

**MEMO# 21224**

June 12, 2007

## **Recent Proposals to Require Employers to Offer Payroll-Deduction IRAs; Conference Call Scheduled for June 20 at 2 pm ET**

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TO: PENSION COMMITTEE No. 16-07

PENSION OPERATIONS ADVISORY COMMITTEE No. 16-07 RE: RECENT PROPOSALS TO REQUIRE EMPLOYERS TO OFFER PAYROLL-DEDUCTION IRAS; CONFERENCE CALL SCHEDULED FOR JUNE 20 AT 2 PM ET

Congress is considering various proposals to require employers to offer payroll deduction IRAs (or "Automatic IRAs") to employees not covered by a qualified retirement plan. This memorandum describes these proposals and similar proposals to encourage more individuals to save for retirement. In addition to proposals at the federal level, several states are exploring offering state-sponsored 401(k) plans for small businesses in their states. The state activity is described here as well. The Institute will formulate positions on the proposals based on member feedback.

The Institute will hold a conference call on Wednesday, June 20 at 2:00 pm Eastern time to discuss Automatic IRAs and the other initiatives described in this memorandum. We do not plan to review the proposals in depth during the call, in order to leave ample time for discussion and consideration of the issues. Please note that Institute member Washington Representatives will be invited to join the call as well. If you would like to participate in the call, please complete the attached response form and fax it to Brenda Turner at 202/326-5841 or e-mail it to [bturner@ici.org](mailto:bturner@ici.org) by noon on Wednesday, June 20, 2007. To participate in the call, please dial 1-800-857-1815 and enter passcode 44454.

## **Automatic IRAs**

Bipartisan legislation has been introduced in the 110th Congress that would require employers to offer payroll-deduction IRAs to employees not covered by a qualified retirement plan. The Automatic IRA Act of 2007 (S. 1141) [\[1\]](#) and the Women's Retirement Security Act of 2007 (S. 1288) [\[2\]](#) contain nearly identical language relating to Automatic IRAs. [\[3\]](#) The Automatic IRA provisions are based on ideas published in a joint paper by Mark Iwry of the Brookings Institution and David John of the Heritage Foundation [\[4\]](#) and are similar to a bill introduced last year by Senator Max Baucus (D-MT). [\[5\]](#) The Women's Retirement Security bill includes additional provisions, such as tax incentives for annuitization, changes to QDRO administration, and a requirement that 401(k) plans cover certain part-time employees. While the bill's provisions are not limited to women, they are intended to improve retirement security for women.

### **Automatic IRA provisions in S. 1141 and S. 1288**

#### *Scope*

- Mandate payroll-deduction IRAs, under a written arrangement of the employer, for employees not covered by a qualified plan during the preceding calendar year and not expected to be eligible during the calendar year. The bill would impose a penalty of \$100 per employee for each calendar year for failure to provide access to a payroll deposit IRA arrangement.
- Allow the employer to exclude certain employees, such as those who either have not completed at least three months of service, are not at least 18 years of age, are covered by a collective bargaining agreement, or participate in a 403(b) arrangement.
- Exclude employers with 10 or fewer employees receiving at least \$5,000 in compensation for the preceding year and employers with less than two years of existence and 100 or fewer employees receiving at least \$5,000 in compensation during the two previous years.
- Provide a tax credit to small employers (100 employees or less) maintaining the payroll deposit arrangement equal to the lesser of \$25 per employee or \$250 (for the first two years only).

#### *Enrollment*

- Require employers to provide notice of the payroll deduction arrangement to employees.
- Allow automatic enrollment in the arrangement, or require the employer to get an explicit election to participate or not (if no election is made, the employee is automatically enrolled).
- Require the IRS to provide a model notice to employees, uniform forms for enrollment,

and a website for small employers to obtain information and forms.

### *Contributions and Investments*

- Allow employers to choose to send contributions to one of three places: (1) the IRA of the employee's choice, (2) a designated IRA trustee chosen by the employer, or (3) the Payroll Tax Deposit Procedure – a central depository to be created under the act by the TSP II Board (a new body established by the act). The TSP II Board would contract with IRA trustees to provide investment funds, investment management, and administrative services. Index funds are contemplated.
- Provide for an automatic contribution percentage of 3% of compensation, increased annually at the discretion of the TSP II Board, up to 8%. Default investments would be life-cycle funds similar to the funds offered under the Federal Thrift Savings Plan (a 401(k)-like plan for federal government employees) or other investments designated by the TSP II Board (after taking into account default investment guidance issued by the DOL).
- Require automatically enrolled employees to be placed in either an IRA of the trustee selected by the employer for all of its employees, or if none is selected, an "Automatic IRA." An Automatic IRA could be a traditional or Roth IRA, and must meet certain investment and fee requirements determined by the TSP II Board (i.e., the investment options must be similar to those of the TSP and it must charge "reasonable" fees).
- Require the Department of Labor to develop basic guidelines for retirement investing, which would describe the benefits of diversification, differences between various types of investments (e.g., stocks, bonds, funds) in terms of risk and return, how allocation may vary depending on age, and sources of more information on investing. The guidelines would include a list of websites with retirement calculators.

### *Miscellaneous*

- Provide for preemption of conflicting state laws.
- Require the DOL and Treasury to conduct joint studies on the feasibility and desirability of (1) extending to Automatic IRAs spousal consent requirements similar to those that apply under the TSP (spousal consent required for loans, in-service withdrawals, and post-separation withdrawals other than a full withdrawal of an account worth no more than \$3,500) and (2) promoting in Automatic IRAs the use of low cost annuities, longevity insurance, or other guaranteed lifetime income arrangements.
- Appear to require that any automatic rollover of a mandatory distribution under Code section 401(a)(31)(B) be invested in the type of default investment required for automatic enrollment in a payroll deposit IRA arrangement (e.g., lifecycle funds similar to those in the TSP or other default investments specified by the TSP II Board).

### **Additional measures in the Women's Retirement Security Act**

- Increase the Saver's Credit to 50% of contributions for all income levels, subject to a

phaseout by specified dollar amounts, and make the credit refundable. The bill would require the credit to be contributed to specified eligible retirement plans.

- Cover more employees by requiring 401(k) plans to cover employees completing either one year of service with 1000 hours or three years of service with at least 500 hours.
- Amend the definition of compensation for IRA contribution purposes to include disability income, unemployment comp, and workers compensation.
- Provide a tax incentive for annuities by excluding 10% of “lifetime annuity payments” from qualified annuities (reduced if the aggregate annual annuity payments exceed 50 percent of the applicable Code §415 limit) or 50% of lifetime annuity payments from nonqualified annuity contracts up to \$20,000. The exclusion would cover variable annuities and various other fluctuating annuity payment amounts or schedules, not just fixed life annuities.
- Require a joint study by IRS and DOL of the feasibility and desirability of extending spousal consent requirements to all defined contribution plans.
- Incentivize the purchase of longevity insurance (an annuity that begins after the individual reaches age 85) in qualified plans and IRAs by deeming the annuity to have no cash surrender value and limited death benefits prior to annuitization (making it less expensive) and disregarding the value of the annuity in calculating required minimum distributions until payments begin.
- Provide a tax credit for small employers (no more than 25 employees receiving at least \$5,000 of compensation in the preceding year) making contributions to a new qualified defined benefit plan, defined contribution plan, simplified employee pension (SEP) or SIMPLE retirement account. The credit would apply for the plan’s first three years and would be equal to 50% of the amount of deductible employer contributions for non-highly compensated employees, up to 3% of compensation.

The attached Appendix includes descriptions of other measures contained in the Women’s Retirement Security Act, such as changes to the QDRO rules and a limited income exclusion for the value of retirement planning advice.

## **PLUS Accounts**

Senator Jeff Sessions (R-AL) has outlined a proposal for “Portable Lifelong Universal Savings Accounts” (“PLUS Accounts”). PLUS Accounts would be opened by the federal government for U.S. citizens born after 2007 with a one-time contribution of \$1,000 (indexed for inflation). Beginning in 2009, PLUS Accounts also would be opened for all workers under age 65, with one percent of each paycheck automatically deposited before taxes. Workers could contribute an additional one to nine percent (on compensation limited to the first \$100,000, indexed). Employers must match the one percent automatic contribution and could contribute an additional one to nine percent (also based on the first \$100,000 of compensation). The proposal would allow rollovers from 401(k) plans and direct deposit of tax refunds. Individuals could not take withdrawals until age 65, at which point, individuals would be required to take a maximum 10 percent annual distribution or convert to an annuity.

While not all of the details are clear, a board similar to the TSP board would administer the program and there would be a limited number of investment options. Parents would make investment decisions for their children and parents and grandparents could contribute \$5,000 annually (unclear whether contribution would be before or after taxes). The proposal is not intended to alter Social Security. The proposal's impact on existing qualified plans is unclear (e.g., whether the Code section 402(g) limit would be calculated independently of any PLUS Account contributions).

## **Amerisave**

House Democrats, lead by Rep. Nancy Pelosi (D-CA), have proposed the Amerisave program, which would provide a federal match on the first \$1,000 contributed to an IRA, 401(k), or "similar retirement plan" by low- and middle-income taxpayers. The matching contribution would be received after the individual files a tax return. The Amerisave match would replace (or partially replace) the Saver's credit under Code section 25B. The proposal also would provide tax credits to employers who encourage employee access to independent, certified financial counselors and to small businesses offering 401(k) and IRA-based plans. Employers would receive tax credits for offering employees the option to convert their retirement plan assets to an annuity upon retirement.

## **State-Sponsored 401(k)s**

Some states are considering legislation to help facilitate the adoption of 401(k) plans by small businesses that do not already offer qualified plans. Under these proposals, the state would partner with providers to make it cheaper and easier for small employers and self-employed individuals to maintain a plan. Proponents contend that because states have experience designing and administering plans, they can lend expertise to small businesses and make available economies of scale associated with the state plans.

Mark Iwry of the Brookings Institution is promoting a state-sponsor proposal that contemplates two tiers. [\[6\]](#) Tier 1 is payroll deposit IRAs for employees and stand-alone IRAs for self-employed individuals. Tier II is employer plans – 401(k) and SIMPLE IRAs. The state can choose to offer one or both tiers.

Under Tier 1, the state would encourage employers to offer payroll deductions to IRAs and emphasize how easy it is. For employees who do not already have an IRA, the state could contract with financial institutions to serve as trustee or custodian and provide a low-cost IRA with limited investment options and a diversified default investment. Employers would have the convenience of sending contributions to a single destination. For self-employed individuals, the state could offer electronic automatic debit arrangements and the convenience of pooled investments.

Under Tier II, the state could offer a prototype 401(k) plan or SIMPLE IRA plan. The state could contract with institutions offering prototype plans. The standardized product could

provide centralized assistance with plan administration, including Form 5500 preparation, SPDs, nondiscrimination testing, etc. This administrative assistance could be provided by private contractors or state employees. The proposal also suggests simplified prototype plan requirements, such as filing a single Form 5500 and developing a uniform national prototype plan approved by the IRS. For SIMPLE plans, the state would take more of an encouragement role, but possibly also provide economies of scale in a way that would not jeopardize governmental plan status (ERISA exemption) for the existing state plans.

So far, bills have been introduced in Washington, Maryland, and Michigan, with Vermont likely to follow suit. The Washington legislation would authorize both Tier I and II programs, but would also go a step further by requiring small employers that don't sponsor retirement plans to offer payroll deduction IRAs. The Michigan proposal would target businesses with 25 or less employees, but would offer retirement pooled investment vehicles for businesses with as many as 150 employees. The state would oversee (or outsource) the plans for 5 years and then turn them over to private sector. Michigan estimates the program's initial start-up cost to be \$559,000 and expects to recover these costs in five years. The Small Business Association of Michigan is actively opposing the state proposal and working on offering its own prototype plan.

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## [Attachment](#)

### **endnotes**

[1] The text of S. 1141 is available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:s1141is.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s1141is.txt.pdf). The bill was introduced by Senators Jeff Bingaman (D-NM), Gordon Smith (R-OR), John Kerry (D-MA), Olympia Snowe (R-ME), and Tom Harkin (D-IA). A companion bill (H.R. 2167) was introduced in the House of Representatives by Rep. Richard Neal (D-MA).

[2] The text of S. 1288 is available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:s1288is.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s1288is.txt.pdf). The bill was introduced by Senators Smith, Kerry, Bingaman, Snowe and Kent Conrad (D-ND).

[3] Robert Pozen has outlined a proposal similar to the Automatic IRA Act, where employers not otherwise offering a qualified plan would be required to offer payroll-deduction IRAs to employees. This proposal provides a safe harbor to encourage automatic enrollment and minimum default contribution rates (such as 3 percent). The default investment would be a balanced fund with 50 percent in a diversified stock fund and 50 percent in a high-quality bond fund. Employees would have 60 days to opt out of the default contribution rate or investment fund. The safe harbor investment menu would include the diversified stock fund, the diversified bond fund, a money market fund, and a bank deposit. Large employers (100 or more employees) choosing to offer a check-off IRA instead of a qualified plan would be required to make contributions to employee accounts (such as a 50 percent match up to 6 percent of wages). No loans or early withdrawals for

education or first-time home buyer expenses would be permitted. Although the idea of this proposal is to shift administrative functions to the financial institution, it is unclear who would serve as plan sponsor – the financial institution or the employer.

[4] The Iwry/John paper is available at <http://www.retirementsecurityproject.org/pubs/File/AutoIRAworpaper.pdf?PHPSESSID=cfd41113816e01007b7143469b01814>.

[5] Baucus introduced the Savings Competitiveness Act of 2006 (S. 2431).

[6] A summary of this proposal is available at <http://www.senate.gov/~finance/hearings/testimony/2005test/062906testmi.pdf>.

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