The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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Senator Harkin Introduces USA Retirement Funds Legislation

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TO: BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 13-14
OPERATIONS COMMITTEE No. 13-14
TRANSFER AGENT ADVISORY COMMITTEE No. 17-14 RE: SENATOR HARKIN INTRODUCES USA RETIREMENT FUNDS LEGISLATION

Senator Tom Harkin (D-IA), chairman of the Senate Committee on Health, Education, Labor and Pensions, has introduced the “Universal Secure and Adaptable (USA) Retirement Funds Act of 2014,” a proposal originally introduced as a concept paper in 2012. [1] The bill (S. 1979), co-sponsored by Senators Sherrod Brown (D-OH) and Tim Johnson (D-SD), would create a privately-run universal retirement plan with lifetime income benefits and pooled, professional management. According to Senator Harkin, "[t]he USA Retirement Funds Act is particularly good for small business owners," because "[i]t would allow them to offer more competitive benefits to their employees while at the same time relieving them of the burden of managing a pension plan themselves." [2] As justification for the proposal, Senator Harkin points to the “growing retirement crisis” in the United States. [3] He asserts that the “retirement income deficit” (i.e., the difference between what people have saved for retirement and what they should have saved) is at least $6.6 trillion, that only half of all workers have access to a retirement plan, and that half of Americans have less than $10,000 in savings.

In addition to the USA Retirement Funds proposal, the bill also includes several discrete changes to the existing rules for defined contribution (DC) plans and defined benefit (DB) plans, as described below.

USA Retirement Funds

Employer Mandate. The USA Retirement Funds Act would mandate businesses (1) with more than ten employees (who each received at least $5,000 of compensation) and (2) that have been in continuous existence since at least the start of the previous calendar year, to offer the proposed USA Retirement Funds account to their workers, if they do not currently provide an ongoing (i.e., not frozen) DB pension plan, or a DC plan that (a) automatically enrolls employees at a specified contribution rate, [4] and (b) provides a “lifetime income”

option at distribution. For DB plans, there does not appear to be any minimum benefit level required for an ongoing DB plan. For DC plans, the term "lifetime income" is not defined. The specified contribution rate for automatic enrollment in a DC plan would be at least 3 percent in 2015, 4 percent in 2016, 5 percent in 2017, and 6 percent in subsequent years. Self-employed individuals and employees of small firms not subject to the mandate could also participate in a USA Retirement Fund.

Automatic Enrollment. Employees would be automatically enrolled into the USA Retirement Funds program at a rate of 3 percent per year in 2015, 4 percent in 2016, 5 percent in 2017, and 6 percent thereafter, but could choose to raise, lower or opt-out of contributions. For example, it appears that an employer who becomes subject to the mandate in 2018 would start out enrolling its employees at 6 percent, while employers who become subject to the mandate in earlier years would start out at the applicable lower percentage and escalate the contribution rate each year until it reaches 6 percent in 2018. Individuals could make pre-tax salary deferrals of up to $10,000 per year, [5] while employers would have the option of making contributions of up to $5,000 per year for each employee on a uniform basis.

Monthly Benefits. Participants would not be allowed to make withdrawals from the plan before age 60 or take lump-sum payments, except as described below. Benefits would be paid monthly for life, with survivor benefits and spousal protections, similar to those offered by traditional pension plans.

- Participants who are age 60 and above could elect to receive distributions at any time, but must begin receiving benefit payments before the age of 72.
- Before age 60, a participant could take a distribution not in excess of $5,500, so long as the distribution is rolled over to a qualifying plan or arrangement.
- At age 60 and above, a participant who has not begun receiving periodic distributions may make a one-time election to take a lump sum distribution of the greater of $10,000 or 50 percent of the "participant's benefit" (upon demonstration to the trustees of the Fund that the participant has sufficient retirement income apart from the Fund or is facing "substantial hardship.")

Fund Management. Each USA Retirement Fund would be overseen by a Board of Trustees whose compensation (unless the individual board member is a federal employee) would be paid for by employees participating in the Fund. The assets of each Fund would be pooled and professionally managed by the trustees. Funds would be approved and overseen by the Department of Labor. [6] Employers would have no fiduciary responsibility in selecting, administering, or managing the funds. Participants in the Fund would be permitted to petition the trustees to remove service providers, comment on the management and administration of the Fund, and approve the trustees' compensation.

Risk Sharing. Benefits would be based on the total amount of contributions made by or on behalf of the participant and investment performance, but individual benefit levels could be adjusted (up or down) based on investment returns experienced by the Fund. Senator Harkin describes this as "eliminating virtually all risk to employers" and spreading "the risks inherent in running a pension across large groups of employees and retirees." [7] In order to shield participants from market volatility, in a severe and long-term economic downturn, the Fund trustees could gradually adjust benefits, but no more than 5 percent per year without DOL approval. Any shortfall presumably would be made up by using incoming contributions from active participants to make payments to current retirees.

Investment Choice and Portability. Employees would be able to choose a USA Retirement Fund or use a Fund selected by their employer, and could change to a different Fund once per year. They could not direct the investment of their assets within the Fund. Participants could roll over 401(k) plan or IRA balances into a USA Retirement Fund. Funds would be required to disclose performance and fees, and the Fund's investment policy, procedures for providing lifetime income, and conflicts of interest policy. Participants would receive an annual statement providing the Fund's terms and conditions and an estimate of the participant's benefits at retirement.

Defined Contribution Plan Reforms

Open Multiple Employer ("Pooled Employer") Plans. The bill would permit multiple employers to participate in a single, individual account plan regardless of whether the employers share any common interest. This new type of plan would be called a "pooled employer plan" as opposed to a multiple employer plan. The pooled plan must have a designated provider responsible for administering the plan and providing key disclosures. Each participating employer would have fiduciary responsibility for the prudent selection and monitoring of the pooled plan provider and the plan's named fiduciary (which could be the pooled plan provider). Pooled plan providers must register with DOL and may be required to meet certain qualifications promulgated by DOL. Employers that share a common interest would still be permitted to participate in defined benefit and defined contribution multiple employer plans to the extent permissible under current law.

Pooled Employer and Multiple Employer Plan Reporting. The bill would require multiple employer plans and pooled employer plans to file with their annual Form 5500s a list of all the employers contributing to the plan along with a good faith estimate of the amount of contributions from each employer. It would also allow for simplified annual reports for small pooled employer plans.

Alternative Fiduciary Arrangements. The bill would allow small employers (no more than 50 employees) to shift some of the responsibility for managing a plan to professionals who register with DOL and meet certain requirements. DOL would also have authority to issue cease and-desist orders to providers when plan professionals are not satisfying their obligations.

Rollover Advice. The bill would indicate that a person may be providing investment advice under ERISA section 3(21) when the person advises a plan participant to take a permissible plan distribution and this advice is combined with a recommendation as to how the distribution should be invested. It would require DOL to issue regulations consistent with this principle and asks the Government Accountability Office to study, among other things, whether financial professionals are aware of applicable ERISA fiduciary and prohibited transaction requirements.

Lifetime Income Disclosure. The bill would require individual account plan benefit statements to include an illustration of the participant's benefit as an estimated lifetime income stream beginning at retirement, determined in accordance with DOL regulations.

Annuity Selection Safe Harbor. The bill would add a safe harbor to ERISA section 404 for a plan fiduciary's selection of an insurer and lifetime retirement income contract under an individual account plan. Under the safe harbor, the fiduciary must conclude that (1) at the time of selection, the insurer is financially capable of satisfying its obligations under the contract and (2) the cost of the selected contract is reasonable in relation to the benefits

and product features of the contract and the administrative services provided under the contract. There would be a safe harbor method for determining whether the insurer is financially capable of satisfying its obligations, which would include obtaining certain written representations from the insurer about its compliance with state insurance regulations.

Default Investment Safe Harbor Clarification. The bill would clarify that an investment does not fail to qualify as a “qualified default investment alternative” under DOL regulations merely because such investment includes features such as guarantees. The provision codifies DOL’s interpretation of current law.

Administration of Joint and Survivor Annuity Requirements. The bill would allow a plan fiduciary for an individual account plan to appoint a third-party to administer any applicable joint and survivor annuity requirements.

Defined Benefit Plan Reforms

The bill contains several provisions intended to encourage the use of DB plans, particularly hybrid plans. The changes include:

- clarification of the rules for crediting rates for cash balance plans;
- permitting the continuation of existing DB plans that define normal retirement age as the earlier of an otherwise permitted age or the attainment of 30 or more years of benefit accrual service;
- a two-year moratorium on enforcement under ERISA section 4062(e) (shutdown liability) while the Government Accountability Office studies the rule and develops alternatives;
- elimination of the credit balance offset for purposes of applying benefit restrictions and determining the adjusted funding target attainment percentage;
- simplification of the method small plans use for determining any quarterly contribution requirements by not reducing the plan’s assets by pre-funding or carryover balances;
- permitting the discounting of contributions from the later of the date of the actual employer contribution and eight and a half months after the end of the plan year for purposes of adding employer contributions to the prefunding balance and determining the value of plan assets;
- establishment of a uniform deadline for making certain minimum funding elections—no later than the due date of any minimum required contribution for the plan year or, if later, the due date of the Schedule SB (actuarial information) of the Form 5500 for that plan year—and a single Annual Funding Notice deadline for small plans and large plans that were at least 80 percent funded in the preceding plan year—not later than two months after filing the annual report;
- earlier reporting of financial information from multiemployer pension plans to DOL, the PBGC, and Treasury and establishment of a centralized database for the agencies to share access to the reports provided by multiemployer plans; and
- various changes to the pension plan termination insurance program under Title IV of ERISA.

Other Systemic Improvements and Technical

Amendments

Plan Audit Quality Improvement. The bill makes several changes to improve benefit plan audit standards in response to recommendations by the Office of the Inspector General. First, it provides DOL with authority to establish accounting principles and audit standards to address, among other things, financial reporting issues that are either unique to or have substantial impact upon employee benefit plans. Second, it would authorize new requirements and qualifications for pension auditors. Third, it would make sure the annual reporting civil penalties under current law are enforceable against non-compliant auditors, rather than just against the plan sponsor. Finally, the bill would authorize DOL to broaden or narrow the "limited scope audit" under current law.

Qualified Domestic Relations Orders. The bill would change the qualified domestic relations order rules to require plans to segregate 50 percent of a participant's benefits for at least 90 days after receipt of a notice that there is a pending domestic relations proceeding. It would also impose a $100 per day penalty for failure or refusal to provide information required to be provided to alternative payees under a domestic relations order.

Correction to Bonding Requirement. The bill would make a technical correction to ERISA section 412, to correct an internal cross-reference.

Retaliation Protections. The bill would clarify that protected activity under ERISA section 510 includes internal complaints relating to ERISA plans, such as complaints made to fiduciaries and employers, which is intended to resolve a split in the circuits regarding the scope of the ERISA anti-retaliation protections.

The Institute is monitoring this legislation closely. If you have any questions or concerns, please contact the undersigned at (202) 326-5821 or elena.chism@ici.org.

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endnotes

[1] The bill text is available at http://beta.congress.gov/113/bills/s1979/BILLS-113s1979is.pdf; Senator Harkin's 2012 paper, "The Retirement Crisis and a Plan to Solve It," is available at http://www.harkin.senate.gov/documents/pdf/5011b69191eb4.pdf. The paper includes a discussion of proposals to strengthen the Social Security system. Senator Harkin introduced the Strengthening Social Security Act (S. 567) in March, 2013.

[2] http://www.harkin.senate.gov/press/release.cfm?i=349368.

[3] See Bill Snapshot, Summary, and FAQs available at http://www.help.senate.gov/newsroom/press/release/?id=841825d1-509e-4934-9d7e-968d0853b795&groups=Chair.

[4] Plans that only provide non-elective employer contributions would need to offer such non-elective contributions at the same specified rate.

[5] The $10,000 limitation on pre-tax salary deferrals is contained in the bill summary and

FAQs, but does not appear in the bill text.

[6] It is unclear what status the Funds would have under the federal securities laws. Language in the bill would deem the Funds to be trusts qualified under Internal Revenue Code section 401(a) and exempt from tax under Internal Revenue Code section 501(a). The Investment Company Act of 1940 contains an exception from the definition of investment company for "[a]ny employee's stock bonus, pension, or profit-sharing trust which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1986." Investment Company Act of 1940 section 3(c)(11). It is unclear whether this language from the Investment Company Act would be interpreted to cover a fund that does not actually meet the section 401(a) requirements, but is deemed to meet those requirements.

[7] http://www.help.senate.gov/imo/media/doc/USARF%20Summary%20-%20Two%20Page.pdf.
