment through payroll deduction because the plan would be administered by a central clearinghouse and the employer is not a plan sponsor, but merely give employees access to the plan. It would also complicate the very limited employer role envisioned by the plan design if the plan were to require employers to sending in loan repayments in addition to contributions. In the case of the Model T, it was felt that it would be difficult for an employer to decide whether a hardship existed when one was claimed. Loans were more attractive because, unlike hardship withdrawals, it was stated the there was the obligation to pay back the loan and the hope this would be done, thereby, preserving more funds for retirement.

Q. Why did the Working Group not offer a proposal that would get more people to save through IRAs?

A. Participation rates for employer-based plans are generally higher than participation rates in individual-type programs, such as IRAs. Further, the data suggest that employees tend participate at a higher level and to save more when they can deduct a portion of their regular pay on a pre-tax basis and have it go directly into the work-based plan. The Model T Plan would be more attractive than a payroll deduction IRA because it would have higher contribution limits and permit pre-tax contributions in all cases. In addition, it would be expected to have a limited list of investments. Employees would not face a choice among the very larger number of investments that might be available through an IRA – or even chose among a number of IRA providers. The fact the Model T Plan will have limited investment choices and providers was seen by the group has helping overcome the difficulty some face in making a choice when too many choices are offered in a plan.

Suggestions and Responses

Suggestion: Conduct a pilot of the Model T and target a community such as a group of churches, who would be exempt from the Employee Retirement Income Security Act, which would make it easier to do the pilot.

Response: This approach is a promising avenue for a pilot and it will be considered in the refinement and implementation phase of the Conversation on Coverage.

Suggestion: The investment choices in the plan should not include managed funds, which will have higher fees, but should include only index funds, which can capture the broad market and are typically operated with low fees.

Response: The Working Group generally agreed that the Model T Plan would be limited to 3 to 5 investment options that would consist of model portfolios and/or lifestyle funds, with the possibility of a guaranteed return investment options. Thus, there is already agreement that the fund would include managed funds. This does not mean the group was not concerned about fees or about having too many choices. The limit on investment options was designed to make the choices easier to understand and to address the difficulty of choosing when too many options are offered. As for fees, the Working Group did generally agree that internal fees charged to manage funds, as well as administrative fees to manage the plan should be low – with a common suggestion that they be kept below 100 basis points in the aggregate. However, the group did not generally agree to recommend that the Securities and Exchange Commission be given authority to regulate fees and determine whether or not fees were reasonable.

Suggestion: Require an employer to have a signature by all employees stating that they were given the opportunity to participate in the plan.

Suggestion: Perhaps it would be better to create a new plan that would be more like a junior 401(k) plan with simpler rules and choices than the proposed Model T plan. This would be helpful to a lot of employers who do not now have plans and might be interested in offering their first retirement savings plan.

Response: The Model T Plan could meet the needs of many employers who do not now have a retirement savings plan. To the extent that half of a participant's account balance can be taken as a lump sum, that half could be seen as a junior 401(k). The other half could be seen as a pension. The Working Group designed the plan with the hope that financial institutions would find it attractive and thus market it to employers. During their conversation, the Working Group discussed offering a two-tiered system – in which one tier would be an incubator plan and the other would be a more complex plan that would offer more options. This approach was seen by some as making the plan more attractive to financial institutions. However, the group was unable to agree on this approach. Those who did not support a two-tiered system with an incubator plan suggested that financial institutions would benefit by offering employers who were ready for it a more profitable single-employer plan, such as a 401(k) or SIMPLE.

Working Group Three 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.

John Ameriks
Senior Research Fellow
TIAA-CREF
(The Vanguard Group)

Christopher Bone
Executive Vice President
Aon Consutling

Douglas Ell
Principal
Groom Law Group

Cathy Heron
Senior Vice President
Fund Business Management Group
Capital Research and Management Company

Pat Humphlett
Women's Institute for a Secure Retirement

Leslie Kramerich
Former Assistant Secretary of Labor, PWBA
(Investment Company Institute)

Ian Lanoff
Co-Chair
Principal
Groom Law Group

Robert Nagle
Labor and Employee Benefits Arbitrator

Pamela Perun
Co-Chair
Affiliated Scholar
The Urban Institute
and
Research Fellow
Initiative on Financial Security
Aspen Institute

Carol Sears
Principal and Consulting Actuary
Actuarial Consulting Group, Inc.

Javier Silva
Senior Policy and Research Associate
DEMOS-USA

Dick Wartman
Second Vice President of Investments
SmithBarney

Christian Weller
Senior Fellow
Center for American Progress

Janice Winston
Former Engineer
Formerly of Verizon