



# AMERICAN BENEFITS COUNCIL

September 21, 2012

## SUMMARY OF USA RETIREMENT FUND PROPOSAL

PREPARED BY KENT MASON OF DAVIS & HARMAN LLP



On July 27, Senator Tom Harkin, Chairman of the Senate Committee on Health, Education, Labor and Pensions released a report entitled “The Retirement Crisis and a Plan to Solve It.” The report makes two recommendations (1) the creation of USA Retirement Funds (“Funds”), and (2) the strengthening of Social Security in certain aspects.

This document provides additional detail on how the Fund proposal may work. These details are based on discussions with individuals with insight into how the proposal could work. However, the details provided in this document have not been approved by Senator Harkin’s office and thus should not be viewed as official.

### EXECUTIVE SUMMARY OF FUND PROPOSAL

Employers that do not offer a workplace retirement plan with automatic enrollment and a minimum level of employer contributions would have to (1) automatically enroll employees in a Fund at a specified level of contributions, and (2) make a minimum level of employer contributions on behalf of the employees to an employer-sponsored plan, a Fund, or a combination of the two. Employees could opt out of participation in the Fund. Employers could participate in a Fund in addition to maintaining their own plan.

Funds would be “privately run, licensed, and regulated retirement plans . . . overseen by a board of trustees consisting of qualified employee, retiree, and employer representatives.” The Funds would have professional asset management (rather than participant direction), and would be conservatively invested. Employers would not have any fiduciary responsibilities with respect to choosing a Fund or the operations of

the Fund. Fiduciary responsibilities with respect to the operations of the Fund would be assumed by the Fund's board of trustees.

The Funds generally resemble defined contribution plans with accounts based on actual earnings. Benefits would be paid out under rules similar to the pension plan rules, which means that benefits would be paid as annuities with spousal survivor benefits in the absence of spousal consent. Lump sum distributions would not be permitted.

Funds might also be permitted to accept IRA contributions from individuals, subject to the IRA rules and limits.

Fund benefits would be portable, so that participants could move from one Fund to another.

## **DISCUSSION OF FUND PROPOSAL**

### **I. Two separate parts of the proposal**

The Fund proposal is best thought of in two separate parts. First, how would the Funds operate? Second, under what circumstances would employers be required to participate in Funds?

This separation is important because from a policy perspective, it is useful to consider how the Funds would function, separate from the more politically difficult issue of mandating employer participation under certain circumstances.

### **II. Fiduciary responsibility**

The core of the proposal is relieving participating employers of all fiduciary responsibility. The policy justification for this part of the proposal is that a Fund's board of trustees assumes such responsibility. For example, if the Fund's investments are not prudently selected, the board of trustees would have the ultimate fiduciary responsibility for that lack of prudence. The board could designate an investment manager to be responsible for the actual investing, but the board would retain responsibility to monitor the investment manager. A Fund would be permitted to include the cost of fiduciary insurance as part of the cost of plan administration to be borne by the employees, as discussed below.

Under the proposal, financial institutions (or other entities) that sponsor Funds would need to appoint a board the majority of whom are independent of the sponsor. Because of this independence, the financial institution would not be treated as a

fiduciary except to the extent that the board delegates specified fiduciary duties to the financial institution.

The board would have to have employee, retiree, and employer representatives. However, further details on the rules regarding the exact composition of the board and the appointment process have not been developed but will be critical components of this proposal.

It is not clear what conditions an entity would need to satisfy in order to sponsor a Fund, though one possibility would be that a sponsor would have to meet requirements similar to the requirements applicable with respect to serving as an IRA trustee. Moreover, the Fund would need to have the governing plan document approved as meeting the Fund rules. It is not clear if any further steps would be required for an arrangement to qualify as a Fund.

All investments would be made by at the Fund level, i.e., there would be no participant direction. The intent is for the investments to be tailored to employees' risk and return profile, patterned after qualified default investment alternatives ("QDIAs") under the Department of Labor's regulations. The report refers to "conservative" investments. It is our understanding that that is intended to apply a prudence standard.

Generally, employers would choose which Fund to participate in. However, in the absence of an employer designation, the report indicates that a "default" Fund could exist (1) for employers in a certain region or industry or (2) through collective bargaining. It is not clear how a regional or industry default Fund would be selected.

### **III. Benefit structure**

Funds would generally operate like defined contribution plans with actual Fund earnings allocated to participant accounts.

As noted, there would be a default level of employee contributions. No decision has been made regarding that default level. Similarly, no decision has been made regarding the applicability of auto-escalation. If permitted by the Fund and the employer, employees would be allowed to contribute more than the default amount, up to a yet to be determined limit.

A minimum level of employer contributions would have to be made on behalf of every eligible employee. Generally, all employees would be eligible, subject to limited exceptions for some but not all part-time employees, some but not all seasonal employees, and nonresident aliens. The extent of any permitted waiting period prior to eligibility has not been determined.

Again, no decisions have been made regarding the minimum level of employer contribution but the main possibilities may be between .5% and 3% of compensation. This minimum could be satisfied through contributions to the Fund, to a separate employer-sponsored plan, or to a combination of the two. It is unclear whether employees would be entitled to this minimum contribution if they do not contribute to the Fund or to another plan. It is possible that an employee would have to contribute a minimum amount in order for the employer to be required to make a minimum contribution on the employee's behalf.

Employers would be permitted to contribute more than the minimum contribution. Neither the minimum contribution nor the additional contributions would be subject to nondiscrimination or top-heavy testing. This leads to the question as to how much flexibility Fund and/or employers would have in structuring their Fund contributions. For example, it is unclear if contributions could be increased based on increases in age and/or service.

Similarly, in the case of an employer that contributes the minimum amount to a Fund and automatically enrolls employees in the Fund, consideration is being given to exempting any separate plan maintained by such employer from nondiscrimination and top-heavy testing. This raises the same question regarding the type of employer contributions to the separate plan that would be covered by this exemption.

It is unclear whether Funds would be treated as defined contribution plans and aggregated with other defined contribution plans of the same employer for purposes of applying the qualified plan contribution limits or whether Funds would be subject to separate limits.

Employee contributions to a Fund would be eligible for a credit similar to the Saver's Credit, except that the credit would be (1) refundable, and (2) payable directly to the Fund as an additional contribution on behalf of the employees.

#### **IV. Distributions.**

Distributions must be made in the form of a lifetime income stream. The default form of distribution would be a qualified joint and survivor annuity; an individual could elect a different annuity form only with spousal consent. If an employee dies before the annuity starting date, the benefit would be payable in the form of a life annuity to the surviving spouse. No decision has been made regarding the payment of the benefit in the event there is not a surviving spouse.

The Fund can either pay out the annuities itself, buy commercial annuities, or do a combination of the two (though the combination seems less likely from a practical perspective). If the Fund decides to "self-annuitize", presumably it would create its own pool of "annuitized accounts" from which to draw on. If that pool runs low due to, for

example, adverse investment performance or unexpected longevity, annuity benefits would be reduced to reflect the lack of sufficient assets since no other party – not the government, the employers, or the taxpayers – would have any responsibility to replenish the Fund’s assets. Alternatively, Funds could privately reinsure their self-annuitization risk out of the pool’s assets. Conversely, annuity benefits could be increased in the case of favorable Fund experience. Fund boards might have discretion regarding the timing and extent of the reductions or increases; alternatively, such adjustments could be governed by precise rules that leave no discretion to the boards.

Because benefits are not payable in a lump sum, benefit statements would only show projected annuity payments. Funds may be able to choose whether to include projected future contributions in these benefit statements projections.

Distributions would not be payable prior to a specified retirement-based age that has not been determined. No loans would be available from the Funds.

## **V. Disclosure**

Funds would be subject to certain minimum standards regarding disclosures to participants. The Fund board would, pursuant to their fiduciary duties, determine what additional disclosures to make. Boards would, again subject to their fiduciary duties, have flexibility regarding how to provide disclosures (e.g., paper, electronic, posting on a secure website, etc.). Participating employees might be required to bear all costs of disclosure (and other administrative costs), which would, of course, have to be taken into account by the boards in exercising their fiduciary discretion regarding disclosure. It is unclear whether employers could contribute to the cost of plan administration.

## **VI. Required Fund participation**

Employers would be required to participate in a Fund to the extent that they do not maintain a Plan that meets the automatic contribution and employer contribution requirements applicable to Funds. It is unclear if small employers participating in a Fund would be eligible for the small employer start-up tax credit applicable with respect to qualified plans.

## **VII. Availability of Funds to individuals**

Individuals might be permitted to make contributions to a Fund even if their employer does not participate in such Fund. Such contributions would be treated like IRA contributions for all purposes. Individuals would have the right to require their employer to make such IRA contributions on a payroll deduction basis.

## **VII. Portability**

Individuals would be free to move assets from one Fund to any other Fund at any time. Employers participating in one Fund could decide to participate in a different Fund and move employee accounts at the original Fund to the successor Fund. However, it is not clear if benefits in pay status could be moved by either employers or employees.