Working Group III

Mission

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Background

The Working Group focused on ways of encouraging small businesses to adopt retirement savings plans. The reason the Group chose this focus is because small businesses represent the fastest growing employment sector in the economy and the one that has the largest block of workers without a workplace retirement plan. Fewer small employers sponsor plans, and as a result, a lower portion of workers in small businesses, compared to workers in medium and large businesses, participate in employer retirement plans. (See sidebar on Small Business Plan Coverage Rates.) Studies show that small businesses would be more likely to start a plan if administrative costs, complexities, and fiduciary responsibilities were reduced and if employer contributions were voluntary. The Group also acknowledged that more had to be done to encourage employees to participate in employer-based plans.

From the beginning, the Group sought to create a plan that would overcome many of the obstacles faced by small businesses in setting up plans. Taking a page from Henry Ford's Model T, which became a symbol of affordable transportation for the masses, the Group decided to create its own clean-slate proposal which they named the Model T plan. This plan is an inexpensive and accessible savings vehicle that could be sold and marketed to small employers. Because it is designed to be sold as a multiple employer plan, it could be a potentially efficient way of reaching numerous small businesses at once, creating momentum toward increasing coverage. It should also lend itself to effective marketing techniques.

The Model T Plan at a Glance

The Model T is a simplified, multiple employer payroll deduction plan offered by financial institutions.

Here are the basic features of the plan:

- Third party financial institutions would run the plan and take on many of the administrative functions.
- Once an employer signs up with the financial institution, both the employer and employees will be able to make contributions to the plan.
- All employees – full-time, part-time, and contingent workers – would be eligible to participate if an employer agreed to be part of a plan. The self-employed and independent contractors can contribute on their own.
- Employees contribute through payroll deduction provided by participating employers.
- Employer contributions are voluntary but there are innovations in the plan design aimed at encouraging employers to contribute on behalf of all employees in the plan.

Small Business Plan Coverage Rates

According to the Bureau of Labor Statistics, different segments of the workplace population have widely differing coverage rates and participation rates. The coverage rate is 78 percent for medium and large businesses (100 employees or more). However, the coverage rate is only 44 percent among small businesses (99 or fewer workers).[xi] The participation rate is 67 percent in medium and large businesses, while it is 37 percent at small businesses.[xii] There is an even sharper divide in coverage rates for full-time (69 percent) workers versus part-time workers (29 percent).[xiii] The same goes for participation rates for full-time (60 percent) versus part-time workers (21 percent).[xiv] Small businesses are more likely to have larger numbers of part-time workers.

Getting small-business owners to sponsor plans is difficult, but not impossible. According to the 2003 Small Employer Retirement Survey by the Employee Benefit Research Institute, 29 percent of small businesses said they were likely to start a plan in the next two years.[xv] Sixty-eight percent said they were not likely to start a plan.[xvi] 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[xvii] if the employer could get tax credits for start-up costs, 57 percent were more likely to start a plan if the plan had fewer 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.

This data suggests 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. 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.[xviii] 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).[xix]

- Funds are automatically placed in investment options that are consistent with the U.S. Department of Labor's default investment regulation.
- The Model T has a recommended "Standardized Performance Report," which will help employers and employees compare fees, services and investment performance of the plan on an apples-to-apples basis.

The Model T Plan could be marketed in an innovative, community-based Demonstration Project.

The Group designed the Model T to be as simple as possible with the notion that the proposed plan could potentially be tested in a community-based demonstration project in the future. Such an idea could be modeled after other successful programs, such as "Cleveland Saves," which is a broad-based community effort aimed at encouraging people to save. The Working Group believes that the Model T could help increase coverage among small businesses, if this low-cost plan is effectively marketed by financial institutions to employers and their employees. Depending on research and interest among financial institutions, employers and employees, the Group will explore the feasibility of launching the plan in a particular community or among associations for employers.

How the Group Went About Its Assignment

The Working Group began as a collection of members who each had a great deal of expertise in retirement savings

plan design and ways to increase coverage, but with diverse views. Over the course of three years, and dozens of meetings, the members hammered out a consensus in areas where they had common ground.

When Working Group III members started their deliberations in the Second Stage of the Conversation in 2003, they first examined a range of existing proposals aimed at expanding coverage in small businesses.[i] Rather than using the features of these proposals to design their plan, the Group instead chose to start with a clean slate and designed the broad outlines of a new simplified multiple employer plan. In taking this initial approach, the Group was responding to a suggestion from the first Conversation on Coverage event 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 potentially reducing fiduciary responsibility.[ii]

The Group ultimately decided to design the simplest plan possible to make future implementation easier. In the Third Stage, from 2005 -2006, the Group devoted dozens of meetings to seeking resolutions on the building blocks of the plan, sometimes bringing in outside experts on fiduciary issues and plan design to address particular areas where agreement was hard to reach. To help facilitate discussions, the Conversation staff developed intensive Discussion Guides which presented specific unresolved issues and options for the Group to explore in order to resolve these issues. When the Group was unable to reach consensus on specific details of a particular part of the plan design, the Group developed guiding principles or offered a choice among alternative solutions. The Group decided to leave some of the finer points of the plan design to the financial institutions that will market the plan.

The Model T Plan

The Building Blocks of the Model T Plan

The design of Model T can be best described as a souped-up SIMPLE IRA[iii] with a few additional elements of a qualified plan. (See Definitions of Plan Types on page 11.) The Group primarily favored the SIMPLE plan design for the Model T because the regulatory framework is less complex and fits the plan's characteristics as designed by the Group. However, members of the Group also supported provisions and design elements of the Model T because they deemed them appropriate for the plan, without regard to whether or not they fit into a specific regulatory framework. The Group strived to develop a better, simpler and more attractive plan than the alternatives now available – one that can be marketed to employers, financial institutions and employees. The Group believes that promoting the Model T as a multiple employer plan will help increase the marketability of the plan and lead to increased coverage in the small-business sector.

This section provides a closer examination of the design elements of the plan and demonstrates how each piece works to make the whole plan effective. This section includes an explanation of why the Working Group chose a particular approach.

Building Block 1

The Plan will be offered by regulated financial institutions to small employers.

The Group agreed that any financial institution regulated by a federal or state agency would be eligible to sponsor a Model T. This includes banks, insurance companies, brokerage firms and mutual fund companies.[iv]

Plans Can Target Regions and Groups. Model T providers can offer plans that are targeted to employers in a specific geographical or regional area or can target employers in specific segments or categories of business and industry. For example, a financial institution in St. Louis could offer the plan to all small businesses in the St. Louis area.

Building Block 2

The Model T will cover all W-2 employees of a participating employer.

The Working Group agreed that they wanted all employees working for an employer to be eligible to participate in the plan. This approach was taken to better reach the target audience of low- and moderate-income wage earners. After looking at ways to ensure that all workers were covered, it was decided that the best approach was to designate any employee at a participating employer who receives a W-2 form as eligible to participate in the plan. There is no limit on eligibility based on age, income, or time on the job. Part-time and seasonal workers are eligible.

While some in the Group argued that there should be an income floor like the SIMPLE IRA, the Group decided against this approach because it would limit eligibility. One member was concerned that without such a floor, employers might not be willing to provide non-discretionary contributions for employees.

Given the Working Group's decision to include the widest possible definition of wage earners, the Group agreed that financial institutions might need some relief in dealing with small balances, especially among small employers that have a high degree of turnover among their workers. The Group decided that financial institutions could cash out balances of $1,000 or less, consistent with common practice today, when an employee leaves a company or reaches the age for distribution.

Self-Employed and Independent Contractors Eligible to Participate. Eligibility to participate in the Model T plan is not restricted to just W-2 workers. Independent contract workers can also participate by contributing directly to the financial institution as though they were an employee of a sole proprietor business. Self-employed workers can also participate and contribute directly to the financial institution.

Rationale: The Group decided that in exchange for simplicity – transferring most of the administrative burdens from the employer to the financial institution – the Model T should provide the widest coverage possible to reach the target population of low-and moderate-income wage earners.

Building Block 3

The Model T will use automatic enrollment to expand coverage.

The Working Group supports the idea of employers automatically enrolling all eligible workers rather than offering workers the opportunity to enroll and then waiting for them to make an affirmative decision to enroll in the plan. The Group ultimately decided to make automatic enrollment a required part of the plan.

Rationale: Studies have shown that automatic enrollment dramatically increases participation rates in a plan. For example, the Employee Benefit Research Institute (EBRI) found that 66 percent of eligible workers at year-end 2000 were participants in 401(k) plans. However, immediately after adding automatic enrollment to the model, the participation rate rose to 92 percent of eligible workers.[v] Additionally, an EBRI survey of Americans found that 66 percent of workers who do not contribute to their employer's retirement plan say they would stay in such a plan if their employer automatically enrolled them in one.[vi]

Building Block 4

Financial institutions can offer automatic escalation of contributions in plans they offer.

Members agreed that after employees are enrolled at an initial percentage of pay, it would be desirable to escalate the percentage of pay contribution until it reaches a designated goal. However, due to concern that automatic escalation might lead some low- and moderate-income workers to opt out of the plan, the Group decided it should not mandate automatic escalation.

The Group ultimately decided to allow the following:

- Financial institutions offering the Model T will decide whether or not to have automatic escalation, which, if offered, should include an opt-out provision.

- Financial institutions will also decide how to structure automatic escalation, including the initial deferral percentage, the target escalation and the pace at which the escalation will occur.

Rationale: While the Group recognized the importance of potentially providing automatic escalation of contributions in the plan, in light of the small size of the Model T, the Group preferred to give financial institutions the flexibility to offer or not offer automatic escalation, based on market demand.

Building Block 5

The Model T will be launched with limited investment options based on the type of default investment options approved by the Department of Labor.

Initially, under the plan design, the plan will offer only investments that are contained in the Department of Labor's proposed Default Investment Regulation[vii] issued in September 2006. As described in the next building block, financial institutions will be able to add other investment options. The proposed regulations include the following classes of investments as appropriate defaults:

- A target date (life-cycle) fund with a mixture of equity and fixed income exposures based on a participant's age, target retirement date or life expectancy;
- A fund with a mixture of equity and fixed-income exposures consistent with a target level of risk appropriate for participants of the plan as a whole, such as a balanced fund; and
- An allocation of an individual's assets by an investment management service that includes a mixture of equity and fixed income exposures offered through investment alternatives under the plan.

Rationale: The Group spent many meetings discussing which investments should be included in the plan. Originally the Group recommended the plan be launched with three to five investment options. But in the name of simplicity and efficiency, the Group generally agreed to launch the plan with these limited investment options. The Group believed limiting investment options to those that have been generally approved by the Department of Labor will simplify choices and, in doing so, help reduce the fiduciary burden on employers.

Building Block 6

Financial institutions can later add other investment choices beyond the initial options.

There was support for allowing financial institutions in subsequent years to add additional investment options beyond the default options – including such options as conservative, moderate and aggressive model portfolios, as well as an option with a guaranteed rate of return. Some in the Group felt that the lack of additional choices might be a disincentive for some employees to participate. Additional investments options could be added later to Model T plans if financial institutions chose to do so – or if research supported the need for additional choices to attract employees to the plan.

Building Block 7

A unique two-tiered contribution limit regime would encourage employers to contribute on behalf of employees.

The Group devoted a considerable amount of discussion time to the issue of contribution limits that would be attractive to employers and employees, as well as setting limits that would more likely lead employers to contribute to the Model T Plan. The Group decided that in order to encourage employers to both participate in the plan and provide an employer contribution, the Model T would have an innovative two-tiered contribution limit structure, with a lower limit set at $8,000 and the higher limit set at $12,000.

Contribution Limits. The two limits are set to be higher than IRA limits but lower than 401(k) limits.

- **$8,000 Lower Limit:** If an employer does not want to make a matching or non-discretionary contribution, then the plan has an $8,000 limit – which the Group set at a level between an IRA and a SIMPLE. This was structured to ensure that the lower limit Model T would be more appealing than an IRA, but would not compete with SIMPLE plans that require a matching contribution.

- **$12,000 Higher Limit:** If the employer is willing to give an across-the-board contribution to all workers, the contribution limit could be $12,000, higher than a SIMPLE, but lower than a 401(k). Thus, employers can be rewarded with a higher contribution limit for their own contributions (and those of key employees) if they:

  - Provide a 100 percent match to employee contributions up to four percent of pay.
  - Or, contribute $750 for each employee with a W-2.

Annual Decision on Employer Limit. The employer can determine on a year-to-year basis whether or not to choose the lower contribution limit or the higher contribution limit – allowing employers the flexibility to provide employer contributions/matches in good business years and to scale back at other times.

Immediate Vesting. Employees are 100 percent immediately vested when contributions are made either by the employer or employee. The Group discussed a possible vesting schedule of two years, which would match the provisions on automatic enrollment in the Pension Protection Act. Ultimately, however, the Group decided to keep 100 percent immediate vesting to simplify administration.

Contribution Levels Indexed. The Group also decided that the contribution limits at both levels would be adjusted as contribution limits move up for the IRA, SIMPLE, and 401(k) to keep the Model T in its relative position. In addition, the Group agreed that the non-discretionary contribution amount of $750 for the higher limit option would be indexed for inflation.

Employee/Employer Contribution Limits. The Group decided that employers that have a Model T are prohibited from having other plans. Keeping that in mind, the joint employer/employee contribution

limits would be $24,000, and there is no need for complex joint-contribution limits, which take into account other plans.

No Catch-Up Contributions. The Group opposed both catch-up and Roth contributions as part of the Model T. Although some members argued strenuously that catch-up contributions would appeal to owners, the sense of the Group was that for simplicity's sake, they should not be allowed in the Model T.

Rationale: There was a lot of discussion about the issue of contribution limits and how they should be addressed. Members of the Group expressed their view that the spread between the $8,000 lower limit and the $12,000 higher limit was significant, and could be an enticement for employer contributions. Also, Working Group members pointed out that, when employers do contribute, employees win because they get a 100 percent match that is higher than a SIMPLE and is immediately vested.

Building Block 8

Nondiscrimination testing does not apply to the Model T.

Safe Harbor Plan at the $12,000 Level. As described above, the Model T was created as a safe harbor plan by ensuring that if employers and key employees want to take advantage of higher contribution levels they must ensure that the same benefit formula applies to all employees. A safe harbor approach assures benefits are provided to all eligible workers and thereby meets the goal of nondiscrimination testing.

No Testing at the $8,000 Level. There was some concern among some Group members that with a lack of required employer contributions at the $8,000 level, the plan could just become a higher-limit payroll deduction IRA that would favor higher-paid employees. While the Group recognized these concerns, there was general agreement that the mandatory automatic enrollment with escalation features would help ensure that most workers of all income-levels would benefit from participation in Model T plans. They also were optimistic that employers, with the added inducement of the higher contribution limits, would choose to make employer contributions and/or matches.

Building Block 9

The employer is assisted in its fiduciary responsibilities by the simplicity of the plan and by an annual performance report that will be provided by financial institutions.

From the beginning of its deliberations, Working Group III sought to find a way to transfer some of the fiduciary responsibilities from the employer to the financial institution. Members saw employer concerns about fiduciary responsibility as a barrier for small businesses to enroll their employees into a retirement savings plan.

Under ERISA, fiduciaries are those who exercise control over the plan's management. Typically, the employer that sponsors the plan assumes the role of the fiduciary on a number of activities including choosing and monitoring the plan service providers, choosing and monitoring investment options and defaults, approving and monitoring fees charged to participants as well as an array of administrative[viii] and other duties.

Studies show that many small businesses are hesitant to take on these fiduciary responsibilities out of concern about their potential liability if the plan is not administered properly or an investment option performs poorly. Some fiduciary experts say that many small employers do not have the time needed to perform the due diligence and monitoring that is required.

As described below, the Group spent many full-day meetings, working to address these issues. The Group was able to resolve most of the fiduciary issues relatively quickly, but on one key issue, ongoing monitoring of plan investments, the Group discovered that transferring these fiduciary duties away from employers posed a bevy of other complex issues. The Group ended up keeping the monitoring duties with the employer but hoped to mitigate the burdens of this task by simplifying the investments and requiring financial institutions to provide employers with annual reports on performance, fees and services, as explained below.

The fiduciary duties allocated to employers under the Model T are as follows:

- **The employer is responsible for choosing the financial institution and the initial selection of investment options.** The Group recognized that these duties should continue to fall on the shoulders of employers. This responsibility includes choosing a reliable financial institution and evaluating the investment options in the plan, as well its fees and services. While the financial institution will offer products to the employer, the employer is the fiduciary with respect to choosing among them. Given that the Model T includes limited investment options, this should make the employer's duties simpler in this regard. As noted earlier, these investments will follow Department of Labor guidance on selecting default investment options.

- **The employer is responsible for remitting participant data and contributions in a timely manner to the financial institution.** If the financial institution allows funds to be taken directly from employer checking accounts by electronic transfer through Automated Clearing House (ACH),[xi] the employer is still responsible, under current law, for transferring data on salary deferral (names of employees, income, contribution, change in status, etc.). In larger plans, the third party payroll provider is responsible for forwarding contributions and employee data to the financial institution once it is received. The financial institution is then responsible for most of the administrative duties under the plan as described in Building Block 10.

- **The employer is responsible for ongoing monitoring of investment options, fees and services.** While the Group decided to keep the employer in this role, the members thought the decision to offer only default investments would simplify the ongoing monitoring in the future because rather than monitoring many options, employers would only monitor one investment option.

- **The Working Group has recommended the development of an innovative Standardized Performance Report to be disseminated by financial institutions to employers as a way to help employers monitor ongoing investments.** The Group recommended that the Department of Labor devise a standardized format for the annual performance data that would allow employers to compare the fees, services and investment performance of the plan on an apples-to-apples basis. The information provided by the financial institution would be provided in a format that would enable a small business, such as the owner of Betty's Beauty Shop, to decide whether or not to retain the provider or ask that some of the investment options be changed. The Group thought this report could be helpful to employers not just in the Model T but also others in the small plan universe. The Report could also be made available to employees.

- **The Group also recommended that there be further examination of other regulatory regimes to address the ongoing monitoring issue.** See discussion below under Potential New Regimes for Ongoing Monitoring.

Rationale: Ongoing monitoring was one of the thorniest issues discussed by the Group. As mentioned above, the Group devoted entire meetings, and numerous subgroup meetings, to finding ways of potentially transferring the responsibility now on employers to financial institutions. However, all the options reviewed by the Group raised practical and legal obstacles that left the Group unable to determine a satisfactory method in the short-term for transferring these duties.

The problem with transferring fiduciary responsibility to the financial institution for ongoing monitoring is that it potentially puts the financial institution into a position of "self-dealing," in violation of the prohibited transaction rules of the Employee Retirement Income Security Act.[x] For instance, if a financial institution decided to change investment options in the plan, it could be deemed to have engaged in self-dealing since some options might have higher fees than other investments and could be perceived as benefiting the institution, rather than the participant.

To address this issue the Group reviewed numerous options and brought in experts on fiduciary issues to explain issues and options. For instance, the Working Group discussed the potential for an independent fiduciary to oversee the monitoring functions. But this raised questions about how the independent fiduciaries would be regulated and what standards would apply. Concerns were raised that hiring an independent fiduciary would be costly. Also, some members of the Group noted that, if the financial institutions paid for this service, there would be questions about how independent these fiduciaries would be. One suggestion was to have a single fiduciary hired by all the employers in a Model T in one particular community (see options described below).

Potential New Regimes for Ongoing Monitoring

The Group looked at a variety of ways to transfer the fiduciary responsibility for ongoing monitoring from the employer to a third party, thereby making the Model T more attractive to

small businesses. To the extent that a way could be found to transfer fiduciary duty for the Model T, it might also work for all plans aimed at small businesses and, thus, help improve coverage in this important sector.

Based on what has been learned from its efforts to find a way to transfer fiduciary duty to a third party, the Group recommends the following ideas for further exploration:

- Reviewing what other countries are doing to relieve employers of fiduciary duties. In Australia, for example, a third party, not the employer, is the fiduciary. To assure that participant interests are protected, the regulatory authorities in Australia have a strict licensing process for trustees and regulators, who go on site to monitor the trustees closely on a regular basis. (See Appendix H on Fiduciary Regulation in Australia.)
- Examining whether there could be a cost-effective system of independent fiduciaries, with appropriate regulation developed in the United States
- Investigating the viability of a *per se* prudence approach which could mean that there would be a government stamp of approval on certain types of investments which could be adopted by financial institutions.

Rationale: The Group successfully designed a simplified plan that would potentially reduce some fiduciary responsibilities on the employer. However, the members recognized that the task of developing a regime to enable the transfer of the bulk of fiduciary duties away from employers to third party entities was broader than the scope of designing the Model T and needed further examination in the public policy arena. The Group considers the development of the Standardized Performance Report an important tool that can help employers and employees compare the performance, fees, and services of plans. But, the Group also strongly recommends that efforts continue to examine ways to relieve small employers of fiduciary duties so that they will be more willing to sponsor plans.

Building Block 10

The financial institution assumes most administrative responsibilities, thereby reducing the potential burden on the employer.

Working Group members developed a regime in which most administrative duties were transferred from the employer to the financial institution. Except for the first item below, the vast array of administrative duties, as noted below, are transferred to the financial institution.

- **The employer provides the financial institution key information.** The employer is responsible for sending the financial institution information about employees, including eligibility and employment status. The employer provides the financial institution with the deferral percentage from the pay of each worker (plus the compensation per employee for each pay period), plus the matches and contributions from the employer.

- **The financial institution maintains basic records**. The financial institution maintains participant records and account balances. It also processes requests from employees and handles loans.

- **The financial institution monitors contributions and matches.** The Working Group discussed ways to simplify the administration of the plan for both employers and financial institutions, given the complexities that might arise from having two contribution limits and given the ability of employers to indicate each year whether they would choose the $8,000 limit or the $12,000 limit. To better handle decisions on these potential choices, employers would indicate each year one of the following to the financial institution:

  - No match (contributions limited to $8,000 deferral).
  - 100 percent match with 100 percent vesting up to four percent of compensation ($12,000 deferral permitted).
  - An across-the-board contribution of at least $750 ($12,000 deferral permitted).

  A standard form could be used by employers, who would check which of the above three choices applied to the plan during the coming year and forward the form to the financial institution. The financial institution would then monitor contributions to ensure no employee exceeded the limits for the year.

  When the employer chooses the maximum contribution each year, the financial institution will notify the employees of the limit for the coming year. The financial institution will return excess contributions for participants who exceed the contribution limit. The financial institution will monitor to see that employer matches and contributions are contributed into participant accounts in those years in which the employer chooses the higher $12,000 contribution limit. The flat rate contribution of $750 or more can be sent in all at once or in quarterly installments.

- **The financial institution provides Model T participants the disclosure and communications documents required by law.** These could include the following items: the prospectus and enrollment material, Summary Plan Document, Summary Annual Report, and annual benefit statement.

Building Block 11

Early withdrawal rules are designed to encourage the preservation of retirement saving in Model T accounts.

The Working Group sought to develop rules governing pre-retirement distributions that would simplify administration and keep down costs. The rules are also designed to preserve savings through the Model T for retirement, as much as possible.

Loans and Hardship Withdrawals

The Group considered whether or not to offer loans and hardship withdrawals, two options commonly found in 401(k) plans. These options are particularly attractive to lower-income savers, who might not save at all or as much if they knew they could not gain access to those savings in the event of financial emergency.

- **No Hardship Withdrawals.** Hardship withdrawals were rejected because of the difficulty in setting up criteria for eligibility and the administrative expense of implementation. Opposition was also partly based on the fact that it would be difficult for a financial institution to know for certain if there was a genuine hardship. Instead, it was argued, those with such needs could simply borrow the funds they required.

- **Financial Institutions Decide Whether to Offer Loans.** The Group decided to allow loans after agreeing that the low-income target audience would be particularly wary of a plan that required them to relinquish control of savings until they reached retirement age. The decision on whether or not to offer loans would be made by the financial institution. A loan provision would bring the Model T under the qualified plan rules.

- **Loan Limits.** There was general agreement that, where loans are made available, workers would be limited to one loan at a time with a maximum of five years to pay it back. The loan cannot exceed 50 percent of the account balance or $50,000, whichever is smaller. Finally, borrowers cannot obtain subsequent loans until the prior loan is paid in full.

Withdrawals and Rollovers after Leaving Employment

The Working Group considered what policies would govern balances in the plan when employees were terminated from an employer who participated in a Model T Plan. The Group's goal was to preserve income for retirement as much as possible. In addition, members wanted to give the Model T much of the flexibility that is currently available to participants in 401(k) plans in order to make the Model T attractive to employees.

- **No Lump-Sum Withdrawals at Termination.** The Model T prohibits cash-out or lump-sum withdrawals that are not rolled over when one leaves employment, except for cash-outs of small balances under $1,000.

- **Option to Keep Balance in Plan to Retirement.** After leaving a company, former employees can also opt to leave part or all of the balance in their account in the Model T until the former employee reaches retirement eligibility age.

- **Rollover Options.** Any participant who leaves a company can roll over 100 percent of the balance into another IRA or Model T Plan.

Building Block 12

Distribution rules after age 59½ offer the potential for a lifetime stream of income.

The Group sought to forge a policy that would reserve half the balance of the accumulated Model T account for an annuity or a series of installment payments that would provide income across the expected lifetime of the retiree. While approving the broad goal of a lifetime income stream in retirement, the Group was unable to agree on a specific policy for the reasons explained below. The Group instead decided to initially leave decisions on distribution rules to the financial institution, keeping open the possibility of further changes in what types of distributions would be allowed and how to define the normal form of retirement benefit.

Retirement Age at 59½. The Working Group considered a range of retirement age options, from 59½ to 62 to the Social Security retirement age, currently rising gradually to 67. Given the fact that lower- and middle-income workers may need to retire earlier than higher-income workers for a variety of reasons, and to keep the Model T consistent with the rules governing 401(k) plans, the Group agreed to set 59½ years as the minimum age one must attain to be eligible to receive the normal form of benefit, regardless of how that benefit is ultimately designed.

Lump-Sum Distributions. While agreement could not be reached on how best to preserve half the accumulated balance for income spread out over the life of the participant, the Group was able to reach agreement that up to 50 percent of the account balance could be withdrawn as a lump sum at or after age 59½. The Group also supported allowing those who continue to work beyond 59½ to take up to 50 percent of the account balance at retirement age. Allowing the distribution of half of the income to be taken at age 59½ for those who continue work gives participants the option of phasing into retirement.

Annuities and Installment Payments. As noted above, the Group supported in concept the idea of requiring participants to take at least 50 percent of the balance in the plan at the time of retirement as an annuity. Or, alternatively, 50 percent of the balance could be paid out in installment payments designed to cover the expected lifespan of the participants. This second option was added so that financial institutions without a life insurance affiliate could offer the Model T plan. Finally, the Group agreed that if participants so wished, they could take out 100 percent of entire balance at retirement as an annuity.

- **Employee Concerns about Annuities.** The Group supported in concept a policy that would reserve half the accumulated balance for an annuity and/or a series of installment payments spread out over the expected lifespan of the retiree. The desire to provide a lifetime income in retirement, however, came up against other concerns. First, members noted that the total accumulated savings might not be high and that annuities are more costly for those with smaller sums to annuitize. Secondly, some members noted that retirees may need a lump sum for urgent medical treatments, or other financial emergencies. A single provision requiring annuitization would not be flexible enough to cover a wide range of participant needs, some members argued.

- **Financial Institution Concerns about Annuities.** The Group suggested that if annuities are required, many financial institutions might not offer Model T plans, either because they do not have an insurance affiliate or because they think annuities are too costly for smaller sums and, thus, not an attractive option to offer participants.

Normal Form of Retirement Benefit. Given the goal of preserving 50 percent for a stream of lifetime earnings and the concerns raised by annuities, the Group was unable to settle on a specific policy regarding the normal form of retirement benefit, beyond allowing for the withdrawal of 50 percent as a lump sum upon reaching retirement age. Instead, the Group agreed that the financial institution should decide what the normal form of retirement benefit is, within the broad outlines suggested by the Working Group. Thus, the normal form of retirement benefit could be designed to include any or all of the following:

- An annuity of 100 percent of the balance.
- A schedule of payments of 100 percent of the balance.
- Up to a 50 percent lump sum plus a 50 percent annuity.
- Up to a 50 percent lump sum plus a 50 percent schedule of payments arrangement.
- Up to a 50 percent lump sum with 50 percent left in the plan; e.g., for phased retirement.

Focus Groups. The Group agreed that questions about how best to handle distributions should be presented to informal focus groups of employers, employees, and financial institutions. The findings from this effort could then be used to make further alterations in the distribution rules for the Model T. It was also suggested that some financial institutions might be interested in conducting some of the informal focus groups of employers and/or employees.

Additional Research. In view of the uncertainties about how financial institutions would view requirements to provide an annuity or schedule of payments, members supported additional research, if practicable, to determine if it is feasible to require that an annuity or schedule of payments be part of the normal form of benefit, or if the distribution rules should be altered from the current decision to leave the choice up to financial institutions, but limit the choices financial institutions can make, as noted above. There is also some interest in further exploring the idea of collective annuitization, such as allowing participants to finance an annuity through the Pension Benefit Guaranty Corporation or Thrift Savings Plan, or a similar institution, as well as directly in the private market.

Mandatory Withdrawals. The current law governing 401(k) plans that requires mandatory withdrawals beginning at age 70½ would also apply to the Model T Plan.

Spousal Consent. The current rules governing spousal consent would apply to any distributions from the Model T, including a joint and survivor requirement for any annuity that might be part of the final plan design.

What's Next?

At the conclusion of the Third Stage of the Conversation on Coverage, the Working Group agreed to set up task forces to continue the work of refining, advancing, and potentially testing the Model T concept in a demonstration project.

- **Focus Group Task Force.** The Group agreed that members should form a task force to explore ways to organize focus groups to review the plan design of the Model T, particularly in the area of distributions and investment options.
- **Implementation Task Force.** The Conversation on Coverage will put together a task force to determine what steps are necessary to make the Model T into a reality. There are only two provisions that are inconsistent with current law, the two-tiered contribution regime and the ability for a SIMPLE-type plan to provide loans.
- **Demonstration Feasibility Task Force.** The Group agreed that there should be a task force set up to explore the feasibility of setting up a demonstration project for the Model T.
- **Task Force for Developing the Standardized Performance Report.** Working Group members will explore the idea of developing this tool with other experts and appropriate government officials.

Endnotes

[i] *Covering the Uncovered, Common Ground Recommendations to Expand Retirement Savings for American Workers, A Working Report* (Washington, D.C.: Pension Rights Center, May 2005), pp. 64-78.

[ii] 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.conversationoncoverage.org/research_conducted/Confronting_the_Pension_Coverage_Challenge.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.

[iii] 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.

[iv] The Group supported a regulatory approach for the Model T that is similar to the Internal Revenue Code provisions that govern who can offer IRAs. These regulations set out the procedures for designating which financial institutions would be authorized to provide the plan to employers.

[v] Sarah Holden and Jack VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions of 401(k) Accumulations at Retirement," Issue Brief No. 283 (Washington, D.C: Employee Benefit Research Institute, 2005), p. 4

[vi] Ruth Helman, Dallas Salisbury, Variny Paladino and Craig Copeland, "Encouraging Workers to Save: The 2005 Retirement Confidence Survey", Issue Brief No. 280 (Washington, D.C.: Employee Benefit Research Institution, April 2005), p. 8.

[vii] "Default Investment Alternatives Under Participant Directed Individual Account Plans; Proposed Rule," Employee Benefits Security Administration, *Federal Register*, September 17, 2006 (v. 71, no. 187), pp. 56806-56824.

[viii] Minutes of Working Group III Meeting of January 24, 2006, p. 3. Description of fiduciary duties taken from summary of comments by Roberta Ufford, partner at Groom Law Group in Washington, D.C.

[ix] Automated Clearing House (ACH). The ACH system of the U.S. Federal Reserve Bank that provides electronic funds transfer between banks. It is used for all kinds of fund transfer transactions, including direct deposit of paychecks and monthly debits for routine payments to vendors. The ACH is separate and distinct from the various bank card networks that process credit card transactions. ACH operations are done in a batch mode, which can take up to 72 hours before the money is actually transmitted. A return notification is sent if there are insufficient funds in the account.

[x] Section 406 of ERISA and Section 4975(c)(1) of the Internal Revenue Service Code relate to prohibited transactions and self-dealing. These rules prohibit, among other things, transactions in which a fiduciary to a plan deals with the assets of a plan in his own interest or for his own account.

[xi] U.S. Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2006,"published August 2006, Table 1, p. 6. From the web site at http://www.bls.gov/ncs/ebs/sp/ebsm0004.pdf.

[xii] Ibid, Table 2, p 7.

[xiii] Ibid, Table 1, p. 6.

[xiv] Ibid. Table 2, p. 7.

[xv] Seven 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.

[xvi] Twenty-five percent were not too likely to start a plan in the next two years, while 43 percent were not at all likely. Source: Ibid.

[xvii] Ibid.

[xviii] 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).

[xix] 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.