

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?

July 22, 2004

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

Despite years of efforts to address the challenge, more than half the private sector work force does not participate in a retirement saving plan. Thus, they are unlikely to accumulate any significant savings for their retirement years, which are likely to be very long as Americans continue to live longer. The workers who might be the most likely to experience poverty in old age are the same workers who are most likely to be without access to a retirement savings plan today.

Working Group III set out to do something about this uncovered group that needs the most attention. Its mission was to look for ways to enroll various financial institutions in new efforts to target the most important segment lacking coverage: small businesses. In this segment only 35 percent participate in a workplace retirement savings plan. The group also wanted to reach 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.

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.

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 brilliant strategy of designing a car for the masses, the group decided to name its plan the Model T. The new Henry Ford's would be executives at regulated financial institutions: banks, insurance companies, brokerage firms, and mutual funds.

- All employees – full-time, part-time, contingent workers and even independent contractors¹ – 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 multiple employer plan could be targeted to a specific region. 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 trades groups.

- The group generally agreed that there should be only 3 to 5 investment options and that they would include model portfolios that would be conservative, moderate and aggressive.
- Employers would also be able to automatically enroll workers.

- When workers do not make a 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 avoid plans would be eliminated. The plan would be administered by the financial institution that provides it and 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.

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 come up with the broad outlines for a new plan they decided to name the Model T Plan, which would be a simplified, low-cost group 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 and how it might work to attract plan providers and employers, seeking to find agreement on as many areas as possible and identifying areas where more work needs to be done.

Background

The goal of providing a retirement plan for all workers is an ambitious one. In 2003, for example, only about 57 percent of American workers had access to a retirement plan sponsored by their employer, according to Bureau of Labor Statistics. Of that group 20 percent have access to a defined benefit plan; that is, a plan that is generally funded by the employer and which usually provides a stream of income for life.²

The number of workers who actually participate in those plans is somewhat lower. Among all private sectors workers, 49 percent of full-time and part-time workers participated in an employer-sponsored retirement plan. That represented 50.5 million in a total private sector work force of 103.5 million in March 2003.³

The employer survey found that different segments of the workplace population have widely differing participation rates. The participation rate is 65 percent among the 45.9 million employed last year in medium and large businesses (100 employees or more). However, the participation rate was only 35 percent among the 59.6 million employed last year by small businesses (99 or fewer workers).⁴ There is an ever sharper divide in participation rates between full-time (58 percent) and part-time workers (18 percent).⁵

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.⁶ At the same time, 68 percent said they were not likely to start a plan.⁷

Unfortunately, there has been a steady decline in the number of small businesses that are likely to start a retirement plan since 1998. At that time 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 does 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 if the plan had reduced administrative requirements, and 55 percent were more likely to start a plan if it had easy-to-understand information about the plan.⁸ Fiduciary responsibility is another stumbling block to employers sponsoring plans.

It would appear from research data that a plan that had discretionary contributions on the part of the employer, was easy to administer, eases fiduciary liability for the choices of employees, provided tax credits for start-up costs, and was easy to understand, would prompt a good deal of interest among small business employers.

Yet, employer-sponsored pension plans still appear to be the best way to motivate workers to save for retirement. If one looks at federal income tax return data, the proportion of filers who claim an IRA or Keogh deduction has been both fairly modest and steadily declining over time. From a peak of 16.2 percent in 1986, it fell to 3.5 percent in 2000 and 2001.⁹ In contrast, the participation rate in workplace plans is 66.2 percent of those eligible for 401(k) plans (a population of workers that represents 32.6 percent of the private sector workforce).¹⁰

How the Working Group Went About Its Assignment

Working Group III first examined a range of existing proposals aimed at workers at small businesses. Instead of recommending any of those proposals, the group instead decided start with a clean slate and design the broad outlines of a new proposal for a simplified multiple employer¹¹ 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.¹²

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 addressing two of the key objections by small businesses to starting a new defined contribution plan. In addition, the simplicity of the proposal would address 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 3 to 5 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 option of choosing a default mix of investments based on a lifestyle fund or a model portfolio.¹³
- **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 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 pension 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 to designating which financial institutions would be authorized to provide the plan to employers that is similar to the Internal Revenue Code provisions governing who can offer IRAs.¹⁴ 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 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 objecting 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 wanting to offer a plan. One member suggested that a study be made of 529 college saving plans¹⁵ 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 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 indicates 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 generally agreed the 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, has found that small business employers would be more likely to offer a retirement saving plan if employer contributions were entirely discretionary.¹⁶

Some members were strongly in favor of a mandatory employer contributions rule. 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 a compromise flexible policy rule in which employers would be required to contribute in x years out of 5, depending on whether or not there are profits. Another member suggested requiring the employer to contribute 1 percent of compensation if the employee puts in 4 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 3 investment options, but no more than 5 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 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 if they fail to make choices on their own.

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 exactly what should be in an investment option, but could not reach agreement on this point.

Two Tiers or One? The group discussed whether or not financial institutions might have two models or tiers to offer employers: a simplified incubator model plus 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 of this institution 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. 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, it was argued.

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 opportunity 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 and that the financial institutions that were interested in sponsoring Model T plans would be opposed to it. Members supporting a government start-up plan, however, continued to strongly support this approach. One asked why the 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 and for any malfeasance and 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, that the IRS should be the guardian for tax rules, and that the Department of Labor would regulate the employer/employee relationship. This 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, in fact, 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 savings 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) and

also generally agreed that the fee could optionally 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 the plan, should be low. Many in the group supported an approach that would keep fees below 100 basis points.¹⁷

Areas Where Views Differed:

SEC Will Regulate Fees. Many in the group supported the view that the SEC would have the responsibility for regulating fees and determining what a reasonable fee might be and 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, stating that putting this 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, while removing the cap would increase competition, which, in turn, would act to 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 retirement savings 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.¹⁸

Study to Address Unresolved Fiduciary Issues. The group generally agreed that a study be done 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.

Among the unresolved issues is a question of 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 it transfers to the plan provider the fiduciary liability for the investment choices within 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 it follows the required list of investment offerings. The group, however, did not reach agreement 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 that were managed for 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, either for hardship or a loan. They also discussed the rules that would apply when employees leave an employer, and the rules that 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 plans, making them less expensive, and also encouraging workers to retain their accumulated balances until they are 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 taxed. This approach was taken to provide some type of pre-retirement access to the assets in the plan. This was done 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 59 ½. 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 59 ½, conforming to the age set for defined contribution plans generally, 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 take out 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 59 ½. A participant would have to either leave the 50 percent of the 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 expectancy¹⁹ 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 and that the spouse would continue to receive the annuity should the plan participant die. 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 59 ½. If a participant decided he or she should 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.²⁰

Areas Where Views Differed:

Other Types of Payment Schedules. Some member suggested that participants be allowed to set up a regular withdrawal schedule timed to life expectancy for the annuity half of the benefit. Participants could, however, outlive the assumed time span for a schedule of payments, while annuities would make regular payments as long as a participant or 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 and distributions 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 to be created.

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 upon separation from service upon termination of employment would be subject to the current withholding rules and 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 ½.

No Tax Subsidy for Plan Providers. The group generally 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 to give employers an incentive to contribute to the plan or 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 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.

Superdeductions for Employers. The group discussed a suggestion to give employers a super deduction, such as 110 percent, for contributions to the Model T Plan. While some members supported this approach, the group did not reach agreement to recommend 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, 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.²¹ 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 more 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 to help enlist financial institutions to provide it and 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 that included ‘personal trainers’ who called up people and asked if they had saved anything that day. 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 of having the government mount a public education campaign on the Model T plan so that financial institutions that offer them will not have to advertise them. Instead, individuals and small businesses would approach potential providers. This was seen as a way to reduce the cost of the plans and attract financial institutions to offer them. The group, however, did not reach agreement to support this approach.

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. Department of Labor Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2003 (Washington, D.C.: Department of Labor, April 2004), Table 1, p. 3.

³ U.S. Bureau of Labor Statistics. *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2000*, Bulletin 2555 (Washington, D.C.: U.S. Department of Labor, January 2003), Table 1, p. 4. The 2000 survey of businesses represents an employed population of 107,538,277, 85,939,757 full-time and 21,598,520 part-time. The survey does not include workers employed by state and local governments, the federal government or the military.

⁴ U.S. Bureau of Labor Statistics, “Employee Benefits in the United States, 2003,” News, UDSL: 03-489, September 17, 2003, Table 1, p. 3. From the web site at <http://www.bls.gov/news.release/pdf/ebs2.pdf>.

⁵ Ibid.

⁶ 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.

⁷ 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.

⁸ Ibid.

⁹ 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).

¹⁰ 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.

¹¹ 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.

¹² 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.

¹³ Lifestyle or life cycle funds allocate funds across the three main asset classes: equities, bonds and cash. For participants who wish to make a choice, there will be a simplified offering of fund options to be determined by the clearinghouse.

¹⁴ 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).

¹⁵ 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.

¹⁶ 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.

¹⁷ A basis point is one one-hundredth of a percentage point. Thus, 100 basis points equals one percentage point.

¹⁸ 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.

¹⁹ Withdrawals at age 70 ½ 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.

²⁰ 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.

²¹ 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).