Summary of the Automatic IRA Act of 2011 (S. 1557)

Introduced by Senator Jeff Bingaman (D-NM)
September 14, 2011

Under the Automatic IRA Act of 2011, employees of firms with 10+ employees that do not sponsor a retirement plan would be automatically enrolled in IRAs at their workplace. Contributions would be purely voluntary; employees would be free to opt out at any time.

A. Policy challenge.

1. Coverage gap. About half of American workers have no employer-provided retirement plan or other opportunity to save for retirement through workplace contributions. While these employees have the opportunity to contribute outside the workplace to IRA accounts, the IRA participation rate is very low – each year, less than one in ten employees contribute.

2. Automatic IRA's reach. The Automatic IRA Act offers a common-sense solution to expand dramatically retirement savings in the United States. Once phased-in, tens of millions of workers will be eligible to save for retirement through payroll deduction. Automatic IRAs have been projected to result in new contributions to IRAs of roughly $15 billion annually.

3. Evidence from Automatic 401(k)s. Automatic enrollment of employees in 401(k) plans (giving employees the opportunity to affirmatively opt-out from enrollment or change default contribution levels) has been shown to dramatically increase participation in those plans. With automatic enrollment, 401(k) participation rates have tended to reach as high as 9 in 10 eligible employees. A study by the Employee Benefits Research Institute (EBRI) found that as a result of automatic enrollment, "the increase in the value of 401(k) accumulations at age 65 as a multiple of final earnings for those currently ages 25–29 would be approximately 2.4 to 2.6 times final salary…."

4. Employer friendly. The Automatic IRA proposal is designed to minimize employers' administrative functions and will involve little (if any) out-of-pocket employer cost. It is paired with a tax credit for employers that should cover any expenses of establishing Automatic IRA accounts.

B. Covered employers and employees.

1. Size. In the first year after enactment, the provision will apply only to firms with 100 or more employees (counting employees who earned more than $5,000 in the prior year); in the second year, 50 or more; in the third, 25 or more; and in the fourth, 10 or

more. (Any employer of any size can opt in at any time.) *This phase-in will enable retirement service providers to prepare for a significant expansion in the number of IRA accounts (through product innovation and marketing) and regulators to address enforcement and other regulatory issues*.

2. Employers with qualified retirement plans generally exempted. An employer that already maintains a qualified retirement plan is generally not required to offer an automatic IRA. However, if such an employer generally does not cover employees in a division, subsidiary or other major business unit, the employer would have to provide an automatic IRA to those employees.

3. Other exemptions. The provision will not apply to employers that have not been in existence for two full years. Nor will it apply to governmental or church employers.

4. Tax credit. To offset administrative costs, employers will receive a $250 tax credit for each of the first two years of Auto IRA operation. *An Optimal Benefit Services study finds this amount will almost always cover costs for employers.*[1]

5. Covered employees. Employees who have been employed for at least 3 months and employees who have attained age 18 as of the beginning of the year are automatically enrolled in an Automatic IRA, but can affirmatively opt out.

6. Penalty for employer failure to offer auto IRA. An employer that fails to offer an automatic IRA for its employees is subject to an excise tax of $100 for each employee who was supposed to be covered. Employers who make an innocent error will have the opportunity to self-correct.

C. Contributions.

1. Amount. Employers will contribute a default percentage of an employee's paycheck into the employee's Automatic IRA account. The bill sets the default at 3% (or such other percentage prescribed in regulations). Employees can raise or lower their contribution percentage, or can opt-out entirely from the program.

2. Savers' credit. Contributions to Automatic IRA accounts could qualify for the savers' tax credit.

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[1] The report finds: "Most small employers will have only small incremental costs to modify their payroll processing systems in order to facilitate enrollment in Automatic IRAs and withholding of Automatic IRA contributions. The widespread adoption of automated payroll systems, including within the small business sector, and the ability of those system providers to build the Automatic IRA into their services, will make this new employee benefit relatively simple to implement."

3. Choice of IRA type. Employees will have the choice of contributing to either a traditional IRA or a Roth IRA. If no choice is made, automatic IRA accounts will be established, by default, as Roth IRA accounts. *Contributions to Roth IRAs are not tax deductible, but inside buildup and qualified distributions are tax-free. These features make Roth IRAs particularly well-suited for the many lower- and moderate-income workers who will have Automatic IRAs. Additionally, Roth IRAs address the problem of a worker needing to access their savings for emergency purposes, since (unlike in the case of non-Roth IRAs) pre-retirement withdrawals of a worker's contributions are not subject to tax or penalty.*

D. Investment trustees.

1. Voluntary provider participation. No investment firm ("provider") will be required to accept ("trustee") Automatic IRA accounts.

2. Employer selection. An employer can select an IRA provider to which all Automatic IRA contributions from their employees will be sent. A central online website developed by Treasury (possibly by contracting out) will list providers that meet regulatory requirements to offer Automatic IRA services and to safely hold accounts.[2] An employer that selects a provider can choose among any of the following:

    a. Individual provider. The employer can choose a provider that is authorized under current law to act as an IRA trustee, such as a bank or credit union; insurance company; securities or mutual fund provider.

    b. Qualified record keepers with individual providers. The employer can choose a record keeper, payroll processor, or payroll software company that has contracted with a qualified individual provider.[3]

    c. Other intermediaries. The employer can choose an entity that sponsors arrangements for multiple employers, such as a trade association, or another authorized intermediary.[4]

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[2] The website will be designed to assist employers in choosing a provider. The employer will enter a small amount of information about itself and its employees in a starting screen. Then, employers will be directed to a page listing providers willing to serve as trustee for employees' Automatic IRA accounts. Once the employer makes a choice, it will be directly connected to the provider.

[3] These may be firms that the employer already has a business relationship with; firms that have solicited the employer's business; or chosen through the central online website.

[4] The Treasury Secretary, in consultation with the Secretary of Labor, will issue regulations relating to the qualification of the record keeper, payroll processor, payroll service provider, sponsor of multiple employer plan, or other intermediary.

3. Optional Employee choice. The employer may also allow each individual employee to send contributions to an IRA provider selected by the employee.

4. Default assignment of automatic IRA provider. An employer that does not want to select a specific IRA provider can specify that employee accounts be maintained by a provider selected for that employer from a group of default private-sector providers.

    a. Establishment. Treasury will accept providers into the group of default providers through a competitive application process. The process will take into account (i) the extent to which the provider will accept all employers and their employees who are assigned to the provider; (ii) the investment options offered, particularly the value such options offer to participants (taking into account the relative fees); and (iii) the concentration of assets among providers.

    b. Assignment. The default program will, at random, assign each employer that does not make a selection to one such provider in the group.

5. Fees. The Department of Labor (DOL), in consultation with the Department of the Treasury (Treasury) and the Securities and Exchange Commission, will be required to promulgate clear and uniform methods for reporting fees. A provider that chooses to offer Automatic IRAs will not be permitted to assess fees based solely on low account balances.

E. Investment options.

1. Uniformity. Regardless of who maintains the Automatic IRA, all Automatic IRAs will offer the same three standardized investment options (each to be developed by Regulations issued by Treasury and DOL). The investment options must be based on low-cost investments, which may include index funds.

    a. Principal preservation fund. The contributions will be invested in a bank or credit union passbook-style savings accounts, certificate of deposit, insurance contract, United States savings bond (including a special Treasury Retirement Bond [R-Bond] that would be designed for use with an Automatic IRA), or similar asset.

    b. Life-cycle or other blended investment option. The contributions would be invested in a broadly diversified class of assets or fund that is substantially similar to target date, life-cycle, balanced, or similar funds. This choice will reflect any changes to the definition and/or composition of such fund types by the DOL; SEC; or other pertinent regulator.

c. Alternative investment option. As specified in regulations, this option will include a somewhat higher concentration of equities than the life-cycle or blended investment option listed above.

2. Default investments.

a. Low-balance accounts. The default investment for new savers will be the "principal preservation" fund (or the R-Bond) until their accounts reached $5,000 (plus an inflation adjustment factor). An employer (or participating employee, in the case of an employer that permits employees to choose investment trustees) can choose a private sector trustee for its principal preservation investment. Absent such a selection, the investment in R-Bonds will generally be held at Treasury.

b. Default change in investment for larger accounts. When a participant's principal preservation account in the private sector reaches a balance of $5,000, the individual will be notified that, unless the participant elects otherwise, future contributions will, by default, be invested in the life-style or balanced fund described above offered by the private sector provider. In the case of an R-Bond, when the account reaches $5,000 the individual will be notified that, unless the participant elects otherwise both the existing balance and future contributions will go into the life-style or balanced fund selected by the employer (or selected through a default assignment if the employer does not select a provider). In either case, a participant could opt out of the default and instead choose to (i) stay in the "principal preservation" fund or R-bond, or (ii) invest in the alternative investment option.

c. Portability. All accounts will be designed to be portable – without regard to employment status – and can be rolled into (and out of) other IRA and qualified plan accounts.

d. Fee disclosures. The disclosures of fees and expenses on the central website will facilitate comparison of options by employers and employees.

F. Fiduciary issues.

1. Limited responsibilities for investment. Employers will have no ERISA fiduciary liability if they use a provider that is on a list of approved providers or uses R-Bonds.
2. Timely remittance. The employer must transmit employee contributions by the end of the month following the month in which the cash would have been paid had it not been contributed to the Automatic IRA. An excise tax will apply if the employer fails to remit on time.

3. No self-dealing. Employers will be subject to self-dealing prohibitions.

4. Disclosure. An employer's sole disclosure responsibility will be to provide the employee with a standardized form explaining the program and investment decisions. This form will be either attached to the IRS Form W-4 or available from a central website or through IRA providers.

G. **Promoting qualified plans.** *To reflect the fact that Congress prefers for qualified plans – i.e., defined benefit pension plans and defined contribution plans, like 401(k)s – to Automatic IRAs, the bill will strengthen incentives for firms to adopt qualified plans.*

1. Start up credit. Current law offers a small business that adopts a new qualified plan a tax credit, which can apply for up to three years, equal to the lesser of (1) 50% of the employer's start-up costs, or (2) $500. The bill increases the $500 amount to $1,000.

2. Multiple employer plans. *To address the low incidence of qualified plans among small businesses, Congress has authorized employers to band together and offer "multiple employer plans." But the risk that a noncompliant employer within the plan will taint the entire plan has stymied the expansion of such plans.* The bill directs Treasury and DOL to issue administrative guidance for multiple employer plans (particularly to reduce disincentives to pooling) and a model plan.

3. Advantages for qualified plans. For several reasons, extensive use of automatic IRAs can be expected to lead to expanded marketing and adoption of 401(k), SIMPLE, and other tax-favored employer plans.

   a. No employer match. Unlike qualified plans, automatic IRAs do not permit employer contributions, matching or otherwise.

   b. Lower maximum contribution amounts. The maximum permitted annual contribution to IRAs (currently $5,000 with an additional $1,000 for those aged 50 or older) exceeds employees' average 401(k) contribution but is not enough to satisfy the appetite for tax-favored saving of many business owners or decision makers. They will still have an incentive to adopt a SIMPLE plan, which allows tax-favored employee contributions of up to $11,500, or a 401(k), with a limit of $16,500. Together with employer contributions, which are allowed in the 401(k) and required in the SIMPLE, total contributions to a 401(k) can reach $49,000 (increased for employees 50 or older).

   c. Lower employer start-up credit. The automatic IRA tax credit ($250/year for two years) will be significantly smaller than the tax credit small employers receive when adopting new retirement plans ($1000/year for three years). Any employer that drops of freezes a 401(k) or other qualified plan within a 2-year look-back period will be ineligible for the Automatic IRA start-up tax credit.

H. Other issues.

1. Study on consolidating IRA accounts. The bill directs Treasury and DOL to conduct a study of the desirability and practicality of using data on IRA investments to enable individuals with multiple IRA accounts that include small accounts to receive periodic notices informing them about the location of these accounts and how they might be consolidated. The study will also consider using investment arrangements associated with automatic IRAs to assist in addressing the problem of abandoned accounts.

2. Additional studies. The bill mandates that Treasury/DOL study and report to Congress on spousal consent, and potential lifetime income options, for Automatic IRAs.