CREATING A WORKABLE SYSTEM OF ADMINISTRATION FOR AUTOMATIC IRAS

A Report Prepared for AARP

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INTRODUCTION

The proposal to adopt Automatic IRAs for individuals who do not have access to an employer retirement plan is based on the presumption that the power of inertia will make savers of those individuals who are least likely to be saving currently. The theory of the power of inertia is that individuals who are required to take affirmative action to participate in a pension plan are less likely to participate than those individuals who are required to take affirmative action NOT to participate in such a plan. The positive effects of the power of inertia have been demonstrated with automatic enrollment 401(k) plans, which require employees to take affirmative action to decline to participate.

However, one problem is that individuals who will be eligible for Automatic IRAs are likely to be younger, lower paid, and have greater job turnover than the average U.S. worker. These individuals may have greater difficulty understanding the Automatic IRA program than the average employee, will be more likely to have multiple Automatic IRA accounts established with multiple employers, and will be less comfortable making investment decisions. Thus, a key element of the success of an Automatic IRA program will be the creation of a system of administration that is relatively simple and takes into accounts the demographics of the Automatic IRA eligible workforce.

The development of a workable Automatic IRA administration system will involve conflicts and tradeoffs that must each be evaluated. Among the issues and objectives that can be identified are the following: (1) an Automatic IRA system will be more efficient if the number of accounts established on behalf of any individual worker can be minimized; (2) flexibility for employers may reduce employer objections to the mandates imposed on them by Automatic IRAs, but may increase the complexity of the Automatic IRA system; (3) a workable Automatic IRA system will have adequate recordkeeping, reporting, and oversight; and (4) the power of inertia may work either for or against the administrability of an Automatic IRA system.

In this paper, we discuss how the design of a system to implement and administer Automatic IRAs may affect the issues addressed above, the potential costs involved with respect to the various alternative approaches to implementation, and how the experiences in other countries might inform the decision making for administering Automatic IRAs in the United States.

SECTION I – OVERVIEW AND EXECUTIVE SUMMARY

Automatic IRAs

Automatic IRAs are a concept that builds on the automatic enrollment 401(k) plan concept and introduces similar automatic retirement savings for individuals who are not eligible to participate in an employer's retirement plan.[1] Under an Automatic IRA, retirement saving would occur through regular payroll deductions with an individual's employer and the amounts withheld would be contributed to IRAs that are selected by employees or by an employer or a default account offered by the Federal government. Under the proposal that has been advanced, there are two types of Automatic IRAs – a payroll deposit IRA (or "opt in" approach) under which an employee elects to have amounts withheld from wages and deposited in an IRA and an automatic enrollment IRA (or "opt out" approach) under which an employee is deemed to have elected to participate unless a specific election not to participate has been made. The primary difference between the two approaches is the level of effort an employer must use to secure an employee's election not to participate.

Automatic IRAs contemplate that workers who are not currently eligible to participate in their employer's qualified retirement plan will begin saving for retirement through payroll deduction contributions to IRAs. Under the Automatic IRA proposal, employers with at least 10 employees who have been in business for at least two years generally would be required to make Automatic IRAs available to any of their employees not covered under a qualified retirement plan. Certain classes of employees could be excluded from consideration, including collective bargaining unit employees, nonresident aliens, employees who are under age 18, employees who have not worked for an employer for at least three months, and employees who have not satisfied minimum age and service requirements to participate in an employer's retirement plan.

Principles for an Administrable Automatic IRA System

While the basic concept of Automatic IRAs is quite simple, the implementation of a workable Automatic IRA system presents problems that must be resolved. The individuals who will be eligible for Automatic IRAs are likely to be younger, to have less education, and to have greater job turnover than the average U.S. worker. These individuals may have greater difficulty understanding the Automatic IRA program, may

[1] The Automatic IRA proposal has been developed by Mark Iwry and David John and is described in detail in two documents. Iwry, J. Mark and David C. John, *Pursuing Universal Retirement Security Through Automatic IRAs.* Iwry-John Working Paper – Draft of Feb. 12, 2006. John, David C. and J. Mark Iwry, *Testimony before the Subcommittee on Long-Term Growth and Debt Reduction, Committee on Finance, United States Senate, June 29, 2006, Pursuing Universal Retirement Security Through Automatic IRAs*. The Heritage Foundation and The Retirement Security Project. In addition, the following bills specifically addressing Automatic IRAs have been introduced in the 110th Congress: S. 1141, introduced by Senators Bingaman, Smith, Harkin, Kerry, and Snowe on April 18, 2007, and H.R. 2167, introduced by Mr. Neal, Mr. English, Mr. Emanuel, Mr. Larson, and Ms. Schwartz on May 3, 2007.

be more likely to have multiple Automatic IRA accounts established with multiple employers, and may be less comfortable making investment decisions.

Thus, a key element of the success of an Automatic IRA program will be the creation of a system of administration that is workable and takes into account the demographics of the Automatic IRA eligible workforce. Certain general principles can be identified that are important when the administrative structure of Automatic IRAs is developed.

Vital to the success of an Automatic IRA program is ensuring that individuals recognize the value of the savings that occurs through payroll withholding. Success with retirement savings through Automatic IRAs will breed further successes as individuals begin to see the accumulation of wealth that an Automatic IRA can provide. This success can only occur if Automatic IRA participants are involved in the management of their accounts and periodically apprised of the value of their Automatic IRA assets.

Yet, the Automatic IRA system could require the creation of a separate account each time an individual worker changes jobs. This can create particular problems trying to keep track both of individuals and of Automatic IRA accounts and may increase the overall costs attributable to the system, which will reduce the account balances of individual employees under the system.

Developing an administrable Automatic IRA system should consider certain general but, important principles.

First, automatic enrollment should be as simple as possible for employers to implement – with efficient and cost effective administration. Flexibility of choices for employers with respect to certain Automatic IRA features (such as the flexibility to choose an Automatic IRA service provider selected by the employer) may reduce some employer objections to the mandates imposed on them by Automatic IRAs, but may also increase the complexity of the Automatic IRA system. Automatic IRAs will have the greatest impact on small employers; these employers tend to use less sophisticated payroll processing systems and have lower profit margins, making the potential burden of complying with the Automatic IRAs requirements a potential significant source of cost and complexity.

Second, an Automatic IRA system will be more efficient if the number of accounts established on behalf of any individual worker can be minimized. The greater the number of accounts established on behalf of any one individual, the greater the administrative costs that will be imposed with respect to that individual's savings. The power of inertia that gets an employee saving under Automatic IRAs may also cause an employee not to take affirmative action to transfer his or her Automatic IRA when the employee changes jobs.

Third, a workable Automatic IRA system will have adequate recordkeeping, reporting, and oversight. While there is a clear Federal government role with respect to ensuring compliance with various Automatic IRA requirements, such as ensuring that employers remit properly the amounts that are withheld from employees' paychecks, the overall

administration of Automatic IRAs could take a variety of forms, including a fully Federal approach to administration or a public-private partnership.

Fourth, a workable Automatic IRA system must include participation by private sector service providers. A pure government sponsored-approach to Automatic IRAs (i.e., investment in Federal bonds) would not offer adequate rates of return to contribute to adequate retirement savings through Automatic IRAs. There are a variety of models that could be employed (discussed below under "Flows of Money"); one approach would have a limited number of private sector participants, selected by the Federal government from among competing bidders. Another approach would provide wide accessibility to Automatic IRAs by private sector service providers, who would have to meet minimum requirements and standards.

Fifth, because the amounts likely to be contributed to Automatic IRAs will be smaller than the contributions typically made to other forms of tax-favored retirement vehicles, it will be particularly important to minimize the administrative costs associated with Automatic IRAs.

Flows of Money

A key decision point for the Automatic IRA proposal is the flow of money that occurs when an employer withholds Automatic IRA contributions from an employee's compensation. An element of this decision is whether the appropriate form of competition within the Automatic IRA market is competition for the customer or competition for the market. If the preferred approach to competition is competition for the customer, then a purely private model for the delivery of Automatic IRAs would be the appropriate choice.

We believe that competition for the market will likely provide a greater level of administrability for the Automatic IRA program and will help to keep overall costs of the system lower. Competition for the market suggests that a centralized authority that receives, at a minimum, default Automatic IRA contributions (i.e., those Automatic IRA contributions that have not been directed to a specific Automatic IRA service provider) will provide a more efficient system.

There are two approaches to competition for the market outlined in this paper – one is the approach that is contained in the introduced bills (the TSP II model) and the other is referred to in this paper as the Federal government intermediary model. In both models, default Automatic IRA contributions are directed to a central authority, which could either invest the assets in pooled accounts or direct the money to private sector service providers who have applied to be default Automatic IRA service providers. The primary difference in the two models is that, under the TSP II model, Automatic IRA contributions that are being directed to an Automatic IRA service provider selected by the employee or by the employer would be sent directly to the service provider, whereas under the Federal government intermediary model, these contributions would be withheld and remitted to the Federal government in the same manner as default IRA contributions.

Then the contributions would be directed to the appropriate private sector Automatic IRA service provider.

We believe that the Federal government intermediary model should be given serious consideration. One of the major issues with respect to Automatic IRAs is whether there would be sufficient private sector interest in the relatively small dollar amounts that might be contributed to the accounts by relatively low wage employees. This is a particular issue with respect to the early years of the program. The Federal government intermediary model solves this problem by pooling assets to create economies of scale, while still leaving all Automatic IRA contributions invested with private sector Automatic IRA service providers.

In addition, the model preserves private sector competition by allowing employers or employees to designate specific service providers. Thus, under this model, private sector Automatic IRA service providers could compete for those Automatic IRA contributions that would be most lucrative and could also compete for a share of the default Automatic IRA contributions.

We believe this model provides the potential to keep Automatic IRA costs relatively low. The recordkeeping necessary for a workable Automatic IRA system would be facilitated by flowing all dollars through the Federal government, creating an immediate record of where each individual employee's money is going. Further, the pooling of assets will facilitate lower overall administrative costs with respect to the default Automatic IRA contributions.

Costs to employers may also be lower because all employee Automatic IRA contributions would be remitted in the same manner and then directed to the appropriate service provider by the centralized authority for Automatic IRAs. This type of model has been adopted by the New Zealand government with respect to their new Kiwisaver program and is under consideration in the United Kingdom for a proposed Automatic IRA type savings scheme.

Costs of Automatic IRAs

The costs of Automatic IRAs will be borne by employers, employees, and the Federal government. In general, we believe that private sector Automatic IRA service providers will pass their costs through to account holders, unless separate constraints are imposed on the amount of costs that can be passed through.

Federal government costs

The Federal government will incur both revenue costs and possible outlay costs attributable to the Automatic IRA proposal. We have estimated that the revenue costs could range from $5 to $10 billion over 10 years. The revenue analysis considers the tax benefits directly attributable to Automatic IRAs, the costs attributable to greater

utilization of the Saver's Credit, and the costs of the tax credits provided to small employers to help offset their costs of complying with Automatic IRAs.

The outlay effects that the Federal government may face could include potential startup costs as well as ongoing expenses related to the administration of the Automatic IRA program. However, the level of Federal government outlays cannot be estimated at this time because they will be highly sensitive to the extent to which Automatic IRA participants are expected to shoulder the costs attributable to the accounts.

Employer costs

Employers will face a variety of costs in implementing an Automatic IRA proposal. These costs will include the costs attributable to (1) identifying the employees who are required to be offered Automatic IRAs, (2) providing election forms and processing paperwork with respect to employee elections or nonelections, (3) any employee choices that are provided under Automatic IRAs, such as the choice of IRA service provider and the level of contributions, (4) determining the appropriate amount of employee contributions to Automatic IRAs and withholding such payments from employee's pay, and (5) identifying whether any employee has exceeded applicable limits on contributions.

The level of costs for any specific employer will vary depending upon the size of the employer, whether the employer utilizes electronic payroll processing, the size of the employer's workforce, and the particular features of Automatic IRAs that the employer elects to use (e.g., whether the employer permits employees to select their own IRA service provider). Given the potential variability of these costs, we have not attempted to quantify them at this time, but have focused instead on the potential administrative costs to employees.

Automatic IRA Participant Costs

The costs that Automatic IRA participants may face will determine whether Automatic IRAs present a viable option for retirement savings for the millions of American without employer retirement plan coverage. The factors that drive these costs relate to account design, the availability of choices to Automatic IRA participants, and the operational and customer service costs of the account.

In order to provide some idea of the costs that Automatic IRA participants may face, we have examined potential fund accumulations, what potential levels of startup costs might be, and the total costs needed to fund Automatic IRAs under either a fully public or a fully private model for Automatic IRAs.

We used experience with the Federal Thrift Savings plan to help inform the possible effects of an Automatic IRA proposal, adjusted to reflect the differences in both the program (plan design, investment options, and other factors) and the demographics of potential participants. The Thrift Savings Plan (with 20 years of experience) showed a

relatively low participation rate (16 to 25 percent) in the first five years with steady, systematic increases to 40 percent participation in 2005. We would expect Automatic IRAs to have lower participation rates and lower dollar contributions than the Thrift Savings Plan. However, the numbers of employees eligible for Automatic IRAs is significantly greater than the number of Federal employees eligible for the Thrift Savings Plan.

In the early years, it is expected that the aggregate assets in Automatic IRAs would remain relatively flat, but could grow to $500 billion in 10 years and $1.4 trillion in 20 years assuming that Automatic IRA participants begin to participate at a moderate rate and an annual average contribution of $3,000.[2] With lower participation rates and an annual average contribution of $1,000, Automatic IRA assets could reach $100 billion in 10 years and nearly $300 billion after 20 years.[3]

The Federal government appropriated approximately $500 million in 1986 for the start-up costs of the Thrift Savings Plan. GAO estimated, in 1999 dollars, that the start-up costs would equal approximately $1 billion. In 2009 dollars, these costs could be more than $1.4 billion.

Under a purely public entity, after the initial Federal government appropriation, ongoing costs of administering the accounts would be paid through a fixed percent of the asset balance. The cost depends heavily upon the level of participation and contribution amounts. However, estimates indicate that the public entity would need to charge a fixed rate of 1.5 percent to become immediately self-funding (assuming lower participation rates and $1,000 average annual contributions). This rate decreases to approximately 0.75 percent with $2,000 average annual contributions and assuming lower participation. The rate further decreases to approximately 0.45 percent with $3,000 average annual contributions and assuming lower participation.[4]

If actual participation and contribution amounts are higher than expected, these rates might be lower. Alternatively, if actual participation and contribution amounts are lower than expected, the fixed percentage could be considerably higher.

Conversely, in a purely private system, it is likely that the fee structure will result in a combination of two charges, a fixed per account fee as well as a percent of asset fee. Often the magnitude of these fees is related inversely. In other words, those accounts with a higher annual per account fee may assess a lower fee as a percent of assets.

The amount of the revenue generated in a purely private system depends heavily upon the participation rate and contribution amounts. However, based on the lower participation rate, in the first year, estimates of the aggregate gross revenue produced from the fixed

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[2] For purposes of these estimates, moderate participation rates are 80 percent of TSP historical participation rates.

[3] For purposes of these estimates, moderate participation rates are 60 percent of TSP historical participation rates.

[4] Cost estimates that rely on higher participation rates are contained in Section 5.

fee charged each account range from $96 to $216 million with a $25 and $45 fixed fee, respectively. This revenue would increase to approximately $170 to $383 million after five years and to $280 to $631 million after ten years with a $25 and $45 fixed fee.[5]

The revenues generated from the second component of the purely private system, the fee based on a percentage of assets, would depend heavily on participation rates and contribution amounts. However, based on the lower participation rate and average annual $1,000 contributions, a 0.05 percent fee would generate first year revenues of approximately $24 million. If the percent increased to 1.5 percent, this would generate approximately $72 million in the first year. The revenue generated from a 0.05 percent fee would increase to $176 million and a 1.5 percent fee would increase to approximately $706 million after five years.[6]

Actual costs and revenues will vary with actual participation and contributions. However, these estimates provide a benchmark for either the necessary Federal funding for administering Automatic IRAs through a purely public system or the potential private sector revenue that might be generated if Automatic IRAs were administered through a purely private system.

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[5] See Table 1, below, for gross revenue estimates that rely on higher participation rates.
[6] See Table 2, below, for gross revenue estimates that rely on higher participation rates.

SECTION 2 – PRINCIPLES OF AN ADMINISTRABLE AUTOMATIC IRA SYSTEM

A. The Automatic IRA Conundrum

While the basic concept of Automatic IRAs is quite simple, the implementation of a workable Automatic IRA system presents problems that must be resolved.

Vital to the success of an Automatic IRA proposal is ensuring that individuals recognize the value of the savings that occurs through payroll withholding. Under this theory, success with retirement saving through Automatic IRAs will breed further successes as individuals begin to see the accumulation of wealth that an Automatic IRA can provide. This success can only occur if Automatic IRA participants are actively involved in the management of their accounts and periodically are apprised of the amount of their Automatic IRA assets.

Yet, the Automatic IRA system could require the creation of a separate account each time an individual changes jobs. Because the Automatic IRA system is intended to benefit those employees who do not have access to employer retirement plan coverage, the typical employee eligible to participate in an Automatic IRA is likely to be younger, lower paid, and more mobile than average. These characteristics can create particular problems trying to keep track both of individuals and of Automatic IRA accounts as some of these individuals change jobs frequently. Further, individuals with multiple accounts with small balances may face greater overall fees.

B. Principles for an Administrable Automatic IRA System

Certain general principles should be considered important to the development of an administrable Automatic IRA system.

First, automatic enrollment should be as simple as possible for employers to implement – with efficient and cost effective administration. Flexibility for employers may reduce some employer objections to the mandates imposed on them by Automatic IRAs, but may also increase the complexity of the Automatic IRA system. Automatic IRAs will have the greatest impact on small employers; these employers tend to use less sophisticated payroll processing systems and have lower profit margins, making the potential burden of complying with the Automatic IRAs requirements a potential significant source of cost and complexity.

Second, an Automatic IRA system will be more efficient if the number of accounts established on behalf of any individual worker can be minimized. The greater the number of accounts established on behalf of any one individual, the greater the administrative costs that will be imposed with respect to that individual's savings. The power of inertia that gets an employee saving under Automatic IRAs may also cause an

employee not to take affirmative action to transfer his or her Automatic IRA when the employee changes jobs.

Third, a workable Automatic IRA system will have adequate recordkeeping, reporting, and oversight. While there is a clear Federal government role with respect to ensuring compliance with various Automatic IRA requirements, such as ensuring that employers remit properly the amounts that are withheld from employees' paychecks, the overall administration of Automatic IRAs could take a variety of forms, ranging from a fully public to a fully private system of administration.

Fourth, a workable Automatic IRA system must include participation by private sector service providers. A pure government sponsored-approach to Automatic IRAs (i.e., investment in Federal bonds) would not offer adequate rates of return to contribute to adequate retirement savings through Automatic IRAs. There are a variety of models that could be employed (discussed below under "Flow of Money"); one approach would have a limited number of private sector participants, selected by the Federal government from among competing bidders. Another approach would provide wide accessibility to Automatic IRAs by private sector service providers, who would have to meet minimum requirements and standards.

Finally, design complexity will increase the costs of the Automatic IRA system. This complexity will be affected by decisions made with respect to (1) the administrative structure that is adopted, including the way that recordkeeping is handled, (2) the flexibility that individual participants have with respect to selecting and changing investments, and (3) the options provided to individuals with respect to their accounts, including customer service, online access to account information, and other features of the accounts. The costs of the system are important because it is likely that Automatic IRAs will have, on average, lower annual contributions than other forms of tax-favored retirement savings. Thus, the design of Automatic IRAs should minimize design complexity in order to minimize the costs that may reduce Automatic IRA account balances.

C. Structural Approaches

There are two major elements to the administration of an Automatic IRA system – the flow of information for reporting and recordkeeping purposes and the flow of money. A decision to adopt a particular model for the flow of money may influence the way in which information flows and how records are kept.

The Federal government has a clear role with the enforcement of Automatic IRAs. Because the Automatic IRA proposal contemplates using the existing payroll withholding system to withhold and transmit at least a portion of Automatic IRA contributions, the Federal government can use existing Federal tax rules to penalize employers that fail to remit properly the amounts withheld from employees' pay. Beyond this compliance and enforcement role, the level of Federal government involvement in Automatic IRAs will be affected by the particular model chosen for information and money flows.

The following section discusses possible choices for the administration of Automatic IRAs and identifies the pros and cons of each approach. These choices identify the two extreme approaches – a fully government-run program and a fully private run program – and two possible approaches that combine a Federal government and private approach. One of the combined approaches reflects the Automatic IRA proposal contained in the introduced bills.

SECTION 3 – Models for Centralized Recordkeeping Authority for Automatic IRAs

A. Overall administration of Automatic IRAs

The Automatic IRA proposal contemplates that individuals who are not currently retirement savers will begin saving for retirement through payroll deduction contributions to IRAs. This proposal targets those people who are least likely to save suggesting that the typical individual targeted by the Automatic IRA proposal will be low or moderate income, younger rather than older, more likely to be a part-time employee, and likely to have higher than average job turnover. Each of these characteristics will identify individuals who are less likely to be saving for retirement. Of course, it is also true that the individuals most likely to become retirement savers as a result of the Automatic IRA proposal will be those individuals who are the higher end of income for the demographic group not saving, who are older rather than younger, who are more likely to be full-time employees, and who are more likely to have some job stability.

The demographics of the individuals who might become retirement savers as a result of the Automatic IRA proposal suggest a potential problem presented by the proposal. As these individuals have amounts withheld from their compensation for IRA contributions, there needs to be a mechanism that ensures that the individuals do not lose track of the IRA accounts that have been established for them. The proposal suggests that employers would not have significant recordkeeping and reporting requirements beyond the proper withholding and transmitting of IRA contributions. What this means is that some other entity or entities must take a substantial role in the tracking of Automatic IRAs.

Ensuring that individuals understand the status of their retirement savings could lead one to conclude that a central recordkeeping and reporting authority is necessary. For example, the introduced bills create a TSP II Board in the executive branch of the Federal government.[7] Under the bills, the TSP II Board would be established and maintained in the same manner as the Federal Retirement Thrift Investment Board, which was created in connection with the Thrift Savings Plan for Federal employees.

The bills specify the duties of the TSP II Board to include the following:

1) establishing and maintaining IRAs to which Automatic IRA contributions can be made;
2) investing and managing the contributions to such IRAs;
3) the amount of contributions and investment of such contributions under a default Automatic IRA created when an employee fails to elect not to participate in an employer's Automatic IRA program;
4) the issuance of regulations relating to Automatic IRAs;

[7] For a more detailed description of the administration of Automatic IRAs under the introduced bills, see Appendix A.

5) facilitating and encouraging the use of automatic debit and other arrangements for the establishment of IRAs for self employed and other individuals;
6) facilitating and encouraging efforts by voluntary associations to promote IRA savings by their members and others; and
7) facilitating and encouraging the direct deposit of Federal and state tax refunds into IRAs.

In addition to these duties, a recordkeeping and reporting system for Automatic IRAs should (1) keep a record of each Automatic IRA created for employees, whatever the source, including the amount of contributions made to such IRAs, (2) receive annual reports from private IRA service providers with respect to the Automatic IRAs established and maintained with such providers, (3) report annually to employees with respect to the Automatic IRAs established and maintained with the central authority, and (4) disseminate materials to employees with respect to the advantages of saving through Automatic IRAs and the consequences of the investment options that employees may have.

Thus, any system for administering an Automatic IRA program should include responsibility for the following:

1) creating and administering Automatic IRA accounts for employees of employers who wish to utilize a default provider;
2) keeping records with respect to Automatic IRA contributions that have been made on behalf of individual employees and where such contributions have been deposited;
3) receiving information from IRA service providers with respect to annual Automatic IRA account balances, contributions, and earnings;
4) reporting at least annually to employees and the IRS with respect to employees' Automatic IRAs; and
5) providing educational materials to employees on the benefits of Automatic IRAs as a retirement savings mechanism and the types of investment options employees should consider.

There are a number of possible models for the administration of an Automatic IRA program. The TSP II Board created under the introduced bills would be a separate Federal entity. Additional options would include the following: (1) a public-private partnership, (2) a government-sponsored entity (GSE), or (3) a fully private approach.

Federal agency

A Federal agency could administer an Automatic IRA program directly. The advantage of this type of approach is that the use of a Federal agency to assist with the administration of Automatic IRAs will facilitate the sharing of information among the necessary parties, including the Internal Revenue Service. Use of a Federal agency will minimize some of the taxpayer privacy issues that may arise in the administration of the Automatic IRA program.

In addition, there is a proven model in the Federal Thrift Investment Board, which manages a large retirement system. The Federal government is accustomed to handling significant amounts of information for geographically dispersed individuals and will be more able to keep track of the individuals participating in Automatic IRAs.

On the other hand, the use of a Federal agency may impose more costs on the Federal government for the administration of an Automatic IRA program than is necessary. A corollary to this problem is that there may be a larger Federal bureaucracy created as a result. In addition, there may be perceptions that the assets in Automatic IRAs will be guaranteed or protected by the Federal government in the event of significant market losses.

Public private partnership

A public private partnership could be used to administer the Automatic IRA program. In fact, certain administrative duties relating to the Federal Thrift Savings Plan are outsourced to private entities. A public private partnership would be a contractual agreement between the Federal government and a private sector entity. Typically, under a public private partnership, there is a sharing of resources as well as a sharing of the risks and rewards of the joint activity. Public private partnerships are frequently used for the development of infrastructure, such as construction of water utility property. As mentioned above, the TSP II Board could use a public private partnership to administer Automatic IRAs.

Government sponsored enterprise

Government-sponsored enterprises (GSEs) are established and chartered by the Federal government for public policy purposes. In general, GSEs are private corporations designed generally to provide credit for specified purposes and their securities are not backed by the full faith and credit of the Federal government. Examples of GSEs include the Student Loan Marketing Association, (Sallie Mae) (now a private corporation), the Federal National Mortgage Association (Fannie Mae) (now a private corporation), and the Federal Home Loan Banks. While GSEs are not backed by the full faith and credit of the Federal government, these entities are generally able to borrow at lower rates of interest than a private firm and have easy access to the capital markets.

The GSE approach might be used to insulate the Federal government from potential liability in the event of significant losses. However, the GSE model has not generally been used in the past for the type of transactions contemplated by Automatic IRAs.

Private sector approach

Under the private sector approach, the responsibility for administering an Automatic IRA program would be the responsibility of those private sector financial institutions that elect to be Automatic IRA service providers, subject to the general rules for IRA service providers. Thus, the Automatic IRA service providers would be responsible for

maintaining account information for each participant in an Automatic IRA and would be subject to periodic reporting requirements.

This approach would make it much more likely that an individual with high job mobility will lose track of the Automatic IRAs that have been established for him or her.

Further, under the purely private sector approach, there still would be a Federal government role in collecting information about Automatic IRAs for Federal tax compliance purposes. In addition, the purely private approach could present challenges in monitoring compliance with the Automatic IRA program as it would be more difficult to ensure that employers who withhold Automatic IRA contributions from employee pay actually remit the withheld amounts to a qualified Automatic IRA service provider.

The choice of model that is used to administer an Automatic IRA program may, in some respects, present a red herring issue with respect to the administration of Automatic IRAs. The reality is that the Federal government can limit the amount of taxpayer funding that is provided for Automatic IRAs under any approach that is used and can take steps to insulate itself from liability in the event there are significant losses to Automatic IRA assets. The Federal government has a clear Federal tax compliance role with respect to Automatic IRAs because of the tax benefits accorded to the accounts and the Federal government may be uniquely situated to ensure compliance with the Automatic IRA program requirements.

More important questions to be addressed include the type of recordkeeping and reporting that needs to take place to implement a workable Automatic IRA program (discussed in the next section) and the possible models for the flow of money under an Automatic IRA program (discussed in the following section).

B. Reporting and Recordkeeping for Automatic IRAs

A workable Automatic IRA system requires adequate reporting and recordkeeping by each of the stakeholders in the system, including employers, Automatic IRA service providers, and the central authority responsible for the overall administration of the Automatic IRA program. The discussion below outlines the types of recordkeeping and reporting that will be necessary to develop this workable system.

Employer reports and efforts with respect to employees

Employers will have the following responsibilities under an Automatic IRA program:

1) identify the employees who are eligible for Automatic IRAs;
2) choose whether to use an opt-in or opt-out arrangement;[8]
3) provide these employees with election forms to elect to participate or not to participate in Automatic IRAs and to elect the percent of compensation (or other accepted form of contribution such as set dollar amount) to be withheld from the

[8] See Appendix A for a description of the difference between an opt-in and opt-out arrangement.

employee's pay, to identify an Automatic IRA to which the employee's contributions will be remitted, and to elect the investment options for the Automatic IRA;[9] and
4) provide a notice to an employee who terminates employment and to notify the employee of his or her rights and responsibilities with respect to any Automatic IRAs created on behalf of the employee.

If employers are provided an option to select an Automatic IRA service provider, then each employer will need to make a decision whether to utilize this option and whether to permit employees to select their own Automatic IRA service provider.

Depending upon whether an employer adopts an Opt In or Opt Out arrangement, the employer will be required to exert particular levels of effort to secure Automatic IRA elections from employees. Employees should be given an annual election period to elect to participate in an Automatic IRA. One option to consider is whether the annual election should only apply to employees who are NOT participating in an Automatic IRA, which might maximize the number of employees participating in Automatic IRAs. On the other hand, such an approach would impose greater burdens on employers than an approach that provides annual notices to all eligible employees.

Employer reports to central recordkeeping authority

Employers will also need to provide information to the recordkeeping authority. Some of this information will ensure that the appropriate employees are being apprised of their right to participate in Automatic IRAs and some of the information will assist the central recordkeeping authority in keeping track of Automatic IRAs that have been established on behalf of particular employees. As we have noted previously, a key element to a low-cost Automatic IRA program will be ensuring that individual employees do not end up with multiple Automatic IRAs established on their behalf. This will present a particular challenge given the more mobile nature of the Automatic IRA workforce.

Thus, employers will need to provide the following information to the recordkeeping authority:
1) identify the employees who are eligible for Automatic IRAs;
2) the amount that will be withheld from an employee's pay and remitted to an Automatic IRA service provider for those employees who elect to participate in Automatic IRAs (or who fail to elect not to participate in the program);
3) where an employee's Automatic IRA contributions are remitted;
4) information concerning employees who elect out of the Automatic IRA program after participating for a period of time;
5) the names of employees who are newly hired and eligible to participate in an Automatic IRA and the names of employees who leave employment with an employer.

[9] It is assumed that a standardized election form would be developed by an administrative authority to assist employers.

Keeping track of individual employees and the location of the Automatic IRAs established on their behalf will be important because the employees who are likely to participate in Automatic IRAs will be less likely than the average employee to keep track of this information on their own.

Reports to employees

Employees will likely become more active participants in their retirement savings if they are kept informed about the status of their Automatic IRAs and encouraged to take an active role in the management of their accounts. However, the costs of administering an Automatic IRA program will be higher depending upon the frequency with which reports are provided to employees by IRA service providers. Thus, the Automatic IRA program needs to balance the competing interests of low costs to employees with adequate reporting of Automatic IRA account information.

Employees will need to receive the following information from their employers:

1) notice of eligibility to participate in an Automatic IRA, along with an election form and information that enables the employee to elect how much will be withheld from the employee's pay and remitted to an Automatic IRA, what Automatic IRAs are available to the employee, the options for investments of Automatic IRA assets, and the consequences of making no election; and
2) upon termination of employment, the options that are available to an employee with respect to his or her Automatic IRA account.

When an employee terminates employment, a number of options are available with respect to an individual's Automatic IRA. If the employee selected the Automatic IRA service provider or if the employee's contributions were deposited with a default Automatic IRA service provider, then at the time of termination, there is no specific action required. On the other hand, if the employee's Automatic IRA contributions have been deposited with an Automatic IRA service provider selected by the employer, then the employee should be given the option to transfer the assets to either an Automatic IRA selected by the employee or to the default Automatic IRA service provider. The primary question will be whether the default option will leave the Automatic IRA assets with the service provider selected by the employee's former employer or if the default option will transfer these assets to another Automatic IRA unless the employee specifically elects to keep the assets where they are.

In addition to the notices required to be provided by an employer, an employee will need to receive periodic reports from the Automatic IRA service provider. At a minimum, an employee should receive an annual statement of the contributions that have been made to an Automatic IRA on behalf of an employee, the earnings on the account assets, and the beginning of the year and end of the year account balances.

To the extent that the information can be provided at a relatively low cost to Automatic IRA participants, online access to account information that has been updated more frequently than annually would be a desirable feature of an Automatic IRA program, as

would be a call-in center to answer employee questions. The feasibility of these features will depend, in part, on the model that is selected for the flow of money under an Automatic IRA program, which is discussed in the next section of this paper. One advantage of more online access to more frequently updated information is that it offers an employee a way of ensuring that the employee's Automatic IRA contributions are being properly deposited.

It should be noted that the proper withholding and depositing of payroll taxes presents a compliance issue with respect to small businesses under Federal tax law. Small businesses are much more likely than large businesses to fail to properly remit payroll taxes under current law. Thus, there is a risk that amounts will be withheld from an employee's pay for Automatic IRAs, but that the amounts will not be properly deposited in the employee's Automatic IRA. Regular reporting to employees (that occurs more frequently than annually) offers an early opportunity to identify a failure by the employer to make Automatic IRA deposits. On the other hand, reporting more frequently than annually to employees can increase substantially the administrative costs of the system.

Alternatively, a central recordkeeping authority could perform this role on behalf of the Automatic IRA participants.

Reports by Automatic IRA service providers

Automatic IRA service providers will need to provide periodic reports (no less frequently than annually) to employees and to the recordkeeping authority with respect to contributions that have been made to Automatic IRAs on behalf of an employee, the earnings on the Automatic IRA account, and the beginning of the year and end of the year account balance in the Automatic IRA.

If an Automatic IRA program allows the designation of contributions as Roth IRAs and permits early withdrawals from the accounts, then basis in the accounts (i.e., contributions made to the accounts) must also be tracked.

In addition, reporting will be needed with respect to the transfer of funds from one Automatic IRA service provider to another.

C. *Flows of money*

In addition to the determination of how to track the necessary Automatic IRA account information, a key decision point for the Automatic IRA proposal is the flow of money that occurs when an employer withholds Automatic IRA contributions from an employee's compensation. There are a number of different models that could be utilized, each with its own pros and cons. These possible models are outlined below.

The key question to selecting the preferred model for the flow of Automatic IRA funds is whether the appropriate form of competition within the Automatic IRA market is competition for the customer or competition for the market. If one believes that

competition for the customer is the preferred approach, then a purely private model (see Model 4, below) would be appropriate.

However, competition for the market likely will provide a greater level of administrability for the Automatic IRA program and will help to keep overall costs of the system lower. Competition for the market suggests that a centralized authority that receives, at a minimum, default Automatic IRA contributions (i.e., those Automatic IRA contributions that have not been directed to a specific Automatic IRA service provider) will provide a more efficient system.

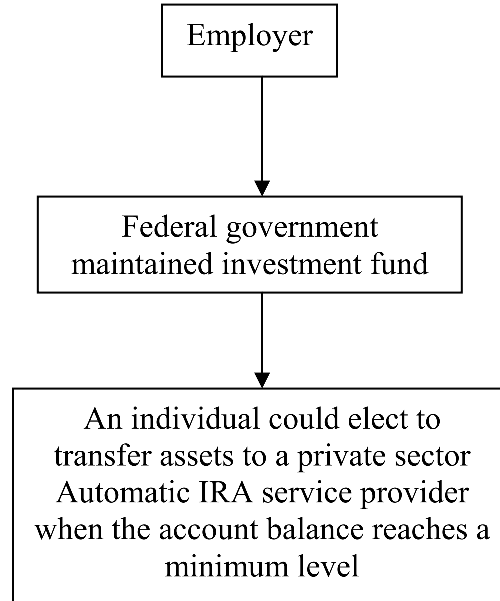
Employees in general have demonstrated a preference for fewer, rather than more, choices with respect to investment decisions and account options. Some studies have suggested that employees presented with too many choices tend not to make any choice. The Automatic IRA eligible workforce is likely to display this tendency to an even greater degree than the workforce in general. This suggests that Automatic IRA eligible employees will, at least initially, prefer the default Automatic IRA service provider rather than making a decision to select their own service provider.

New Zealand (with respect to their new Kiwisaver program) and the United Kingdom (with respect to their proposed automatic personal savings program) have both concluded that a flow of funds model based on competition for the market is the most effective and efficient system for implementing a new savings system. In addition, both of these models utilize a centralized authority that collects all contributions, handles inquiries from employers, keeps records with respect to contributions, and makes sure that contributions are invested properly. Model 2 (the Federal intermediary model discussed below) is most consistent with the New Zealand and United Kingdom approaches. The United Kingdom proposal contemplates that much of the centralized authority's duties would be outsourced to the private sector, suggesting a strong public-private partnership would be utilized.

Model 1 – the Federal model

Under this model, the amounts withheld from employee's compensation are remitted directly to the Federal government. Assets would be pooled for investment and no private accounts would be established until an individual's account balance reaches a minimum level.

Flow of funds – Federal government model



In essence, the Federal government would become the first-line Automatic IRA service provider and would invest the money received from employers (or separately from self-employed individuals and others eligible to participate in the Automatic IRA program). There were be two possible options for the investment of funds – all money could be invested solely in Treasury bonds or the Federal government could set up a balanced mix of investment options such as those provided for Federal employees under the Federal Thrift Savings Plan.

Once an individual's interest in the fund reaches a specified minimum level (e.g., $1,000), the amounts could be transferred, at the individual's option, to a private Automatic IRA service provider. Another option could be to require that an individual's assets be transferred to a private sector Automatic IRA service provider when the assets reach a second higher level (such as $15,000).

Pros

This approach could present the lowest cost alternative for Automatic IRAs by utilizing the pooling of a large number of small individual contributions with a single service provider.

If the Federal government selects the possible investment options for the investment of Automatic IRA assets, it is possible that returns to individuals will be greater than they would be if an individual had invested his or her Automatic IRA assets in a separate account.

By allowing individuals to transfer their funds to a private sector Automatic IRA service provider when their account balance reaches a minimum level, the possibility of private sector participation in the Automatic IRA market is retained.

Cons

Under this approach, the participation of private sector IRA service providers would be minimized. Reducing or eliminating competition for Automatic IRA products could create disruptions in the market for existing IRAs as some individuals who currently invest in IRAs might shift their investments to the government-sponsored entity. In addition, the private sector IRA service provider market would likely not support an option that limits the opportunities for private sector participation.

One of the concerns about Automatic IRAs is that they may eliminate the incentive for an employer (particularly a small employer) to establish or maintain a qualified pension plan. This problem could be exacerbated if the Federal government's role in Automatic IRAs is too pronounced. This model would eliminate the potential interaction of employers with private sector service providers who might convince an employer to establish a qualified plan in lieu of complying with the Automatic IRA requirements.

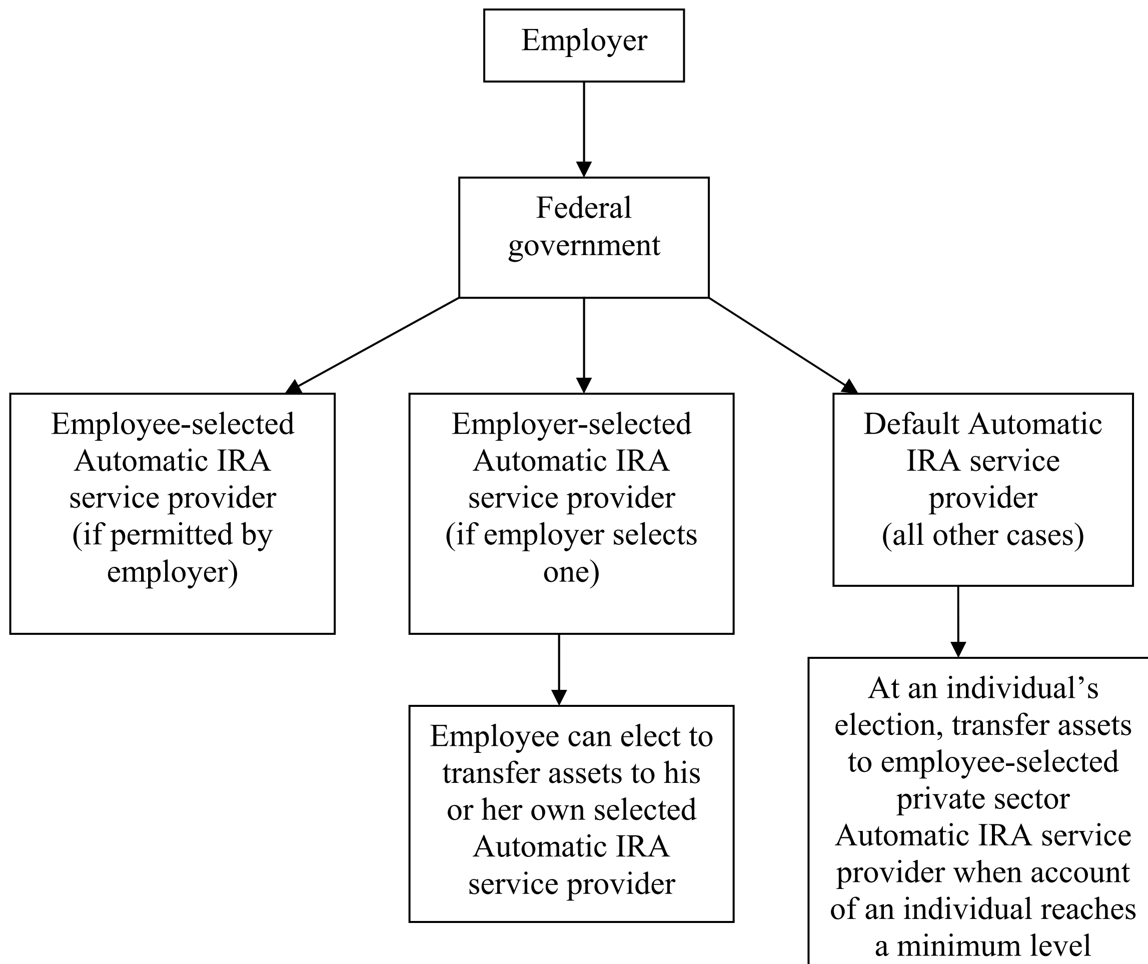
The use of the Federal government as the Automatic IRA service provider might lead individuals to believe mistakenly that their investments are (1) safer than they might otherwise be or (2) more likely to be guaranteed by the Federal government. If assets are invested only in Treasury bonds, then the investments indeed will be quite safe, but the rate of return on them will be much lower than individuals could receive with a more balanced portfolio of investments. Furthermore, just as with the Federal Thrift Savings Plan, asset losses would not be guaranteed by the Federal government. Moreover, the public is increasingly skeptical about government run enterprises

Model 2 – the Federal government intermediary model

Under the second possible model, all Automatic IRA contributions withheld by an employer would be transmitted to the Federal government. The amounts would then be allocated to the private sector Automatic IRA service provider selected by an employee or employer or, if no such service provider has been selected, to a default Automatic IRA service provider.

The Federal government would select those private sector Automatic IRA service providers to be default Automatic IRA service providers. The default service providers would not be required to maintain individual accounts for each participant; rather, the Federal government would transmit to each default Automatic IRA service provider its allocated share of default Automatic IRA contributions, which would be invested in a collective investment vehicle on behalf of the Automatic IRA participants assigned to that provider. The Federal government would maintain the individual account information for each Automatic IRA participant and the default Automatic IRA service provider would have no responsibility for recordkeeping with respect to the individual accounts. New Zealand will utilize this type of approach with respect to their new KiwiSaver program.

Flow of funds – Federal government intermediary model



Pros

One of the major issues with respect to Automatic IRAs is whether there would be sufficient private sector interest in the relatively small dollar amounts that might be contributed to the accounts by relatively low wage employees. This model solves this problem by utilizing the pooling of assets to create economies of scale, while still leaving all Automatic IRA dollars invested with private sector Automatic IRA service providers. Presumably IRA service providers would be much more interested in the Automatic IRA market if they can be assured that they will get more than de minimis amounts of contributions. Thus, this model has the advantage of providing immediate private sector participation in the Automatic IRA market, thereby improving competition for Automatic IRA dollars.

The model also retains the option for private sector Automatic IRA service providers to compete for individual accounts selected by employees or by employers. Thus, under

this model, the private sector Automatic IRA service providers (1) would compete for those Automatic IRA contributions that would be most lucrative and (2) could have an interest in the fairly large default investments in Automatic IRAs that are likely to occur.

This model provides the potential to keep Automatic IRA costs relatively low. First, the recordkeeping necessary for a workable Automatic IRA system would be facilitated by flowing all dollars through the Federal government, creating an immediate record of where each individual employee's money is going. Second, the pooling of assets for the default Automatic IRA fund will help to lower the costs attributable to small Automatic IRA contributions.

Cons

The potential private sector Automatic IRA service provider market may object to the Federal government selecting those service providers eligible to receive default Automatic IRA assets. By so doing, the Federal government will interfere with the operation of the Automatic IRA market, making it more difficult for smaller Automatic IRA service providers to compete for Automatic IRA dollars.

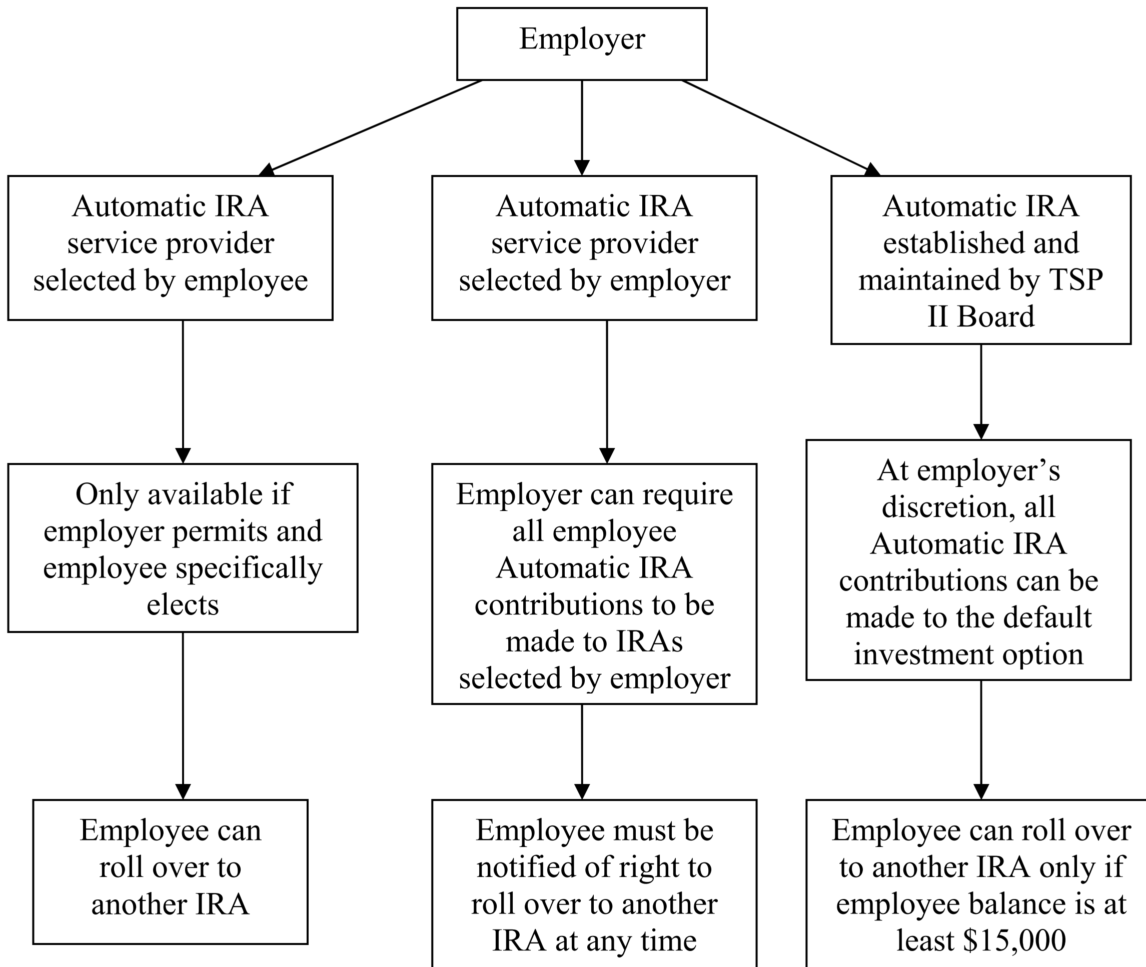
Model 3 – the TSPII model (as contained in S. 1141 and HR 2167)

Under the introduced bills, a TSP II model is used. Under this model, the options for IRAs to which employee contributions will be made include the following: (1) an Automatic IRA selected by the employee (but only if the employer permits this option); (2) an Automatic IRA selected by the employer; or (3) an Automatic IRA established and maintained by the TSP II Board, similar to the accounts maintained by the TSP Board for the Federal Thrift Savings Plan for Federal employees.

In the case of contributions to an IRA selected by the employee or the employer, the amounts contributed to the IRA can be transferred, without penalty, to another IRA selected by the employee. The employee must be given notice of the right to transfer the balance in the employee's IRA to another IRA established by the employee without cost or penalty.

In the case of contributions to an IRA established and maintained by the TSP II Board, the employee can only make a rollover to another IRA if the balance in the employee's IRA is at least $15,000.

Flow of funds – TSP II Model



Pros

The TSP II model offers maximum flexibility to employers and to employees by permitting contributions to an Automatic IRA service provider selected by either the employer or employee, while still maintaining the backstop protection of the default investment program offered by TSP II.

Cons

The TSP II model increases the recordkeeping and reporting requirements needed to keep track of Automatic IRA contributions and account balances.

If an individual has contributions made to multiple Automatic IRAs established on the individual's behalf, it is more likely that the individual will lose track of one or more of

the accounts. By flowing money directly from an employer to an Automatic IRA service provider, the TSP II model may increase the likelihood of this result occurring.

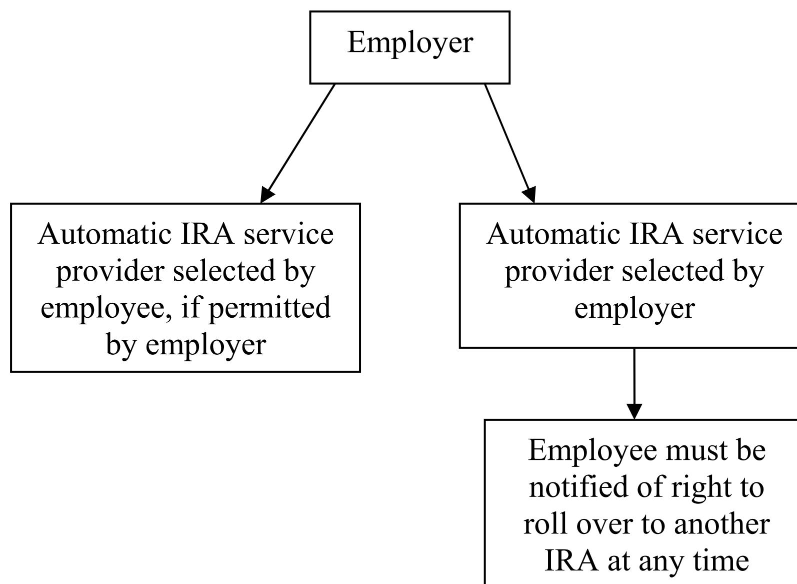
The TSP II model makes it more difficult for the Federal government to guarantee that amounts that employers have withheld from employee compensation have, in fact, been deposited in the proper Automatic IRA. This has the potential of increasing the costs of compliance.

Model 4 – the purely private model

Under the final possible model, Automatic IRAs would be available only through private sector Automatic IRA service providers. Employees would be entitled to select an Automatic IRA service provider or employers could select an Automatic IRA service provider for all of its employees' accounts. If an employer-selected service provider was utilized, an employee would be given the right to transfer their assets to an Automatic IRA service provider that he or she selects without penalty. Employers would be required to select an Automatic IRA service provider that would be used if an employee fails to elect a service provider.

Under this model, employers and Automatic IRA service providers would be required to provide detailed reporting and recordkeeping information to the Federal government.

Flow of funds – purely private model



Pros

The purely private model minimizes the role of the Federal government and allows the private markets to work with minimal intervention.

Cons

It is unclear whether there will be sufficient interest among existing IRA service providers for the types of small dollar contributions that could occur regularly with Automatic IRAs. Without some default investment option to overcome this problem, small employers may have difficulty finding service providers willing to accept their Automatic IRA business.

The purely private Automatic IRA approach requires employers to select an Automatic IRA service provider that will be the default if an employee fails to select his or her own Automatic IRA service provider.

The purely private model would increase significantly the difficulty with respect to the reporting, recordkeeping, and compliance of Automatic IRAs.

SECTION 5 – COSTS OF AUTOMATIC IRAS

A. Costs Attributable to Automatic IRAs

The costs of implementing and running an Automatic IRA program will be a key component of the success or failure of the program. Because the average account size under an Automatic IRA program will be smaller than the average account size under an employer-sponsored retirement plan, the costs must be kept low enough to make the accounts feasible.

Estimating the costs of implementing and running an Automatic IRA program depends heavily on certain variables. The overall costs of Automatic IRAs will depend heavily both on design considerations and on the operational model that is chosen to implement the program. Certain variables may influence overall participation while others may influence the way the accounts are marketed or administered. One general rule applies – the cost of administering and processing the accounts will be lower with a more simplified and streamlined design. The design and policy decisions include many choices in account design and enrollment options, account management, and customer services.

Without knowing the full extent to which employers, employees, and private sector IRA service providers will embrace the Automatic IRA concept, it is difficult to estimate with certainty the costs of such a program. However, it is possible to evaluate the different cost drivers that will impact the Automatic IRA program and draw certain conclusions about the relative costs that may be incurred.

These costs could be borne by the Federal government, by employers who are required to make Automatic IRAs available to their employees, and by employees who participate in the Automatic IRA program. It is assumed that private sector service providers generally will pass their costs on to account holders unless constraints are imposed on their ability to pass costs through. Because the viability of an Automatic IRA program could hinge on the administrative costs that may be borne by individuals who participate in the program, much of our analysis below relates to the potential effects of administrative costs on these accounts.

Federal government costs

The potential costs to the Federal government will include both the revenue costs of the proposal and the potential outlays required to implement and administer the program. In our previous paper, we estimated that the revenue costs of Automatic IRAs could range from \$5 to \$10 billion over ten years.[10] These revenue costs will include the tax benefits

[10] Schmitt, Mary M. and Judy Xanthopoulos. *Automatic IRAs: Are They Administratively Feasible, What Are the Costs to Employers and the Federal Government, and Will They Increase Retirement Savings?* A Preliminary Report Prepared for AARP, March 8, 2007.

directly attributable to Automatic IRAs, the costs attributable to greater utilization of the Saver's Credit, and the costs of the tax credit provided to small employers to help offset their costs of complying with the Automatic IRA requirements.

In addition to the revenue losses to the Federal government under the Automatic IRA proposal, there are potential outlay effects that may be incurred as well. These outlays may include startup costs, as well as ongoing expenses related to the administration of the program. The level of Federal outlays will depend on the extent to which Automatic IRA participants are expected to shoulder the full costs attributable to the accounts, both on a startup and ongoing basis.

Employer costs

Employers will face a variety of costs in implementing an Automatic IRA proposal. These costs could include the costs attributable to (1) identifying the employees who are required to be offered Automatic IRAs, (2) providing election forms and processing paperwork with respect to employee elections or nonelections, (3) certain employee choices that are provided under Automatic IRAs, such as the choice of IRA service provider and the level of contributions, (4) determining the appropriate amount of employee contributions to Automatic IRAs and withholding such payments from employee's pay, and (5) identifying whether any employee has exceeded applicable limits on contributions.

For small employers who do not maintain a retirement plan, the task of identifying eligible employees may not be too burdensome. However, the proposed Automatic IRA legislation identifies seven classes of employees who can be excluded from Automatic IRA eligibility, so each employer will at least be required to evaluate whether any particular employee is excludable. Employers can avoid this requirement by making Automatic IRAs available to any employee who is not participating in an employer-sponsored retirement plan. While this approach would reduce the costs of identifying eligible employees, it could also increase the costs to employers of processing employee elections and withholding contributions from pay.

Providing election forms to eligible employees and processing the paperwork related to employee elections entails costs to employers. Because it is contemplated that the Form W-4 could be used to secure employee elections, these costs may be minimal for many employers. The level of employer effort to secure elections from each employee will depend upon whether the employer selects an "opt-in" or "opt-out" Automatic IRA arrangement; the "opt-out" arrangement requires less employer effort and, therefore, should be a lower cost option.

The frequency of remittance of withheld Automatic IRA contributions will also affect employer costs. To the extent Automatic IRA contributions are remitted with payroll tax amounts withheld, the employer's costs will be lower. Under the introduced Automatic IRA bills, default Automatic IRA contributions are remitted with an employer's payroll tax withholdings, but amounts that are contributed with an IRA service provider

designated by an employee or selected by an employer are separately remitted directly to the service provider.

Individuals familiar with the administration of employer-sponsored retirement plans have told us that employer costs will be higher if certain features are incorporated in an Automatic IRA program. For example, if the employer permits employees to select their own IRA service provider, the costs of processing employee contributions will be higher. There are also potential costs attributable to the level of contributions that can be made to Automatic IRAs. Under the proposal, the default contribution level is three percent of compensation. Some individuals noted that employers with an hourly workforce may have more difficulty with a percentage of pay contribution formula. This occurs because an employee's hours worked may vary from pay period to pay period, requiring separate calculations of the appropriate contribution amount for each employee each pay period. In addition, a number of individuals noted that an Automatic IRA program that includes an automatic escalator in the level of employee contributions will increase the burden on employers because the level of contribution for each employee must be calculated separately. Larger employers using computerized payroll processing could handle this quite easily; small employers doing payroll processing by hand may have more difficulty with this requirement.

Finally, there will be costs if the employer is required to make a determination of when any applicable limits on Automatic IRA contributions have been reached by an employee.

The level of costs for any specific employer will vary depending upon the size of the employer, whether the employer utilizes electronic payroll processing, the size of the employer's workforce, whether the employer maintains any qualified retirement plans, and the particular features of Automatic IRAs that the employer elects to use (e.g., whether the employer permits employees to select their own IRA service provider). Given the potential variability of these costs, we have not attempted to quantify them at this time, but have focused instead on the potential administrative costs to employees.

The Automatic IRA proposal offers a small employer tax credit to help offset the costs to employers of complying with the Automatic IRA program. The credit is only available for the first two years that an employer with no more than 100 employees maintains an Automatic IRA program. The credit is limited to the lesser of $25 times the number of employees for whom contributions are made or $250.

Automatic IRA participant costs

Overview of cost considerations for Automatic IRA participants – The costs that Automatic IRA participants may face will determine whether Automatic IRAs present a viable option for retirement savings for the millions of American without employer retirement plan coverage. The factors that drive these costs relate to account design, the availability of choices to Automatic IRA participants, and the operational and customer service costs of the account.

Account design and enrollment – Many of the variables that will influence the cost of the Automatic IRA program are design issues that must be determined before the program could be administered. As these design issues become more streamlined, the Automatic IRA program will become easier and less costly to administer.

One important program design issue is enrollment. The current version of the bill envisions that enrollment is available to all eligible employees.[11] This means that all eligible employees would be required to opt-in or opt-out of the program. Estimates suggest that the current provisions of the proposal could require automatic enrollment for approximately 48 million eligible workers.[12]

Certain variables influencing account design will influence the cost to the processing agency. One such account design issue includes whether or not the employee may choose (or employer may offer choice) between a Roth and traditional IRA. In many respects, this appears to be an almost trivial distinction. However, in practice, offering choice between the two types of IRAs could pose significant administrative costs. In the short run, the most important distinction is the tax deduction that is available with the traditional IRA. In order to take advantage of the available tax deduction, participants would have to understand the current law rules for eligibility, any income limits that might apply, and rules limiting contributions. Further with Roth IRAs, the account holder and administering agency must maintain records on basis for tax purposes in the event that the Automatic IRA account holder is permitted to take a distribution that is taxable, such as certain early withdrawals from the account.[13]

The private sector representatives of plan administrators with whom we have spoken state that offering employees the choice between Roth and traditional IRAs adds complexity to the recordkeeping for Automatic IRAs, which will result in increased costs.[14] From a cost saving perspective, it would be better to identify Automatic IRAs as either Roth or traditional, but not to permit employees (or employers) to choose the character of the accounts.

The deferral design (fixed percentage) and the flexibility in that design (allowing either employer or employee discretion to change the percentage) will influence the annual contribution amounts. These contributions will determine how quickly (slowly) the participant will accumulate assets. This influences the aggregate asset accumulation, but it will also influence the individual's desire to remain in the program and could impact program costs.

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[11] One alternative is to offer Automatic IRAs to new employees only.

[12] See Automatic IRA Report for AARP, by the authors.

[13] Under current law, certain Roth IRA distributions are includible in income. The amount includible equals the account balance minus the contributions made to the account. Thus, under current law, an individual's basis in the Roth IRA account must be calculated.

[14] It should be noted that the choice between Roth and traditional IRAs also adds complexity for the individual employees eligible to participate in Automatic IRAs as many employees will not be capable of evaluating the tax benefits with respect to each type of account.

Account management **–** After completing enrollment into the Automatic IRA program, assuming a viable framework for account design and enrollment variables, there are many factors that will continue to influence the cost of the program. As employees contribute to the account and the assets begin to accumulate, policymakers must decide the available options for managing assets.

The first important management issue to consider is the number of investment options available to the participants. The number of investment options may be influenced by the choice of delivery model that is selected.

For example, in a purely public centralized administration of accounts, it is possible that only a limited number of investment options might be available. These options might include a life-cycle investment vehicle or other indexed funds. For example, the TSP offers a fixed number of funds from which the participants may choose.

On the other hand, in a purely private decentralized administration, in which many private financial institutions manage the accounts, it is possible to have a wide variety of investment options. In this case, policymakers must decide who should make the investment decision.[15] In other words, should the employer make the decision on behalf of the employees? Should the employee be responsible for finding the financial institution with certain investment options for their contributions? Should the Federal government determine a default investment option or several investment options from which the employer or employee must choose?

In general, the greater the number of investment options, the greater the costs to administer the accounts irrespective of the delivery model chosen. The contributions must get to the various financial centers on a timely basis and find their way to the appropriate investment.

Another important issue is the timing of the contributions. The timing of contributions affects the overall costs of the system and account earnings. Requiring deposit of employee contributions quickly will increase the earnings credited to employee's accounts, but could also increase the overall costs of the system.[16]

Once these investments are registered with the Automatic IRA service provider, what happens with respect to the investment allocation of the assets must also be considered. For instance, it must be determined who may make changes to the investment types and allocations and how frequently changes are permitted. As the number of parties eligible to make changes to the investment allocation increases, the cost will also increase. The

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[15] An additional consideration is the appropriate investments. For the purposes of this analysis, it is assumed that eligible investments for Automatic IRAs would conform to those available to traditional and Roth IRAs.

[16] Currently, the Social Security Administration can have time lags from seven to 18 months for crediting employment taxes to the individual's employment record. Since automatic IRAs will rely at least in part on the payroll and withholding system, this could potentially present an additional problem, reducing the accumulated earnings in the individual's account.

greatest potential for a large volume of transactions exists if all automatic IRA participants are able to make changes to their investment allocation at will.[17]

In addition to account access for investment purposes, it is important to consider access to the funds for certain pre-retirement withdrawals from the accounts. Generally, allowing access to the funds before retirement (irrespective of whether they are subject to penalty or penalty-free withdrawals) will increase transaction costs as the service providers will have processing costs for these withdrawals.[18]

Adhering to the goal of design simplicity, it follows that eliminating the additional transactions for early withdrawals will keep costs low. In the case of traditional and Roth IRAs, current law permits both special purpose penalty-free withdrawals and pre-retirement withdrawals subject to taxes and penalty. Therefore, from a policy perspective, it may prove difficult to deny access to these funds, despite the potential for cost savings.

Customer services – Related to account management is the level of services that are made available to each participant. Such considerations as the frequency of reporting to both the Federal government and the individual participants present significant cost considerations. The greater the frequency in reporting, the greater the overall cost to the system. In addition to the frequency, the form of the reporting, paper statements versus electronic statements, will also influence the cost. Paper statements pose the greatest costs compared to electronic statements; we have been advised by one plan administrator that paper statements cost $2 per participant per statement. Thus, quarterly paper statements to Automatic IRA participants would cost approximately $8, as opposed to $2 for an annual statement.

Electronic reporting would reduce these costs. However, it is important to recognize that Internet access is not universally available and many participants may not have the capability to receive electronic statements.

In addition to Automatic IRA participant statements, customer services must also be provided to these individual. These customer services might include phone services or call centers. These call centers would provide account information and address any participant questions. However, they would require adequate staffing as well as access to updated computerized records. As with statement reporting, call centers would also increase the overall cost of the administering the accounts.

An alternative to call centers is online services. Many qualified plans, including the TSP, offer secure online access to defined contribution accounts. The participant may perform such tasks as managing their investment allocation or changing the deferral rates. The online services would reduce costs compared to phone centers, but consideration must be given to the availability of Internet access.

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[17] Participants in the TSP may make changes online to their investment allocation at any time throughout the year.

[18] It should be noted that restricting access to Automatic IRA funds could reduce the willingness of employees to participate in the Automatic IRA program.

One final factor that will influence the cost is distributing marketing information and educational information about the automatic IRA account. For instance, in a purely private setting, the cost of the accounts may increase as marketing costs increase.[19]

Further, in addition to marketing information, in both public and private settings, policymakers must decide who bears the responsibility of educating the participants and the requirements of any educational efforts. As with marketing costs, as the educational requirements increase, so will the overall costs of administering the system.

Once the policy decisions are made regarding the design of the Automatic IRA program, the administration and processing framework must be determined. In the next section, we discuss the variables most likely to influence the cost of the program. In addition, we present estimates of two models of administration – the purely public and purely private models to help identify possible outside estimates of the costs of Automatic IRAs.

B. *Estimating the Costs of Two Possible Models for Administering Automatic IRAs*

As described in the previous sections, there are a variety of possible models for administering and processing Automatic IRAs. Associated with these possible models is a continuum of costs depending upon the various policy decisions implemented. This section presents estimates of the cost of administering Automatic IRAs through either a purely public or purely private model. We have chosen these models in an attempt to identify the outer bounds of possible approaches to Automatic IRAs. Presumably, models within the range of these two approaches would have costs similarly within the range.

Each section estimates these costs using alternate estimates of participation and annual contribution amounts to demonstrate the sensitivity of these assumptions. Further, for each alternate set of assumptions, the estimates consider variations in account management services as well as customer services. These estimates consider the impact on the aggregate savings in Automatic IRAs as well as the impact on the individual's account.

[19] On the other hand, the marketing of Automatic IRA accounts may play a significant role in the success or failure of the effort to enroll employees in the accounts.

Participation and Contributions Assumptions –

Participation – Estimating likely participation in Automatic IRAs presents certain challenges, because the eligible population is not covered currently under an employer-sponsored plan and is unlikely to save privately for retirement. Early evidence of overall participation rates for automatic enrollment in 401(k) plans shows some promising patterns of increased savings behavior. However, it offers little more than select plan information or surveys of a small subset of employers. Further, it is premature to obtain time series evidence of participation patterns in automatic enrollment 401(k) plans over time.

In order to estimate the likely participation in Automatic IRAs, the estimate relies on empirical evidence from the Federal Thrift Savings Plan (TSP) program. The TSP evidence provides approximately 20 years of experience and demonstrates a pattern that is likely to emerge with Automatic IRAs. Specifically, in the early years participation was 16 percent of eligible employees and grew to 25 percent in the fifth year.[20] Participation rates continued with a steady, almost systematic increase until they reached 40 percent participation in 2005 (the 19th year).

Characteristically, TSP participants are likely to differ somewhat from Automatic IRA participants.[21] Generally, Automatic IRA participants are likely to have lower participation rates than those observed in the TSP. For the purposes of these estimates, we assume two patterns of participation, low (60 percent) and moderate (80 percent) of the historical evidence for similar plans. These are referred to below as the low participation rate and the moderate percent participation rate.

Based on the various options for account design and enrollment, the estimate assumes that participation rates may vary with the above mentioned design issues. For instance, the more streamlined a system, which offers fewer options, the more likely that participation would increase. For instance, if employers implement the automatic IRA program exclusively as an 'opt-out' system, offering one type of IRA with simpler contribution rules (e.g. low fixed percent of pay), it is likely that a larger proportion of eligible workers will participate in automatic IRAs.

On the other hand, if employers implement the automatic IRA program exclusively as an 'opt-in' system, offering choice between traditional and Roth IRAs, as well as elections with respect to contribution amounts, it is likely that a much smaller proportion of eligible workers will participate in automatic IRAs.

Contribution assumptions – Since workers participating in Automatic IRAs are likely to be lower income workers, annual account contributions are likely to be somewhat lower than contribution amounts observed in current law IRA contributions. Recently, when the annual contribution limits for traditional and Roth IRAs were $3,000, the average

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[20] See EBRI, Federal Public Pension Plan Participants, Tables 18.1a & b, updated in January, 2007.

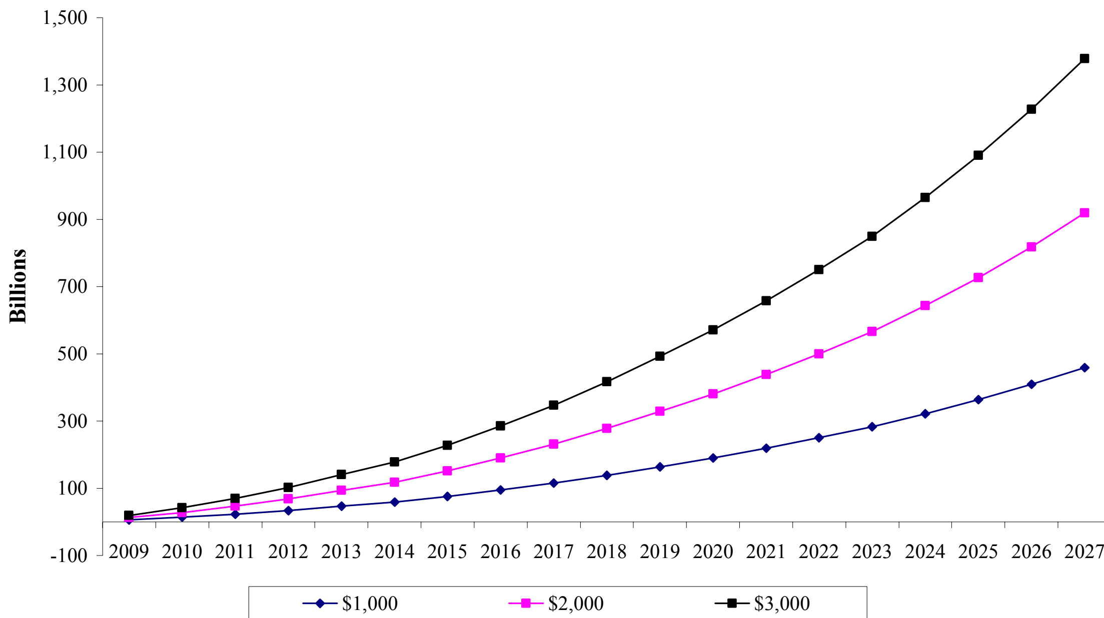
[21] In general, the estimate assumes that Automatic IRA savers are likely to be younger, lower income, and currently not saving for retirement.

annual contribution amount was approximately $2,400. However, for lower income taxpayers, the average annual contribution amount ranged between $1,300 and $1,800.[22]

Since the annual contribution limit for traditional and Roth IRAs will increase to $5,000 in 2008, the estimates rely on three average annual contribution amounts $1,000, $2,000 and $3,000.

***Impact on aggregate account accumulations* –** Graphs 1 and 2 display the impact on asset accumulation for three contribution amounts as well as for both assumptions on participation. Graph 1 (assuming a moderate participation rate) shows that in the early years, the aggregate assets remain relatively flat. However, within ten years and assuming a $3,000 average annual contribution and four percent rate of return, Automatic IRA asset accumulations reach $500 billion and within twenty years, the accumulated assets reach approximately $1.4 trillion. Even with a $1,000 average annual contribution, assets could exceed $300 billion after 20 years.

Graph 1 Estimated Aggregate Assets, at Various Average Annual Contribution Amounts
(Estimate assumes moderate participation)



Graph 2 shows the anticipated asset accumulation for a lower rate of participation. As in the first example, in the early years, the aggregate assets remain relatively flat. However, within ten years and a $3,000 average annual contribution and four percent rate of return,

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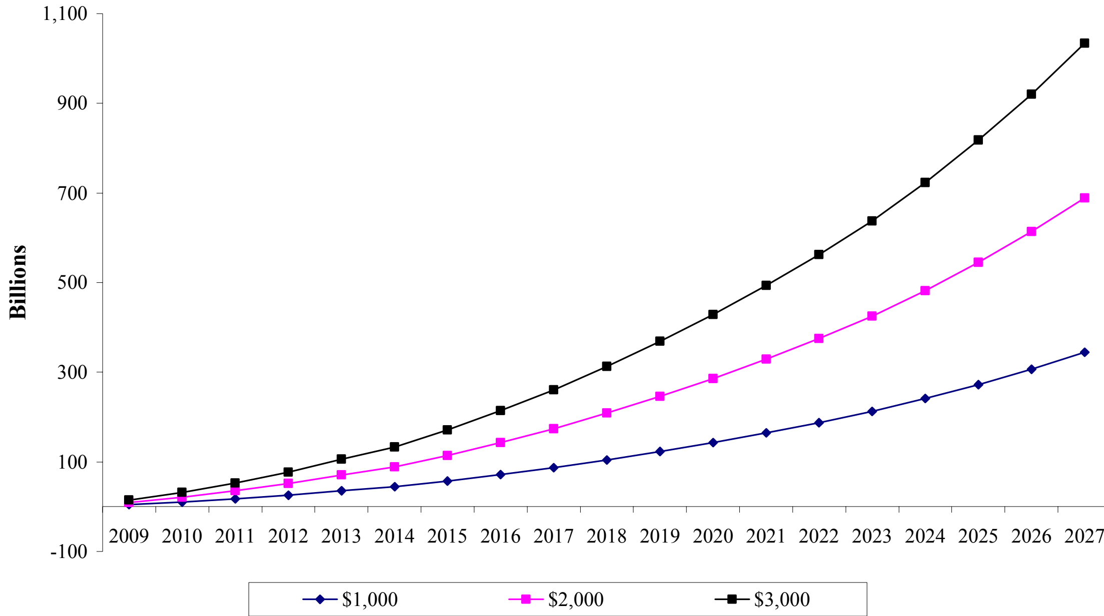
[22] Average contributions amounts are from "Accumulation and Distribution of Individual Retirement Arrangements, 2001-2002," Internal Revenue Service, Statistics of Income Division, by Victoria L. Bryant and Peter J. Sailer.

Automatic IRA asset accumulation could reach $300 billion and within twenty years, the accumulations could exceed $1.0 trillion.

Graph 2 Estimated Aggregate Assets, at Various Average Annual Contribution Amounts
(Estimate assumes lower participation)



Based on these two alternate scenarios for participation and with the various average annual contribution amounts, it is possible to estimate the ongoing costs (or gross revenues) of the automatic IRA system.

Purely public central authority to administer Automatic IRAs – Creating a purely public entity to administer the Automatic IRA would most likely involve both an initial outlay and possibly an ongoing outlay to fund the operations until the accumulated assets could generate adequate income.

Initial outlays – The Federal government appropriated approximately $500 million in 1986 to start the TSP program. This amount was necessary to create the physical entity, develop computer systems, and hire staff to operate the system. GAO estimated that in 1999 dollars, that amount would grow to approximately $1 billion.[23] Estimates suggest that, unless some data and resource sharing arrangements were possible, this amount is likely to exceed $1.4 billion in 2009.

Ongoing outlays and operational costs to Automatic IRA participants – Currently, the TSP operates on a budget of approximately $90 million. The TSP generates income from two sources, forfeited agency matching amounts and a fee assessed as a flat percent of assets. In 2006, forfeitures under the TSP equaled approximately $16 million and in

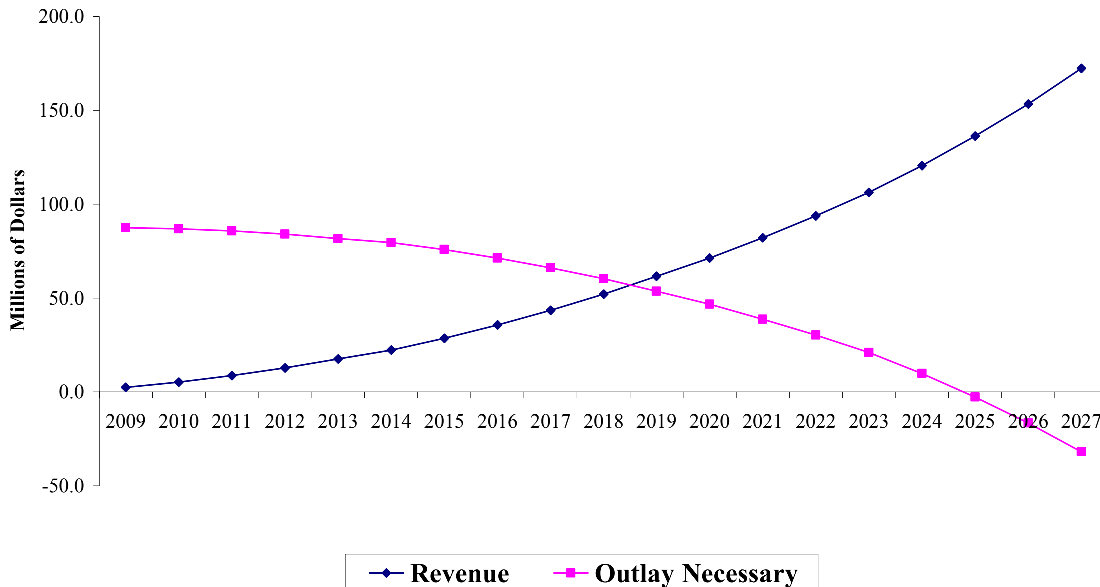
[23] GAO/HEHS-00-131, June 1999.

2005, these amounts were approximately $13.4 million. Forfeitures will not be available to help offset costs in an automatic IRA program because the accounts generally have an identified owner at the time of the first contribution and amounts are non-forfeitable. There is some possibility of so-called "orphan" accounts in an Automatic IRA program, but these amounts would likely be much smaller than the forfeitures that occur under the TSP. In addition, state law may govern the disbursement of these accounts and the amounts may not be available to help reduce overall costs of the program.

The second source of funding for administrative costs, a flat percent of assets, charged by the TSP is currently 0.05 percent (five-one hundredths of a percent). This rate is one of the lowest administrative charges of any program. In an ideal world, a new public entity would strive to achieve this level of efficiency over time. However, it is likely to take many years before the efficiency and asset accumulation could generate adequate revenues at this low fixed rate.

Graphs 3, 4, and 5 assume that participation in automatic IRAs is at the lower participation rate and assume that contributions average $1,000, $2,000, and $3,000 respectively. Graph 3 shows that with a 0.05 percent of assets administrative charge, the public entity would become self-funding in approximately 18 years.

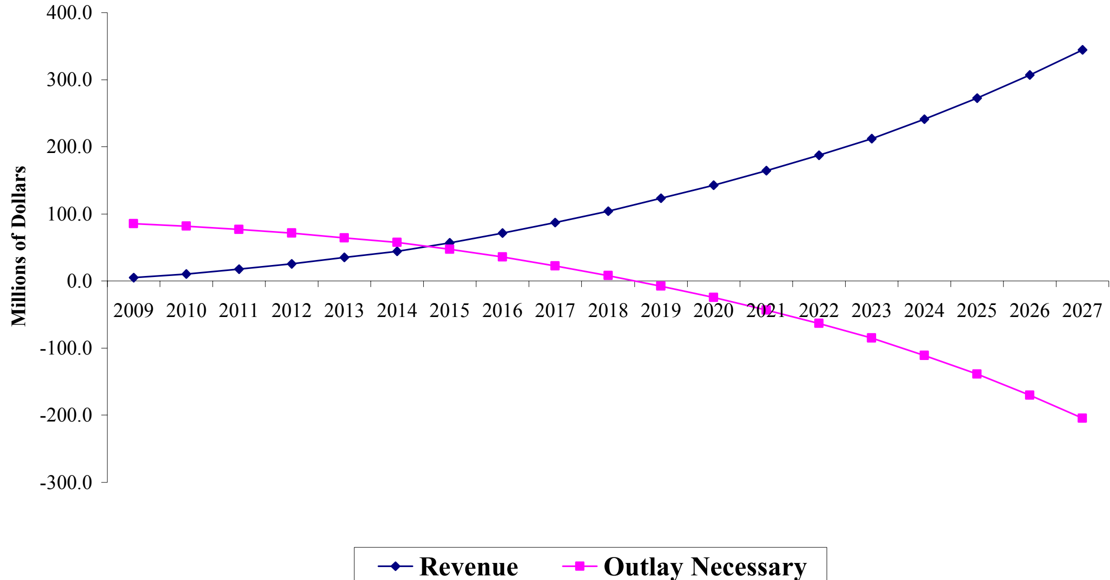
Estimates indicate that the public entity would need to charge a fixed rate of 1.5 percent to become immediately self-funding (assuming lower participation rate and $1,000 average annual contributions). This rate would be reduced in four years to approximately 0.5 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2027. While this approach would make the public entity self-funding immediately, it would impose a significant burden on the earliest participants. It is also important to note that achieving this low rate depends heavily on the accumulated asset base. If participation or contributions decrease over time, the rate would be considerably higher.



Graph 4 shows that with higher average contributions ($2,000) and with a 0.05 percent of assets charge, the public entity would become self-funding in approximately twelve years.

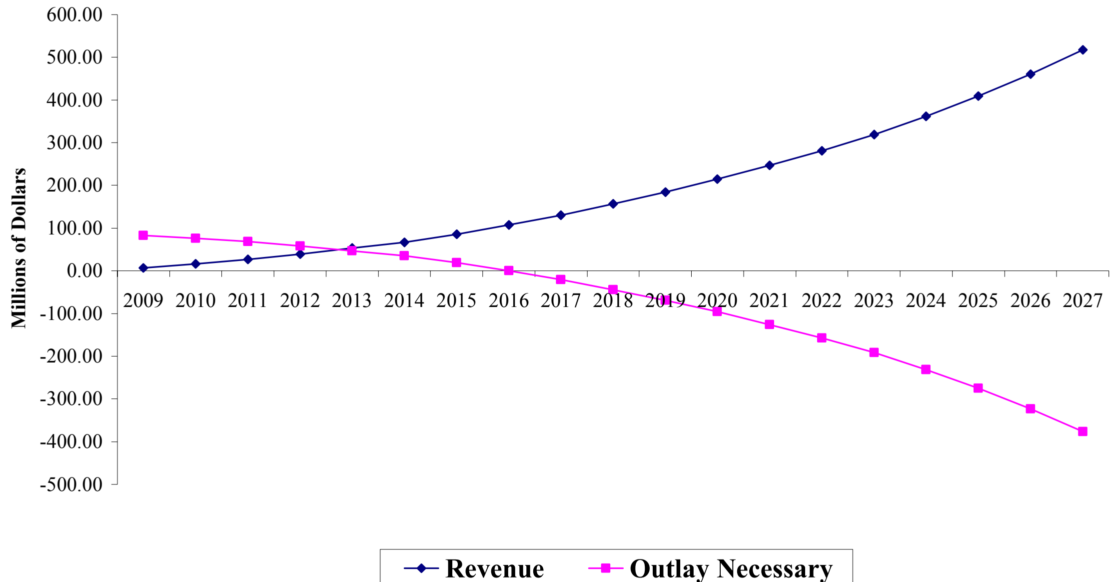
Estimates indicate that the public entity would need to charge a fixed rate of 0.75 percent to become immediately self-funding (assuming lower participation rate and $2,000 average annual contributions). This rate would be reduced in two years to approximately 0.23 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2027. While this approach would make the public entity self-funding immediately, it would also impose a significant burden on the earliest participants. As mentioned, achieving this low rate depends heavily upon the assumptions made for participation and contributions.

Graph 4 Estimated Revenues and Outlays Necessary to Fund from Automatic IRAs Operations, Public Entity
(Assumes lower participation; 0.05 percent administrative charge; and $2,000 Average Annual Contribution)



Graph 5 shows that with higher average contributions ($3,000) and with a 0.05 percent of assets the public entity would become self-funding in approximately ten years.

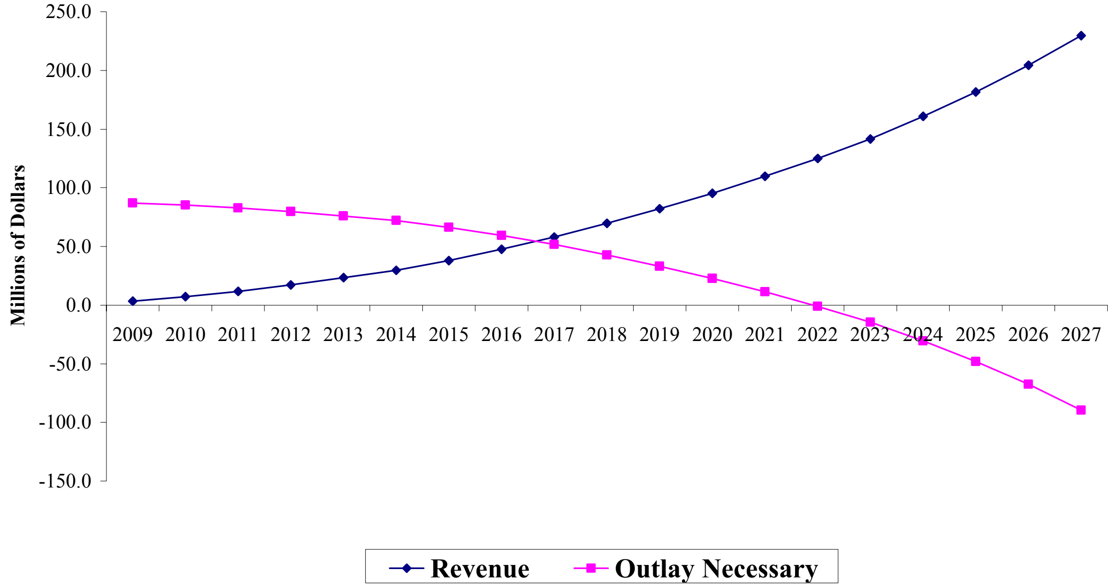
Estimates indicate that the public entity would need to charge a fixed rate of 0.45 percent to become immediately self-funding (assuming lower participation rate and $3,000 average annual contributions). This rate would be reduced in two years to approximately 0.21 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2023. As mentioned, achieving this low rate depends heavily upon the assumptions made for participation and contributions.



Graphs 6, 7, and 8 assume that participation in automatic IRAs is at the moderate assumed participation rate and assume that contributions average $1,000, $2,000, and $3,000 respectively. Graph 6 shows that with a 0.05 percent of assets charge, the public entity would become self-funding in approximately 14 years, five years earlier than with the lower participation rates.

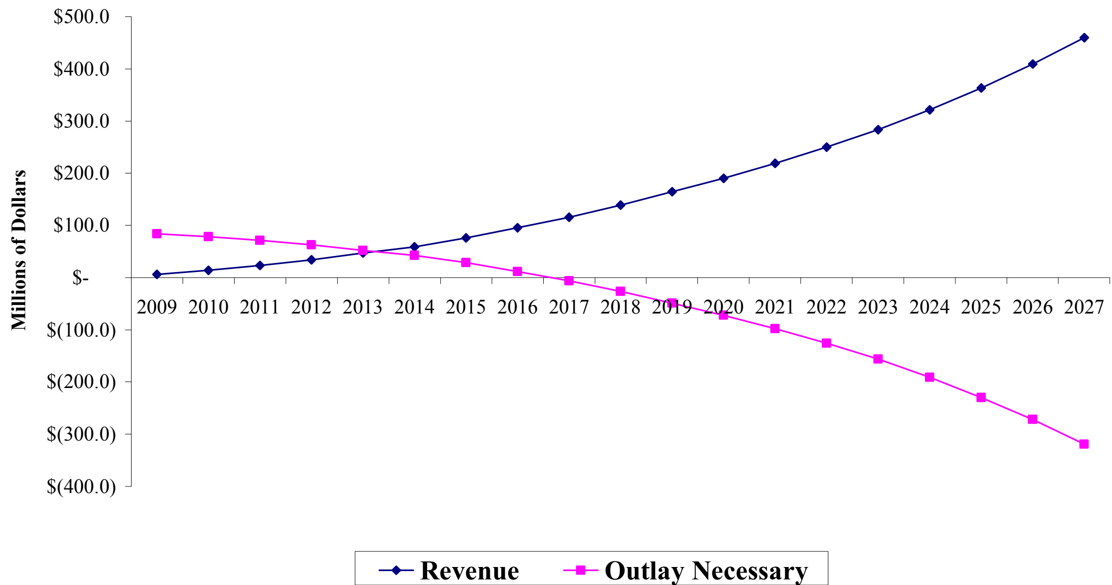
Graph 6 Estimated Revenues and Outlays Necessary to Fund from Automatic IRAs Operations, Public Entity

(Assumes moderate participation; 0.05 percent administrative charge; and $1,000 Average Annual Contribution)



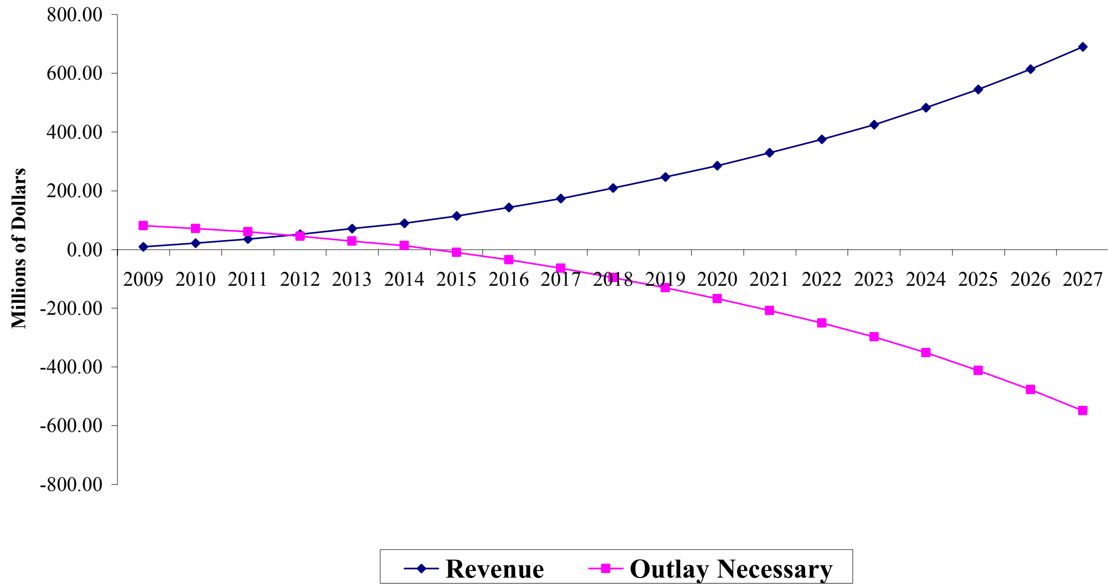
Graph 7 Estimated Revenues and Outlays Necessary to Fund from Automatic IRAs Operations, Public Entity

(Assumes moderate participation; 0.05 percent administrative charge; and $2,000 Average Annual Contribution)



Graph 8 Estimated Revenues and Outlays Necessary to Fund from Automatic IRAs Operations, Public Entity

(Assumes moderate participation; 0.05 percent administrative charge; and $3,000 Average Annual Contribution)



Estimates indicate that the public entity would need to charge a fixed rate of 1.01 percent to become immediately self-funding (assuming moderate participation rate and $1,000 average annual contributions). This rate would be reduced in two years to approximately 0.85 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2025. As mentioned, achieving this low rate depends heavily upon the assumptions made for participation and contributions.

Graph 7 shows that with higher average contributions ($2,000) and with a 0.05 percent of assets the public entity would become self-funding in approximately ten years.

Estimates indicate that the public entity would need to charge a fixed rate of 0.5 percent to become immediately self-funding (assuming moderate participation rate and $2,000 average annual contributions). This rate would be reduced in two years to approximately 0.21 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2024. While this approach would make the public entity self-funding immediately, it would also impose a significant burden on the earliest participants.

Graph 8 shows that with higher average contributions ($3,000) and with a 0.05 percent of assets the public entity would become self-funding in approximately eight years.

Estimates indicate that the public entity would need to charge a fixed rate of 0.45 percent to become immediately self-funding (assuming moderate participation rate and $3,000

average annual contributions). This rate would be reduced in two years to approximately 0.25 percent and could further decline every two years by approximately 0.02 percent until reaching the low of 0.02 percent in 2020.[24] Recall that, in each of these examples, achieving this low rate depends heavily upon the assumptions made for participation and contributions.

Purely private decentralized authority to administer Automatic IRAs – Creating a purely private system to administer Automatic IRAs would require no government outlay. The cost of establishing the system would be borne by the financial services providers in the private sector. As with any private sector market, the service recipient would pay the service provider directly. The cost of administering and processing the accounts would be recovered through various fees and charges.

The typical fee structure for private 401(k) plans often involves two separate fees – an annual flat fee and fixed fee expressed as a percentage of assets. The fixed fee is assessed on each account and is either a one time charge when the account is created or an annual charge assessed each year. These fees range from $26 to $45 per account.[25]

The second source, a flat percent of assets, is similar to the fee charged by the TSP. In an ideal world, the private institutions would strive to achieve a lower rate to remain competitive. However, it is likely to take many years before the efficiency and asset accumulation can produce modest fees expressed as a percent of assets. Most empirical evidence indicates that private sector 401(k) plan fees vary from 0.5 percent to 2.0 percent of assets.

The costs associated with the private system will vary by financial institution and will vary with the number of accounts and the aggregate amount of assets. In other words, they will be able to manage their costs better if the assets in the automatic IRA accounts may be pooled and invested in aggregate.

Private costs – It is nearly impossible to estimate the overall cost for private financial institutions, since the actual costs will depend on such factors as their size, location, and internal cost structure. However, based on other empirical estimates, we are able to estimate the gross revenue that would be generated with the various aggregate asset levels with various fixed fees and rates.

For instance, if assets are dispersed among a large number of providers in the form of many small accounts, higher than average flat fees and percentage of asset rates (see Tables 1 and 2) will occur. Alternatively, if the assets are dispersed among a small number of providers in the pooled asset accounts, the opportunity for greater efficiency and lower costs may prevail.

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[24] A following section considers the potential impact on the individual account balances of the various fee structures that might result from the forms of administrations.
[25] See the Congressional Budget Office, "Administrative Costs of Private Accounts in Social Security," March 2004.

Table 1 Estimate Gross Revenue From Purely Private Structure
Flat Fee Charged to Each Account
(*Gross revenue in Millions*)

	Year One	Year Five	Year Ten	Year Twenty
Lower of TSP Participation				
$20 per account	$ 96	$ 170	$ 280	$ 512
$25 per account	$ 120	$ 213	$ 350	$ 640
$35 per account	$ 168	$ 298	$ 490	$ 895
$45 per account	$ 216	$ 383	$ 631	$ 1,151
Moderate of TSP Participation				
$20 per account	$ 128	$ 227	$ 374	$ 682
$25 per account	$ 160	$ 284	$ 467	$ 853
$35 per account	$ 224	$ 397	$ 654	$ 1,194
$45 per account	$ 288	$ 511	$ 841	$ 1,535

Table 1 presents estimates of the aggregate gross revenue produced from the potential charges that each automatic IRA account holder could face with a private system. The first estimates rely on participation rates at 60 percent of TSP participation, while the second rely on the higher moderate of TSP participation assumption.

However, given the potential numbers of workers likely to be eligible for automatic IRAs, the gross revenues generated from the fixed fee would grow substantially over the life of the program.

The same is true for the fee (often referred to as the investment management fee) based on the asset balance. Table 2 presents estimated annual gross revenues likely to result under the two assumptions of participation. In each case, the early years produce modest gross revenues, but as with the fixed fee, the gross revenues would grow substantially over the life of the program.

Table 2 Estimate Gross Revenue From Purely Private Structure Fee as a Percent of Assets, (*Gross revenue in Millions*)

	Year One	Year Five	Year Ten	Year Twenty
Lower Percent Participation Rate				
$1,000 Average Annual Contribution				
0.5 percent	$ 24	$ 176	$ 522	$ 1,723
1.0 percent	$ 48	$ 353	$ 1,043	$ 3,446
1.5 percent	$ 72	$ 529	$ 1,565	$ 5,170
2.0 percent	$ 96	$ 706	$ 2,087	$ 6,893
$2,000 Average Annual Contribution				
0.5 percent	$ 48	$ 353	$ 1,043	$ 3,446
1.0 percent	$ 96	$ 706	$ 2,087	$ 6,893
1.5 percent	$ 144	$ 1,059	$ 3,130	$ 10,339
2.0 percent	$ 192	$ 1,412	$ 4,174	$ 13,786
$3,000 Average Annual Contribution				
0.5 percent	$ 72	$ 529	$ 1,565	$ 5,170
1.0 percent	$ 144	$ 1,059	$ 3,130	$ 10,339
1.5 percent	$ 216	$ 1,588	$ 4,696	$ 15,509
2.0 percent	$ 288	$ 2,117	$ 6,261	$ 20,679
Moderate Participation Rate				
$1,000 Average Annual Contribution				
0.5 percent	$ 32	$ 235	$ 696	$ 2,298
1.0 percent	$ 64	$ 471	$ 1,391	$ 4,595
1.5 percent	$ 96	$ 706	$ 2,087	$ 6,893
2.0 percent	$ 128	$ 941	$ 2,783	$ 9,191
$2,000 Average Annual Contribution				
0.5 percent	$ 64	$ 471	$ 1,391	$ 4,595
1.0 percent	$ 128	$ 941	$ 2,783	$ 9,191
1.5 percent	$ 192	$ 1,412	$ 4,174	$ 13,786
2.0 percent	$ 256	$ 1,882	$ 5,565	$ 18,381
$3,000 Average Annual Contribution				
0.5 percent	$ 96	$ 706	$ 2,087	$ 6,893
1.0 percent	$ 192	$ 1,412	$ 4,174	$ 13,786
1.5 percent	$ 288	$ 2,117	$ 6,261	$ 20,679
2.0 percent	$ 384	$ 2,823	$ 8,348	$ 27,572

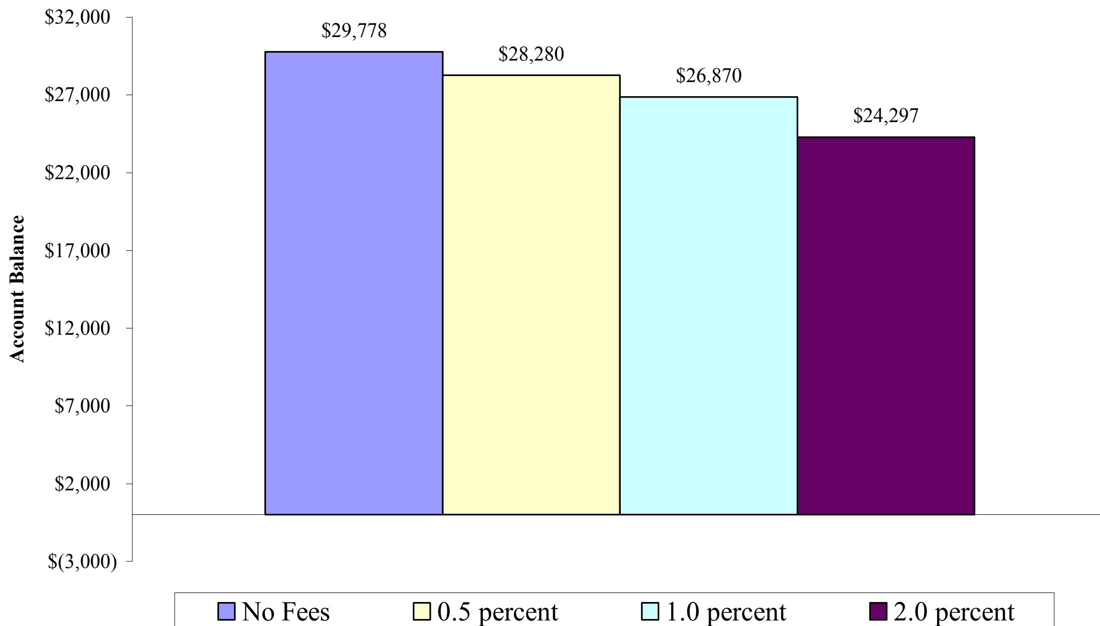
In a purely private system, it is likely that the fee structure will result in a combination of the two charges, a fixed per account fee as well as a percent of asset fee. Often the magnitude of these fees is related inversely. In other words, those accounts with a higher annual per account fee may assess a lower fee as a percent of assets. However,

depending upon the willingness of private financial service providers to enter the market, the fees may demonstrate a positive relationship.

***Impact of cost structures on participant account balances* –** The Automatic IRA program seeks to address the lack of retirement savings facing nearly half of all workers. Consequently, preserving the assets that accumulate as workers make contributions to Automatic IRAs (preventing fees from eroding the balances) is an important consideration. Graphs 9 and 10 show that as costs increase and are passed along to account holders, available balances in retirement are likely to decline significantly.

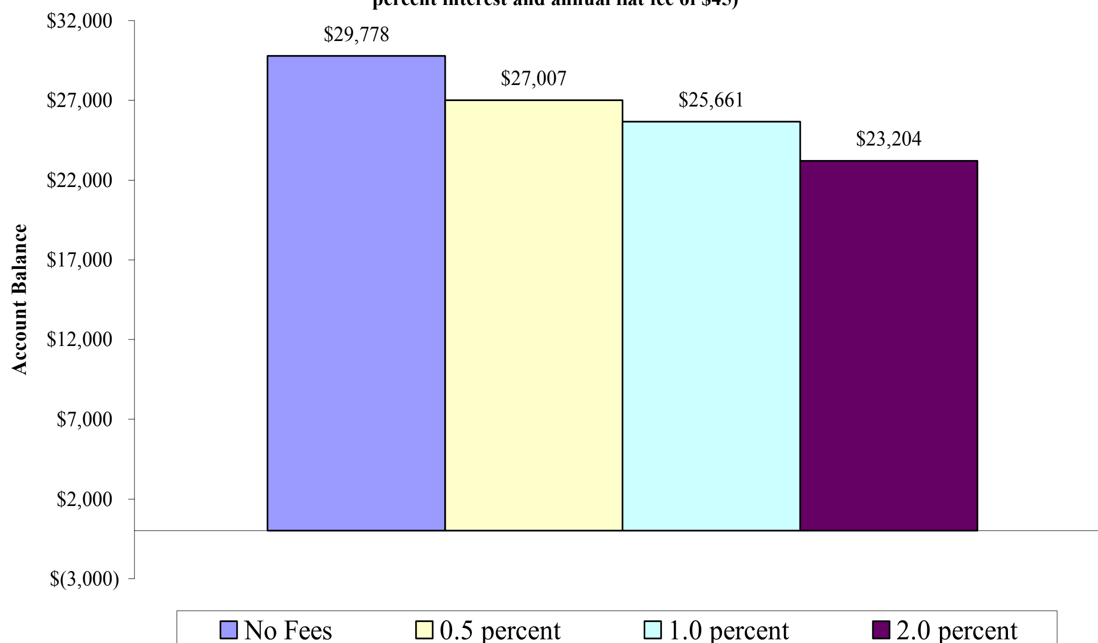
Graph 9 Estimated Account Balances with Various Fees as a Percent of Assets

($1,000 annual contribution for twenty years with 4 percent interest)



Graph 9 shows the potential balances for a participant that contributes $1,000 per year for twenty years. In each case, the account holder earns an average of four percent per year in interest. However, the fees assessed as a percent of assets increase, holding all else constant. Graph 9 demonstrates an overall decline of approximately 20 percent in asset value when the fees increase from 0 to 2.0 percent.

In Graph 9, if the administrative costs can be kept low (0.05 percent of assets), the annual account balance would lose only 5 percent of its accumulated value (second column from the left in Graph 9).



As with Graph 9, Graph 10 shows the potential balances for a participant that contributes $1,000 per year for twenty years. In each case, the account holder earns an average of four percent per year in interest. However, in addition to the fees assessed as a percent of assets, the account holder pays an annual fee of $45 per year. Graph 10 demonstrates an overall decline of approximately 24 percent in asset value when the fees increase from 0 to 2.0 percent with the annual $45 per account fee.

The above graphs demonstrate that overall lower costs will preserve assets in Automatic IRAs and make larger amounts of assets available for retirement.

SECTION 5 – Experience in Other Countries

In recent years, a number of countries have introduced new pension systems with individual account plans or are considering the introduction of such plans. Some of these proposals or plans have design features that are similar to the Automatic IRA proposal. While each system has features that distinguish it from the Automatic IRA proposal, it is helpful to explore how recordkeeping and reporting is handled under these foreign systems in order to help inform the debate over the proper structure of the Automatic IRA system. Thus, this section examines the approach to individual account plans in Sweden, New Zealand, Ireland, Germany, and the United Kingdom.

A. Sweden

During the 1990's, Sweden implemented an individual account plan as a supplement to the "income pension" system.[26] This universal individual account plan requires contributions from all workers of 2.5 percent of compensation. While the Swedish plan is a universal mandatory individual account plan, the level of contributions are similar to what is contemplated as the default Automatic IRA contribution rate (three percent), so it may be informative to examine the Swedish experience.

There are 5.3 million account holders under the Swedish individual account plan system. Individuals are entitled to select an investment option; if they do not elect an investment fund, then an individual's contributions are invested in a default investment fund. There is no marketing of the default investment fund and once an individual elects any other investment fund option, the default investment fund is no longer available to the individual.

The Swedish individual account plan is administered by the Swedish government Premium Pension Authority, an agency with approximately 200 employees. The Premium Pension Authority achieves certain cost savings by depositing contributions only once per year, engaging in bulk trading, and through automation. In 2004, the costs attributable to the system were 0.27 percent of account balances; the stated goal is to reduce costs to 0.1 percent. In 2002, the individual fund manager charges were 0.44 percent of account balances and, in 2000, the first year program costs were 0.95 percent of assets.

Individuals are offered a huge number of investment fund choices under the Swedish system. Once they made an election, individuals tended not to make subsequent fund switches. In the first round of investment elections under the system, two-thirds of eligible individuals made a specific election, but the number of new entrants selecting an investment option subsequently dropped to 10 percent. This occurred in part because the fund companies did not do much marketing because of the relatively small dollars

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[26] For more information, see the following: Weaver, Kent. *Social Security Smorgasbord? Lessons From Sweden's Individual Pension Accounts.* Brookings Institution Policy Brief #140, June 2005.

involved. In addition, individuals apparently perceived the default investment option as a relatively safe, low-cost alternative to the wide array of fund choices.

The default investment fund has a high priority on keeping costs low. In 2004, after rebates, the charges attributable to the default investment fund were 0.15 percent compared to 0.60 percent for equity funds.

B. Ireland

In 2002, Ireland adopted a system of Personal Retirement Savings Accounts (PRSAs) for individuals who are not eligible to participate in an employer-sponsored retirement plan.[27] Employers are required to provide access to a PRSA if the employer either (1) does not maintain a pension plan, (2) operates a pension plan that does not cover all employees or requires employees to wait more than six months after being hired to participate in the employer's plan, or (3) maintains a pension plan that does not allow for Additional Voluntary Contributions (AVCs). The requirement to make PRSAs available to employees applies to all employers regardless of size and is available to all employees who aren't covered under a pension plan regardless of whether the employees are part-time workers, seasonal workers, or fixed contract workers.

Pension coverage in Ireland is approximately 50 percent of the 2.1 million people in the workforce.[28] The goal of Ireland's government with the adoption of PRSAs was to increase private pension coverage from 50 percent to 70 percent among workers over age 30; this threshold will be met if approximately 350,000 people establish PRSAs.[29] The number of PRSA accounts and the total amount of PRSA assets had a fairly slow take-up rate, but has shown some steady growth. At the end of March 2006, PRSAs had been set up by more than 71,000 people, with total assets equal to €552 million (552 million Euros).[30]

PRSAs are IRA-type accounts established with authorized PRSA providers. They are similar to Automatic IRAs because an employer is required, at an employee's request, to withhold amounts from the employee's pay and remit the amounts to the selected PRSA service provider.[31] PRSAs are opt-in arrangements in that an employee is required to take affirmative action before a PRSA is established for the employee. Like Automatic

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[27] For general information about PRSAs, see the following: Korczyk, Sophie, Ph.D., *Mandatory Employer Pensions in Ireland, Germany, and the United Kingdom,* AARP Public Policy Institute, #2007-03, January 2007. *Pensions: Personal Retirement Savings Accounts (PRSA)*. Finfacts Ireland. http://www.finfacts.ie./fincentre/prsa.htm. February 15, 2007. *Personal Retirement Savings Accounts (PRSAs) Employers' Obligations.* Ad Bord Pinsean – The Pensions Board. Mensah, Lisa, Rachel Schneider, and Magda Aboulfadi. *Filling the Retirement Savings Gap in Ireland.* The Aspen Institute Initiative on Financial Security. Issue Brief, November 2004.

[28] *National Report for Ireland on Strategies for Social Protection and Social Inclusion, 2006-2008.* ec.europa.eu/employment_social/social_inclusion/docs/2006/nap/Ireland_en.pdf.

[29] *Filling the Retirement Savings Gap in Ireland*, supra.

[30] *National Report for Ireland*, supra.

[31] The amounts withheld from an employee's pay are required to be remitted to the PRSA service provider no later than 21 days following the end of the month in which the payroll deductions occurred.

IRAs, PRSAs are owned by an individual, are transferable from job to job, and are available from a variety of service providers. Unlike Automatic IRAs, employers can also elect to make employer contributions to an employee's PRSA.

The requirements for employers who must make PRSAs available to employees include the following: (1) the employer must enter into a contract with at least one PRSA service provider to enable employees to participate in a Standard PRSA, (2) the employer must notify employees of their right to participate in a PRSA, (3) the employer must allow PRSA service providers reasonable access to the employees to discuss Standard PRSA contracts, and (4) the employer must withhold PRSA contributions from an employee's pay and remit such amounts to the PRSA service provider. The employer must advise the employee and the PRSA service provider in writing at least once a month of (1) the total amount deducted from the employee's pay and (2) any employer contributions made on behalf of an employee. This information is generally provided on an employee's pay stub.

Employers who do not comply with the PRSA requirements are subject to penalties ranging from fines from €1,500 to €12,700 and imprisonment from one to two years.

There are two types of PRSA accounts – a Standard PRSA and a non-Standard PRSA. The primary differences between the two types of accounts is that a Standard PRSA (1) is prohibited from imposing charges in excess of 5 percent of contributions and 1 percent per year of the PRSA assets, (2) is only permitted to invest in pooled funds and temporary cash holdings, (3) cannot be marketed or sold if the product is dependent on the purchase of any other product, and (4) is subject to restricted disclosure requirements. Employees are permitted to transfer PRSA assets from one PRSA service provider to another without charge.

As noted above, an employer is required to make at least one Standard PRSA available to its eligible employees. The employer does not bear fiduciary responsibility with respect to employees' PRSAs.

PRSA service providers include investment firms, insurance companies, and credit companies. The service providers can require minimum levels of contributions up to €300 per year, €10 per electronic funds transfer, and €50 per transaction using other methods. PRSA service providers are required to report quarterly on the number and cumulative asset values for the PRSA contracts that they hold.

The PRSA products that can be offered for sale are approved jointly by two government agencies – the Revenue Commissioners and the Pensions Board. PRSA service providers are subject to specific disclosure requirements. Approximately 24 Standards PRSAs and 34 Nonstandard PRSAs have been approved. The majority of PRSA contracts that have been established are Standard PRSAs. At the end of 2005, there were 53,000 Standard PRSAs and 15,250 non-Standard PRSAs in effect.

Both types of PRSAs are required to provide a Default Investment Strategy. The Default Investment Strategy is a fund that shifts primarily from equity holdings to fixed income holdings to reduce risk as an employee nears retirement age. Employees can elect in writing to opt out of the Default Investment Strategy.

PRSAs are established through a system in which employers negotiate contracts with PRSA service providers and make contributions directly to an employee's PRSA. In addition to the responsibility for approving PRSA products, the Pensions Board has specific responsibilities to monitor compliance with the PRSA requirements.[32] The Pensions Board is responsible for monitoring and supervising a PRSA provider's activities. As part of this responsibility, the Pensions Board requires PRSA service providers to report quarterly and annually on the number and employment status of PRSA contributors, as well as on the level and source of contributions.

The Pensions Board is authorized to collect fees annually from PRSA providers to help defray the costs of administering the PRSA program. For 2005, the Pensions Board PRSA responsibilities were financed with state grants of €1.234 million and fees from PRSA service providers of €210,182.[33] These costs, representing only the costs of PRSAs to the government, averaged approximately €25 per PRSA account.

C. New Zealand

Overview

Beginning on July 1, 2007, New Zealand will implement a new type of savings program called the KiwiSaver.[34] The KiwiSaver is a work-based savings plan similar to the proposed Automatic IRA program.

The KiwiSaver program is available to all New Zealand residents up to age 65. In the case of new employees hired on or after July 1, 2007, the employee will be automatically enrolled in the KiwiSaver program, but can elect to opt out up to eight weeks after the date of hire.[35] Withholding from employees' pay begins with the first paycheck; if an employee elects to opt out, the amounts that have been withheld are refunded to the employee. Individuals to whom automatic enrollment does not apply (e.g., individuals who continue to work for the employer for whom they worked prior to July 1, 2007) can elect to participate in the KiwiSaver program by enrolling directly through a KiwiSaver provider or through their employer.

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[32] The Pensions Board was established by the Minister for Social Welfare pursuant to the Pensions Act of 1990. The Board includes representatives of trade unions, employers, Government, pension plan trustees, the pensions industry, consumer interests, and various professional groups.

[33] *Annual Report and Accounts 2005.* An Bord Pinsean – The Pensions Board.

[34] For general information about the KiwiSaver program, see the following: *KiwiSaver.* http://www.kiwisaver.govt.nz/. *KiwiSaver: Overview of the Scheme.* New Zealand Treasury, September 2006.

[35] Certain employees, including casual agricultural workers, private domestic workers, workers under age 18, and those who are employed on a temporary contract basis for 28 days or less, are not required to be automatically enrolled in KiwiSaver.

The minimum level of KiwiSaver contributions is four percent of compensation; individuals can alternatively elect to have eight percent of compensation contributed to a KiwiSaver account. Employers are permitted to make either lump sum contributions on behalf of employees or to make contributions in lieu of all or part of the employee's contributions. The government makes a NZ$1,000 contribution to employees' accounts when they first begin to participate in KiwiSaver.

After an individual has contributed to a KiwiSaver account for at least 12 months, the individual is entitled to apply for a temporary contributions holiday of between three months and five years.

The KiwiSaver program includes a mortgage diversion option, in which up to one-half of the amounts withheld from an employee's pay for KiwiSaver could be used to pay a mortgage on the employee's home. In addition, beginning in 2010, the government will fund a first home deposit subsidy of NZ$1,000 per year, up to a maximum of NZ$5,000 and is available to individuals who have been saving through KiwiSaver for at least three years, meet specific criteria, and satisfy income and house price cap limits.

Individuals can access their KiwiSaver funds at the later of when they reach age 65 or have been a KiwiSaver for at least five years. Withdrawals may also be taken (1) once for the purchase of a first home, (2) for a significant hardship, or (3) for a serious illness.

Employees' contributions to KiwiSaver are transmitted by employers to the Inland Revenue Department, which transfers the contributions to the correct KiwiSaver provider. Inland Revenue holds the contributions of new KiwiSaver members for three months while the individual decides upon a KiwiSaver provider. If the individual does not select a KiwiSaver provider, then their contributions will be allocated to the service provider selected by their employer, or if the employer does not select a service provider, then the contributions are allocated to an authorized default provider.

Employers

In general, all employers are subject to the KiwiSaver requirements and must make the program available to their new and existing employees. Employers can apply to the Government Actuary for an exemption from the automatic enrollment requirements if they have a registered superannuation scheme that meets the following criteria: (1) the scheme is open (in practice) to all new permanent (including part-time) employees; (2) the arrangement must be portable so that employees can transfer balances to and from other schemes; (3) the total contributions on behalf of an employee (minimum employee contributions plus maximum employer contributions) is at least four percent of compensation; and (4) employer contributions that are counted toward satisfying (2) must vest within five years. Defined benefit plans that satisfy these requirements can also qualify for exemption. If an employer is exempt from the KiwiSaver automatic enrollment requirements, employees are still permitted to elect to participate in KiwiSaver by opting in.

Under KiwiSaver, employers are required to (1) provide information to employees on the KiwiSaver program, (2) provide information to New Zealand's Inland Revenue to enable employees to be enrolled, and (3) withhold and remit KiwiSaver contributions from employees' pay. In addition, employers are required to keep records of which employees are KiwiSavers, what their KiwiSaver contributions are, and whether any employees have either opted out of KiwiSaver or elected to take a contribution holiday. Employers are permitted to choose a preferred KiwiSaver provider, in which case employees who don't select their own KiwiSaver provider would be allocated to the provider selected by the employer, rather than to a default provider selected by Inland Revenue.

Employers are subject to penalties for failure to provide Inland Revenue with the required information under the KiwiSaver program or for failing to withhold KiwiSaver contributions from employees' compensation. If an employer withholds KiwiSaver contributions, but does not transmit them to Inland Revenue, the government makes the payment on behalf of the employee, tries to collect the contributions from the employer, and applies shortfall penalties to the employer.

Inland Revenue of the New Zealand government is the central administrator of the KiwiSaver program. As such, Inland Revenue is responsible for the following:

1) providing information packets about KiwiSaver to employer for distribution to employees;
2) allocating new employees and existing employees to default providers and sending the employee an investment statement for the default provider;
3) receiving contributions from employers and forwarding them to KiwiSaver providers;
4) paying a NZ$1,000 initial contribution to each KiwiSaver account;
5) administering contribution holidays, and
6) administering certain withdrawals for financial hardship or serious illness.

The Government Actuary has responsibility for the following:

1) registering KiwiSaver providers;
2) registering conversions of existing schemes to KiwiSaver providers;
3) maintaining a registry of KiwiSaver providers;
4) approving employer exemptions from the automatic enrollment provisions;
5) maintaining ongoing regulation of providers; and
6) monitoring the government contribution to members' fees.

The New Zealand government initially has named six KiwiSaver default providers. Default providers are required to have a default investment product with a conservative risk profile. Default providers are initially appointed to a term of seven years and are required to accept all members allocated to them.

The government will also (1) register other KiwiSaver providers if they meet statutory criteria, (2) negotiate fees down with providers of default schemes, and (3) pay a contribution to members' accounts to meet some of their ongoing fees. The amount of

the government's subsidy of KiwiSaver account fees is not yet known, but will be a flat dollar amount per KiwiSaver per year. If the dollar amount of the subsidy exceeds the fees for the account for a year, the KiwiSaver member is entitled to keep the excess of the fee subsidy over the actual fees for the year. The fee subsidy will apply to all members, even those on a contribution holiday.

The New Zealand government does not guarantee any KiwiSaver account.

D. United Kingdom

Stakeholder pensions

In 2001, the United Kingdom enacted stakeholder pensions, which are intended for those who do not participate in the voluntary employer-based pension system and to provide a source of supplementary retirement savings for those who do.[36] Stakeholder pensions are required to be made available by employers who have at least five employees unless the employer already maintains a pension plan or pays at least three percent of compensation for person pensions. Certain employees can be excluded from eligibility for stakeholder pensions, including employees (1) who have been employed for less than three months; (2) are already enrolled in the employer's pension plan or declined to participate when offered; (3) are excluded from the employer's pension plan due to age; or (4) earned less than a minimum amount during one or more weeks of the previous three months.

Stakeholder pensions are also available on an individual basis to certain participants in occupational pensions, to self-employed and unemployed individuals, and to certain individuals not working because they are care for a child under age six or a disabled person.

It has been estimated that approximately 2.7 million stakeholder pensions have been established, but there is evidence that many of the plans have had few or no participant contributions.[37] Many employees who do participate make small contributions or transfer savings from other accounts. For the year ending April 5, 2006, 1.68 million individuals made contributions totaling £2.720 billion to stakeholder pensions, for an average contribution of £1,619.[38] For the year ending April 5, 2004, 1.07 million individuals made contributions to stakeholder pensions averaging £1,280.[39] Contributions to stakeholder pensions increase as earnings increase. For individuals earning up to £10,000

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[36] For further information, see Korczyk, Sophie, Ph.D., Analytical Services, Inc. *Mandatory Employer Pensions in Ireland, Germany, and the United Kingdom.* AARP Public Policy Institute #2007-03, January 2007.

[37] *Security in Retirement: Towards a New Pensions System* (presented to Parliament by the Secretary of State for Work and Pensions by Command of Her Majesty). Department for Work and Pensions, March 2006.

[38] *7.5 Stakeholder pensions for individuals: cumulative quarterly contributions.* HM Revenue and Customs. http://www.hmrc.gov.uk/stats/pensions/table7-5-2005-06.pdf

[39] *7.10 Personal and stakeholder pensions.* HM Revenue and Customs. http://www.hmrc.gov.uk/stats/pensions/7-10-200405.pdf

per year, the average contribution for the year ending April 5, 2004, was £820 while the average contribution for individuals earning more than £30,000 was £3,160.[40]

Annual fees for stakeholder pensions cannot exceed 1.5 percent of the total value of the fund. Any extra services and extra charges are optional. Transfers into or from a stakeholder pension must be allowed at no additional charge.

Stakeholder pensions are required to have a default investment option that is subject to "lifestyling" under which the investments are gradually moved into less volatile investments as an individual approaches retirement.

Personal accounts

The British government is now considering the implementation of a new scheme of personal accounts (National Personal Savings Scheme (NPSS)) to be effective in 2012.[41] Under the new system, an employee over age 22 and under the age for eligibility for a State pension would be automatically enrolled in either a personal account or into his or her employer's pension plan, assuming it met certain minimum standards. Employees outside these age bands could also elect to participate.

Employees would contribute four percent of earnings between approximately £5,000 and £30,000 per year. Employers would make matching contributions of three percent of the same band of earnings; the employer matching contribution requirement would be phased in over a three year period. Approximately one percent of normal tax relief would also be available for the contributions.

Contributions to the personal saving scheme would be limited to £5,000 per year. In addition, a separate contribution limit of £10,000 would be provided for the first year to allow individuals to deposit accumulated nonpension savings into their personal saving scheme.

Under the proposed new system, employees would be able to elect not to participate in the new personal accounts scheme, in which case the employer would not be required to contribute on behalf of the employee. In addition, self-employed individuals and nonworking individuals would be eligible to elect into the new personal accounts scheme. Employees who elect out of the personal account scheme would be automatically reenrolled after three years.

Employers who operate a pension scheme of generally equal, or better, contributions for employees would be exempt from the personal savings account scheme.

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[40] Id.

[41] For further information, see: *White Paper -- Security in Retirement: towards a new pension system.* Department for Work and Pensions. May 25, 2006. www.dwp.gov.uk/pensionsreform/whitepaper.asp. J. Mark Iwry. *Automated Savings: Making Retirement Saving Easier in the United States, United Kingdom, and New Zealand.* The Retirement Security Project. RSP Policy Brief No. 2006-2. June 14. 2006.

Under the personal savings scheme, a central clearing house would be responsible for the collection of contributions to the scheme, handling employer questions, keeping records of contributions made on behalf of employees, and transmitting the contributions to the proper investment funds. An administrator of accounts would handle individual employee questions, maintain the account for the employee, and generally be responsible for sharing information with employees.

The NPSS model contemplates that all operations of the system would be run by a single organization – the NPSS. Day-to-day operations and management would be outsourced to the private sector. Individual employees would deal directly with the NPSS.

The central delivery authority would be charged with the following responsibilities:

1) achieving optimal participation rates among the target group;
2) achieving low charges and costs;
3) encouraging additional contributions above the minimum eight percent level;
4) ensuring high levels of customer service;
5) acting transparently and consulting with affected groups;
6) adopting an investment strategy in the best interest of the members;
7) providing appropriate consumer protections; and
8) minimizing the potential effect on other pension schemes and on employers.

With respect to investment choices, the United Kingdom is considering the extent to which investment choice should be offered in their new personal savings scheme. They have identified choice of administrator (i.e., service provider) as a low priority, but believe that there is a need to identify options for fund choices for employees. Thus, they expect the new system to adopt a default fund, social, environmental, and ethical investment options, and branded funds.

APPRENDIX A –ADMINISTRATION OF ACCOUNTS UNDER EXISTING AUTOMATIC IRA PROPOSAL

The discussion in this section provides an overview of the administration and operation of Automatic IRAs based upon the bills that were introduced in the House of Representatives and the Senate in 2007. These bills are S. 1141, introduced by Senators Bingaman, Smith, Harkin, Kerry, and Snowe on April 18, 2007, and H.R. 2167, introduced by Mr. Neal, Mr. English, Mr. Emanuel, Mr. Larson, and Ms. Schwartz on May 3, 2007.

A. General Employer Responsibilities

Under the existing Automatic IRA proposal, the first step for an employer is to determine whether the employer is exempt from the Automatic IRA requirements. The employer is statutorily exempt from the Automatic IRA requirements if the employer (1) did not have more than 10 employees who received at least $5,000 of compensation from the employer for the preceding calendar year or (2) was not in existence at all times during the preceding two calendar years and did not have more than 100 employees who received at least $5,000 of compensation on any day during this period. In addition, an employer is effectively exempt if the employer is a State or local government employer or is a church or convention or association of churches exempt from tax under Internal Revenue Code section 501.

If the employer is not statutorily exempt, the employer may be de facto exempt if all of the employer's employees are excludable employees who are not eligible to participate in an Automatic IRA. For example, if the employer maintains a qualified pension plan covering all employees (other than excludable employees, such as employees who have not met minimum age and service requirements to participate in the plan), the employer is exempt from the Automatic IRA requirements.

If the employer is required to make Automatic IRAs available to employees, then the employer must identify the employees who must be offered the opportunity to participate in an Automatic IRA. In general, Automatic IRAs must be offered to all employees other than (1) employees who are subject to a collective bargaining agreement (i.e., union employees), (2) employees who are under the age of 18, (3) employees who have not completed at least three months of service with the employer, (4) employees who have not satisfied minimum age or service requirements for participation in an employer-sponsored qualified plan, (5) employees eligible to make salary reduction contributions under a tax-sheltered annuity program, or (6) all employees if the employer maintains a SIMPLE plan.

The employer must decide whether to adopt an Opt-In or Opt-Out approach to Automatic IRAs. Under the Opt-In approach, an employee generally is required to make an explicit election either to participate or not to participate in an Automatic IRA. The employer is required to take all reasonable actions to secure an explicit election from an employee to

whether the employee elects to participate. Under the Opt-Out approach, the employee is presumed to have elected to participate in an Automatic IRA unless the employee makes an explicit election to opt out of such coverage (see the further discussion below).

In addition, the employer must decide whether (1) to select an Automatic IRA service provider that would be used for all employee contributions, (2) to allow employees to designate their own Automatic IRA service provider, or (3) to use the default Automatic IRA service provider (TSP II under the introduced bills).

B. Employer Notice and Employee Elections

Under either the Opt-In or Opt-Out approach, an employer must provide notice to employees of their right to participate in an Automatic IRA at the time an employee is hired and once a year thereafter.

If the arrangement uses an Opt-Out approach, then a model notice will be developed by the Secretary of the Treasury in consultation with the TSP II Board. The employer's notice should also specify the following:

1) the maximum amount that may be contributed to an Automatic IRA on an annual basis;
2) each employee's options with respect to the IRAs to which the employee's contributions can or will be made (including whether the employee may specify his or her own IRA to receive the Automatic IRA contributions);
3) the choices that an employee has with respect to the investment of his or her IRA assets; and
4) the extent to which an employee has the right to transfer his or her balances to another IRA established by the employee.

Employees must be given an election period of at least 60 days during which to make an election to participate in an Automatic IRA or to change an employee's previous election including the amounts to be contributed to an Automatic IRA and the manner in which such amounts are to be invested. The election period is given before the beginning of each calendar year and at the time an employee becomes eligible to participate in an Automatic IRA (e.g., when an employee is hired).[42]

Figures 1 and 2 outline the possible outcomes of the notices provided by an employer to an employee under either an Opt-In or Opt-Out approach. If an employee elects to participate in an Automatic IRA, the employee's election will may or may not specify the Automatic IRA in which the contributions should be deposited and may or may not specify an investment option. If an employee fails to make an election, then the employee will be enrolled in an Automatic IRA that is either selected by the employer or is a default Automatic IRA.

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[42] In the case of a new employee, the employer would give notice to the employee at the time of hiring. However, the employee could be excluded from participating in the Automatic IRA program for up to 3 months.

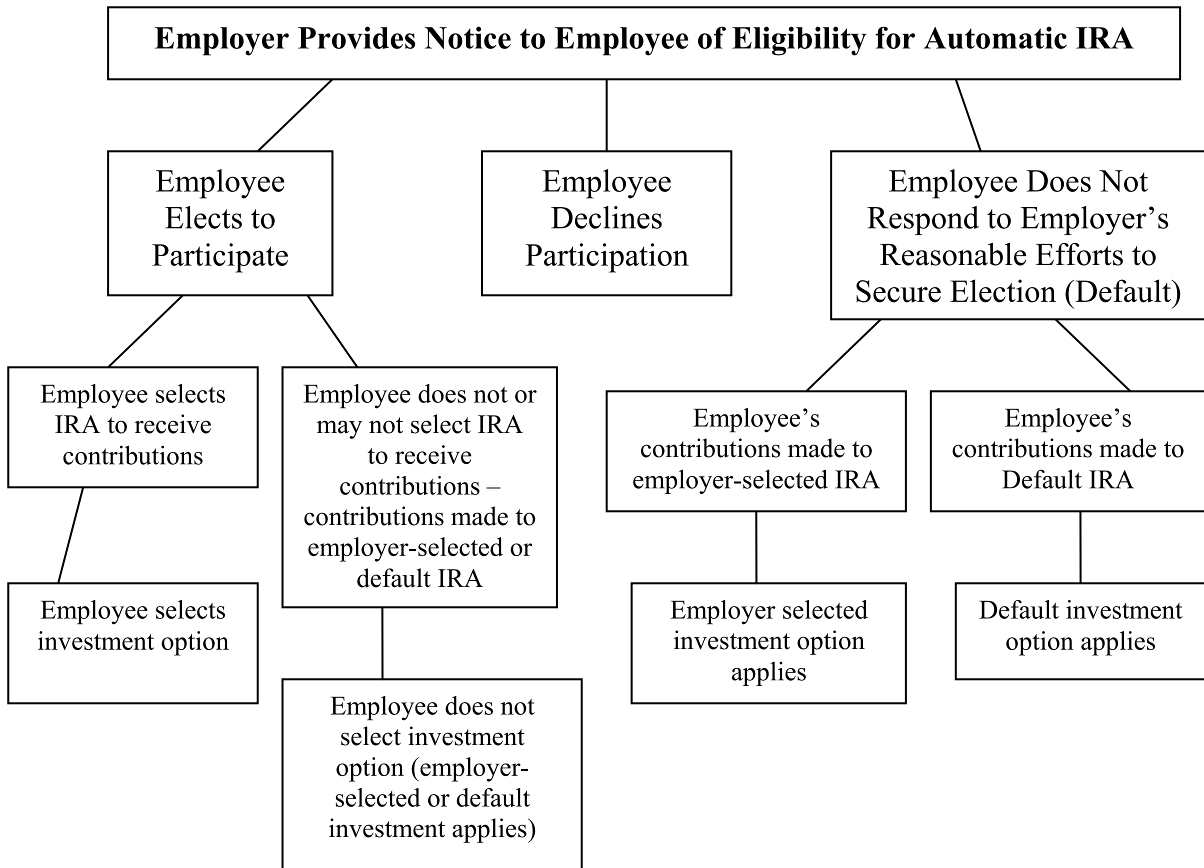
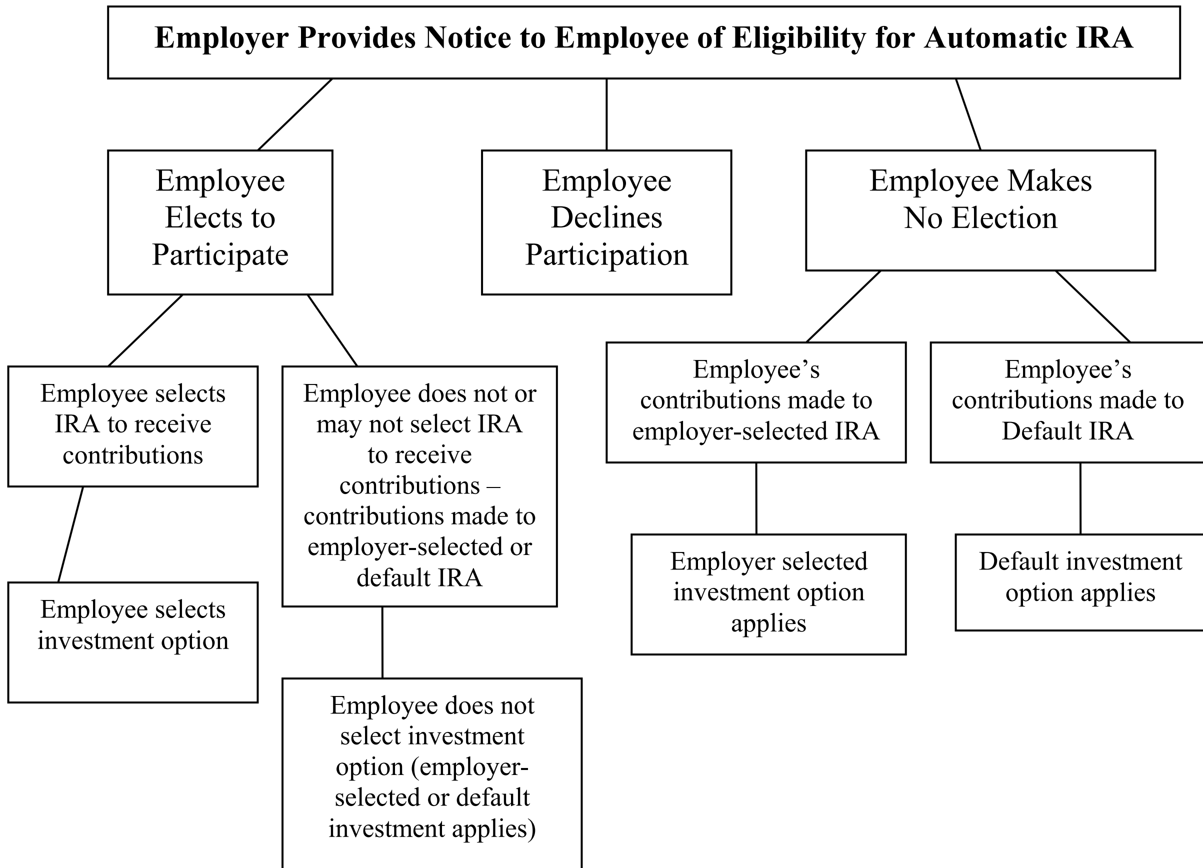


Figure 1 – OPT-IN ARRANGEMENT
Employer Provides Notice to Employee of Eligibility for Automatic IRA
Employee Elects to Participate
Employee Declines Participation
Employee Does Not Respond to Employer's Reasonable Efforts to Secure Election (Default)
Employee selects IRA to receive contributions
Employee does not or may not select IRA to receive contributions – contributions made to employer-selected or default IRA
Employee's contributions made to employer-selected IRA
Employee's contributions made to Default IRA
Employee selects investment option
Employer selected investment option applies
Default investment option applies
Employee does not select investment option (employer-selected or default investment applies)



The primary difference between the Opt-In and Opt-Out approach is the level of effort required by an employer to secure elections from employees. With the Opt-In approach, an employer is required to use "all reasonable actions to solicit from all employees eligible to participate in the arrangement an explicit election to either participate or not to participate in the arrangement."[43] If an employee fails to make an election during the applicable election period even after the employer has taken "all reasonable actions," then the employee is deemed to have elected to participate in the same manner as if the employer had used the Opt-Out approach and the employee failed to make a specific election.

If an employee makes an election to participate in an employer's Automatic IRA program, the employee election should specify the following information:

a) the amount the employee is electing to contribute to an Automatic IRA;

[43] S. 3952, proposed sec. 408B(b)(2)(F)(i).

b) whether the employee's contributions will be made to an IRA selected by the employee (if the employer permits such an option); and
c) how the employee's IRA contributions will be invested.

If an employee fails to make a specific election not to participate in the Automatic IRA program, then the employee is presumed to have elected to participate in such program. In this case, the employee is deemed to have elected to make an Automatic IRA contribution of three percent of compensation. In the case of an employee who fails to make a specific election, the employee's contributions are transferred to an IRA established by the employer on behalf of the employee or to an IRA established by the TSP II Board.

Under the introduced bills, the options for IRAs to which employee contributions will be made include the following: (1) an IRA selected by the employee (but only if the employer permits this option); (2) an IRA selected by the employer; or (3) an IRA established and maintained by the TSP II Board. In the section relating to the flows of money (below), an analysis is provided for alternative approaches to the deposit of amounts withheld from employees' pay for Automatic IRA contributions.

In the case of contributions to an IRA selected by the employee or the employer, the amounts contributed to the IRA can be transferred, without penalty, to another IRA selected by the employee. The employee must be given notice of the right to transfer the balance in the employee's IRA to another IRA established by the employee without cost or penalty.

In the case of contributions to an IRA established and maintained by the TSP II Board, the employee can only make a rollover to another IRA if the balance in the employee's IRA is at least $15,000.

C. TSP II Board

The introduced bills create a TSP II Board in the executive branch of the Federal government. Under the bills, the TSP II Board would be established and maintained in the same manner as the Federal Retirement Thrift Investment Board, which was created in connection with the Thrift Savings Plan for Federal employees.

The bills specify the duties of the TSP II Board to include the following:

1) establishing and maintaining IRAs to which Automatic IRA contributions can be made;
2) investing and managing the contributions to such IRAs;
3) the amount of contributions and investment of such contributions under a default Automatic IRA created when an employee fails to elect not to participate in an employer's Automatic IRA program;
4) the issuance of regulations relating to Automatic IRAs;
5) facilitating and encouraging the use of automatic debit and other arrangements for the establishment of IRAs for self employed and other individuals;

6) facilitating and encouraging efforts by voluntary associations to promote IRA savings by their members and others; and
7) facilitating and encouraging the direct deposit of Federal and state tax refunds into IRAs.