

GAO

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INDIVIDUAL RETIREMENT ACCOUNTS

Government Actions Could Encourage More Employers to Offer IRAs to Employees

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Education, Workforce, and Income Security





Highlights of [GAO-08-890T](#), a testimony before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Congress created individual retirement accounts (IRAs) with two goals: (1) to provide a retirement savings vehicle for workers without employer-sponsored retirement plans, and (2) to preserve individuals' savings in employer-sponsored retirement plans when they change jobs or retire. Questions remain about IRAs' effectiveness as a vehicle to facilitate new, or additional, retirement savings. GAO was asked to report on (1) the role of IRAs in retirement savings, (2) the prevalence of employer-sponsored and payroll-deduction IRAs and barriers discouraging employers from offering these IRAs, and (3) changes that are needed to improve IRA information and oversight. GAO reviewed published reports from government and financial industry sources and interviewed retirement and savings experts, small business representatives, IRA providers, and federal agency officials.

What GAO Recommends

GAO is not making recommendations at this time.

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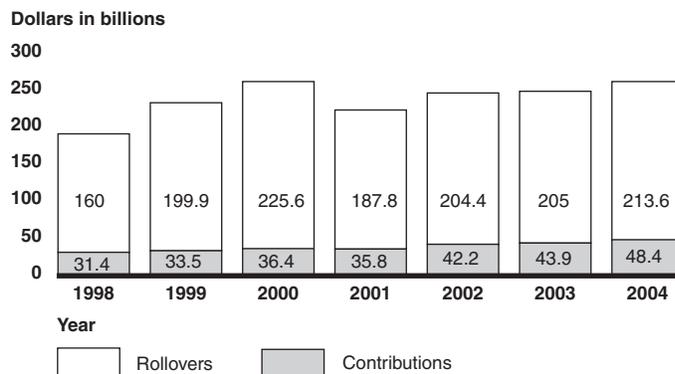
What GAO Found

Although Congress created IRAs to allow individuals to build and preserve their retirement savings, IRAs are primarily used to preserve savings through rollovers rather than build savings through contributions. Over 80 percent of assets that flow into IRAs come from assets rolled over, or transferred, from other accounts and not from direct contributions. Assets in IRAs now exceed assets in the most common employer-sponsored retirement plans: defined contribution plans, including 401(k) plans, and defined benefit, or pension plans.

Payroll-deduction IRA programs, which allow employees to contribute to IRAs through deductions from their paychecks, and employer-sponsored IRAs, in which an employer establishes and contributes to IRAs for employees, were established to provide more options for retirement savings in the workplace. Experts GAO interviewed said that several factors may discourage employers from offering these IRAs to employees, including administrative costs and concerns about employer fiduciary responsibilities. Information is lacking on how many employers offer employer-sponsored and payroll-deduction IRAs and the actual costs to employers for administering payroll-deduction IRAs.

Earlier this month, GAO reported on the role that federal agencies can have in helping employers provide IRAs to employees and in improving oversight of these savings vehicles. GAO made several recommendations to the Department of Labor (Labor) and the Internal Revenue Service to provide better information and oversight, but in the course of the review, GAO found that Labor does not have jurisdiction over payroll-deduction IRAs. Consequently, GAO also suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. A clear oversight structure could be critical if payroll-deduction IRAs become a more important means to provide a retirement savings vehicle for workers who lack an employer-sponsored retirement plan.

IRA Contributions and Rollovers, 1998 to 2004



Source: Investment Company Institute.

To view the full product, including the scope and methodology, click on [GAO-08-890T](#). For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjerg@gao.gov.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today as you examine issues related to individual retirement accounts (IRAs) and their role in facilitating retirement savings for individuals. Congress created IRAs more than 30 years ago through the Employee Retirement Income Security Act of 1974 (ERISA) with two distinct purposes: (1) to provide individuals who are not covered by an employer-sponsored retirement plan with a tax-preferred account in which to save for retirement, and (2) to provide individuals who are covered by a plan a means to preserve their savings by allowing them to rollover, or transfer, plan balances into IRAs. Since that time, IRA assets have grown to an estimated \$3.5 trillion in 2004.

Over the years, Congress has created different types of IRAs to encourage saving for retirement. Traditional and Roth IRAs are designed to be set up and used by individuals; two other types are employer-sponsored IRAs and are designed for small employers and their employees. Under payroll-deduction IRA programs, also known as payroll-deduction IRAs, employees may contribute to traditional and Roth IRAs through their employer's payroll system. Despite the growth in IRA assets and the varied types of IRAs, questions remain about whether Congress's initial goal for IRAs has been met: to help workers without a workplace retirement plan to save for retirement on their own behalf.

My comments today are based primarily on findings from our June 2008 report entitled *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*.¹ My remarks focus on (1) the role of IRAs in retirement savings, (2) the prevalence of employer-sponsored and payroll-deduction IRAs and barriers discouraging employers from offering these IRAs, and (3) changes that are needed to improve IRA information and oversight.

In conducting our work, we evaluated retirement fund assets using published data from federal agencies, including the Federal Reserve's Survey of Consumer Finance, and the Internal Revenue Service's (IRS) Statistics of Income, and relevant data from financial industry associations on retirement funds. We also analyzed demographic data from household surveys, including the U.S. Bureau of the Census Current Population

¹GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, [GAO-08-590](#) (Washington, D.C.: June 4, 2008).

Reports, and the Investment Company Institute's IRA Owners Survey, which focuses on IRA ownership. To determine the prevalence of employer-sponsored and payroll-deduction IRAs, we consulted available government and financial industry data on the percentage of households and workers participating in employer-sponsored IRAs. To corroborate available data, we interviewed officials at IRS and the Department of Labor (Labor) as well as representatives of small business member organizations, financial industry representatives, and other retirement and savings experts. To identify barriers that may discourage small employers from establishing employer-sponsored IRAs and from offering payroll-deduction IRAs to employees, we interviewed federal agency officials, industry associations, financial company representatives, small business and consumer advocacy groups, and retirement and savings experts. To evaluate federal oversight of IRAs, we reviewed laws governing agency responsibilities regarding IRAs and interviewed officials at IRS and Labor.² We conducted this performance audit from September 2007 to June 2008 in accordance with generally accepted government auditing standards, which included an assessment of data reliability. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In summary, we found that although Congress created IRAs for individuals to both build and preserve retirement savings, IRAs are primarily used to preserve savings through rollovers rather than to build savings through contributions. In fact, the majority of assets that flow into IRAs come from other accounts and not from new contributions. We also found that employee access to payroll-deduction and employer-sponsored IRAs is limited. Although employer-sponsored and payroll-deduction IRA programs could help many workers to save, experts we interviewed said several factors may discourage employers from offering these IRAs, including administrative costs. Data on the actual cost to employers for managing payroll-deduction IRAs are not available. Earlier this month, we reported on the role that federal agencies can have in helping employers provide IRAs to employees and improve oversight of these savings vehicles.³ We made several recommendations to Labor and IRS to improve

²A more detailed discussion of our methodology is provided in app. I to [GAO-08-590](#).

³[GAO-08-590](#).

IRA information and oversight, but during the course of our work, we found that Labor provides guidance, but does not have jurisdiction over payroll-deduction IRAs. Consequently, we also suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. A clear oversight structure could be critical if payroll-deduction IRAs become a more important means to provide a retirement savings vehicle for workers who otherwise lack an employer-sponsored retirement plan.

Background

Since the early 1980s, roughly half of the private-sector work force has participated in either a defined benefit (DB) retirement plan, commonly known as a pension, or a defined contribution (DC) plan, such as a 401(k) plan.⁴ In 2006, approximately 79 million—or about half of all workers—worked for an employer or union sponsoring either a DB or DC plan, and about 62 million workers participated in such a plan.⁵ Congress created IRAs, in part, to help those individuals not covered by a DB or DC plan save for retirement. Employees of small firms, for example, are unlikely to work for an employer that sponsors either a DB or DC retirement plan. Almost half of all U.S. private sector workers in 2006 were employed by firms with fewer than 100 employees, and only 1 in 4 of these workers worked for an employer sponsoring a retirement plan.⁶ Currently there are

⁴Private sector pension plans are classified either as DB or DC plans. DB plans promise to provide, generally, a fixed level of monthly retirement income that is based on salary, years of service, and age at retirement, regardless of how the plan investments perform. In contrast, benefits from DC plans are based on the contributions to and the performance of the investments in individual accounts, which may fluctuate in value. Examples of DC plans include 401(k) plans, employee stock ownership plans, and profit-sharing plans. The most dominant and fastest growing DC plans are 401(k) plans, which allow workers to choose to contribute a portion of their pre-tax compensation to the plan under section 401(k) of the Internal Revenue Code.

⁵Craig Copeland, “Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006,” *Issue Brief*, no. 311, (Washington D.C, Employee Benefit Research Institute, November 2007).

⁶The Employee Benefit Research Institute, a private, nonprofit public policy research organization, estimated that in 2006, over 66 million workers were employed by private sector employers with fewer than 100 employees. Of these workers, 16.7 million had access to an employer-sponsored retirement plan. See Craig Copeland, “Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006,” additional data from the U.S. Bureau of the Census, March 2007 Current Population Survey provided by the author.

Individual IRAs

several types of IRAs for individuals and small employers and their employees.⁷

Traditional and Roth IRAs are geared toward individuals and offer different tax preferences to encourage savings:

- **Traditional IRAs.** Traditional IRAs allow individuals to defer taxes on investment earnings accumulated in these accounts until distribution at retirement. Eligible individuals may make tax-deductible contributions, and others may make nondeductible contributions.⁸
- **Roth IRAs.** Through Roth IRAs, eligible individuals may make after-tax contributions, and after age 59½, enrollees may take tax-free distributions of their investment earnings.⁹

Both traditional and Roth IRAs can also be established through payroll-deduction IRA programs (also called payroll-deduction IRAs) which require employer involvement.

- **Payroll-deduction IRA Programs.** Employees may establish and contribute to either traditional or Roth IRAs through voluntary deductions from their pay forwarded by their employer to employee IRAs. As long as employers follow guidelines set by Labor for managing payroll-deduction IRAs, employers are not subject to the fiduciary requirements in ERISA Title I that apply to employer-sponsored retirement plans.¹⁰

⁷This is a simplified discussion of the features and rules associated with traditional, Roth, and SIMPLE and SEP IRAs and payroll-deduction IRA programs. For a more detailed discussion, see [GAO-08-590](#).

⁸Other rules for traditional IRAs also apply. For example, yearly contribution amounts are subject to limits based on earned income, pension coverage, and filing status. Taxpayers over age 70½ cannot contribute and must begin required minimum distributions from these accounts. Withdrawals are generally taxable and early distributions made before age 59½ other than for specific exceptions are subject to a 10 percent additional income tax. Withdrawals for the purchase of a first-time residence or payments for higher education are not subject to additional tax, as provided under specific tax rules.

⁹Other rules apply to Roth IRAs. For example, yearly contribution amounts are subject to limits based on earned income and filing status. Withdrawals of investment earnings before age 59½ are subject to a 10 percent additional tax and other taxes. Yearly contribution amounts are subject to limits based on income and filing status. There are no age limits on contributing, and no distributions are required during the owner's lifetime. Withdrawals are generally tax free after age 59½ as long as the taxpayer held the account for 5 years.

¹⁰See 29 C.F.R. § 2509.99-1 (also known as Interpretive Bulletin 99-1).

Employer-Sponsored IRAs

Congress created two types of employer-sponsored IRAs with fewer regulatory requirements than DB and DC plans to encourage small employers to offer IRAs to their employees:

- **Savings Incentive Match Plans for Employees (SIMPLE).** SIMPLE IRAs, available only to employers with 100 or fewer employees, allow eligible employees to direct a portion of their salary, within limits, to a SIMPLE IRA.¹¹ Employers sponsoring SIMPLE IRAs must either match the employee's contributions up to 3 percent of his or her compensation or make 2 percent contributions of each employee's salary to the SIMPLE IRAs for all employees making at least \$5,000 for the year.
- **Simplified Employee Pensions (SEP).** SEP IRAs allow employers to make tax-deductible contributions to their own and each eligible employee's traditional IRA at higher contribution limits than other IRAs.¹² SEP IRAs do not permit employee contributions, and annual employer contributions are not mandatory.¹³

IRS and Labor share oversight responsibilities for IRAs. Labor's Employee Benefits Security Administration (EBSA) enforces ERISA Title I, which specifies the standards for employer-sponsored retirement plans, including applicable fiduciary reporting and disclosure requirements. EBSA also oversees the fiduciary standards for employer-sponsored IRAs, and seeks to ensure that fiduciaries, such as employers, operate their plans in the best interest of plan participants. While Labor does not have direct oversight of payroll-deduction IRA programs, it has provided "safe

¹¹Congress created SIMPLE IRAs in the Small Business Job Protection Act of 1996. SIMPLE IRAs replaced the Salary Reduction Simplified Employee Pension IRA (SAR-SEP IRA)—a tax-deferred retirement plan provided by sole proprietors or small businesses with fewer than 25 employees. SAR-SEP IRAs could not be established after December 31, 1996, but plans in operation at that time were allowed to continue. For those plans still in operation in 2008, SAR-SEP IRAs allow eligible employees to contribute up to \$15,500 per year, and employers may contribute 25 percent of an employee's compensation, up to a maximum \$46,000.

¹²Congress established SEP IRAs in the Revenue Act of 1978. As with DB plans, SEP IRA contributions must be based on a written allocation formula and cannot discriminate in favor of highly compensated employees.

¹³In addition to SEP and SIMPLE IRAs, employers may offer "deemed IRAs" to their employees, which allow employees to keep IRA assets in their employer's tax-qualified retirement plan as a separate traditional or Roth IRA. Employees may make voluntary contributions to the deemed IRA, subject to IRA rules. According to the Department of the Treasury, few such IRAs exist.

harbor” guidance to employers, which sets the conditions by which employers may offer payroll-deduction IRA programs without becoming subject to ERISA Title I requirements.¹⁴ IRS enforces Title II of ERISA for all types of IRAs, which provides tax benefits for retirement plan sponsors and participants and details participant eligibility, vesting, and funding requirements. IRS also enforces various tax rules for IRAs, including rules for eligibility, contributions, distributions, and rolling assets into IRAs or converting assets from a traditional IRA into a Roth IRA. (See table 1 for annual contribution limits for IRAs.)

Table 1: Contribution Limits for IRAs, 2008

	Individual IRAs		Employer-Sponsored IRAs	
	Traditional IRA ^a	Roth IRA ^a	SIMPLE IRA	SEP IRA
Individual/employee contribution limit ^b	Up to \$5,000, or \$6,000 for eligible participants over age 50	Up to \$5,000, or \$6,000 for eligible participants over age 50	Up to \$10,500, or \$13,000 for eligible participants over age 50	Employees cannot contribute
Employer contribution limit	Not applicable	Not applicable	Contribution equal to 2 percent of employee’s compensation or matching contributions up to 3 percent of employee’s compensation ^c	25 percent of an employee’s compensation, up to maximum of \$46,000

Source: Internal Revenue Service.

^aEmployees may choose to contribute to either traditional or Roth IRAs through an employer’s payroll-deduction IRA program, and employee contributions are subject to either traditional or Roth IRA rules. Employers may not contribute to employee IRAs through payroll-deduction IRA programs.

^bOnly employees of firms offering SIMPLE or SEP IRAs may contribute to these IRAs, while any eligible individual may contribute to traditional or Roth IRAs. The annual total IRA contribution limit applies across Roth and traditional IRAs and is not an annual limit for each IRA type.

^cEmployers may reduce the 3 percent contribution limit to a lower percentage but not lower than 1 percent. Employers may not contribute less than 3 percent for more than 2 calendar years in a 5-year period.

¹⁴See Interpretive Bulletin 99-1. Labor’s guidance explains that an employer who establishes a payroll-deduction IRA program is not considered to have established an employee retirement plan subject to ERISA if the following are satisfied: (1) the employer maintains neutrality with respect to IRA investment options available in communications with employees; (2) the employer establishes limitations on the number of IRA investment options available, the program discloses any costs or limitations on employees’ ability to rollover to other IRAs; (3) the employer does not pay any administrative, investment management, or other fees which the IRA sponsor would require an employee to pay for establishing or maintaining the IRA; (4) the employer does not receive any consideration beyond “reasonable compensation” for operating the program.

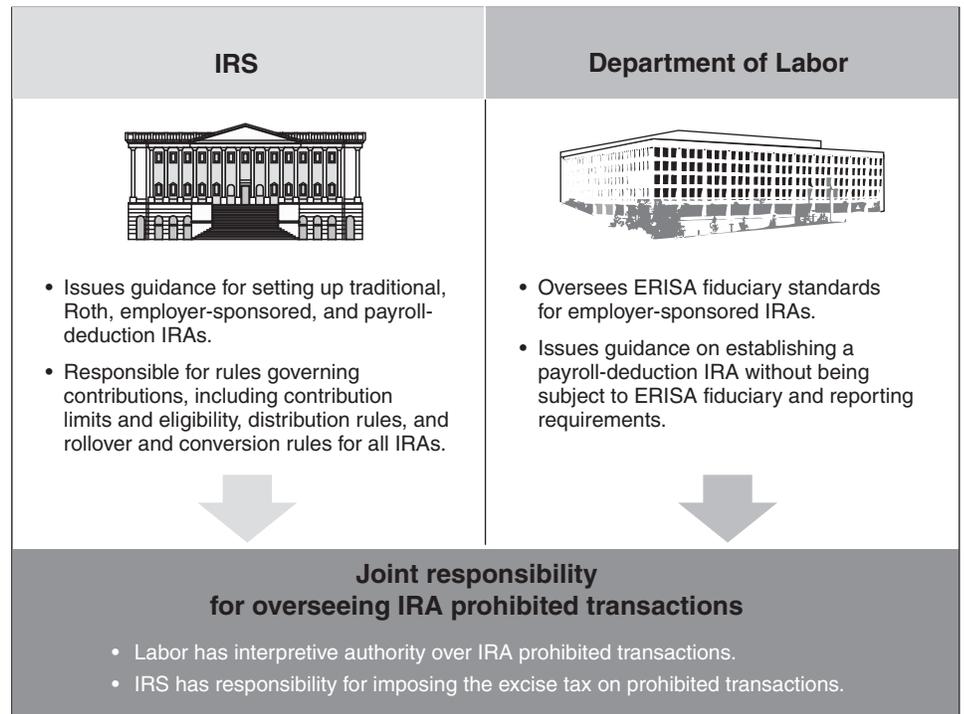
Labor and IRS work together to oversee IRA prohibited transactions. In general, prohibited transactions include any improper use of an IRA by the account holder or others.¹⁵ Labor generally has interpretive jurisdiction over prohibited transactions and IRS has certain enforcement authority. Both ERISA and the Internal Revenue Code contain various statutory exemptions from the prohibited transaction rules, and Labor has authority to grant administrative exemptions and establish exemption procedures.¹⁶ Labor may grant administrative exemptions on a class or individual basis for a wide variety of proposed transactions in a plan. IRS has responsibility for imposing an excise tax on parties that engage in a prohibited transaction.¹⁷ (See fig. 1 for a description of IRS and Labor responsibilities regarding IRAs.)

¹⁵Individuals subject to prohibited transaction rules include the individual who established the IRA, members of the individual's family, and fiduciaries. Examples of prohibited transactions with an IRA include: borrowing money from an IRA, selling property to it, receiving unreasonable compensation for managing the account, using the account as security for a loan, and buying property for personal use with IRA funds. The Department of the Treasury retains authority only with respect to transactions that are exempted by subsection 404(c) of ERISA from the application of the prohibited transaction provisions of Title I of ERISA.

¹⁶The statutory exemptions generally include loans to participants, the provision of services needed to operate a plan for reasonable compensation, loans to employee stock ownership plans, and investment with certain financial institutions regulated by other state or federal agencies. Reorganization Plan No. 4 of 1978 transferred the Department of the Treasury's authority over prohibited transaction exemptions to Labor, with certain exceptions.

¹⁷A provision of the Internal Revenue Code directly imposes an excise tax against disqualified persons, including employee benefit plan sponsors and service providers, who engage in prohibited transactions with tax-qualified pension and profit-sharing plans. The IRS must coordinate with Labor regarding the imposition of the excise tax under section 4975 of the Internal Revenue Code. In place of the imposition of an excise tax under the Internal Revenue Code, if the prohibited transaction involves the IRA owner, the IRA is disqualified from favorable tax treatment.

Figure 1: Primary Responsibilities of IRS and Labor for IRAs



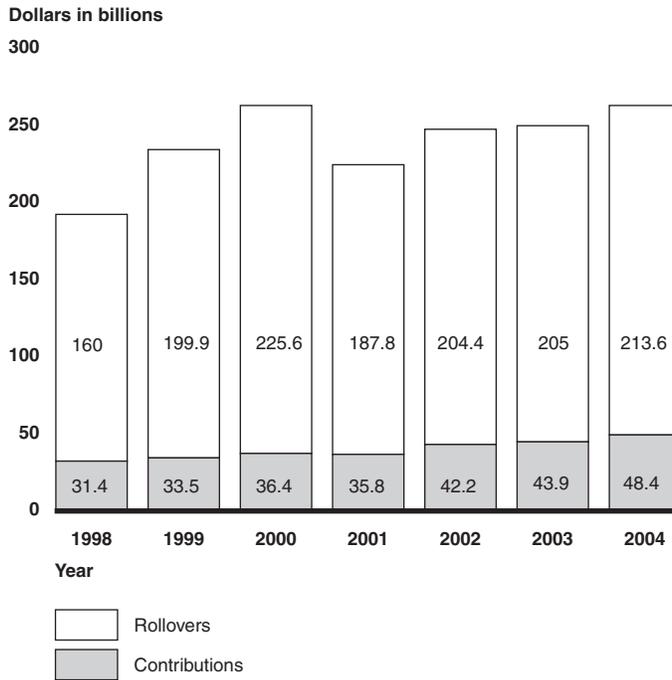
Sources: GAO analysis of Employee Retirement Income Security Act of 1974 and the Internal Revenue Code; Art Explosion (images).

IRAs Are Primarily Used to Preserve Savings through Rollovers

Most assets flowing into IRAs come not from direct contributions, but from transfers, or rollovers, of retirement assets from other retirement plans, including 401(k) plans. These rollovers allow individuals to preserve their retirement savings when they change jobs or retire. As shown in figure 2, from 1998 to 2004, more than 80 percent of funds flowing into IRAs came from rollovers, demonstrating that IRAs play a significantly smaller role in building retirement savings than in preserving them. In addition, IRA accounts with rollover assets were larger than those without rollover assets. For example the median amount in a traditional IRA with rollover assets in 2007 was \$61,000, while the median amount in a traditional IRA without rollover assets was \$30,000.¹⁸

¹⁸Sara Holden and Michael Bogdan, "The Role of IRAs in U.S. Households' Saving for Retirement," *Research Fundamentals*, vol. 17, no. 1 (Washington D.C., Investment Company Institute, January 2008).

Figure 2: IRA Contributions and Rollovers, 1998 to 2004



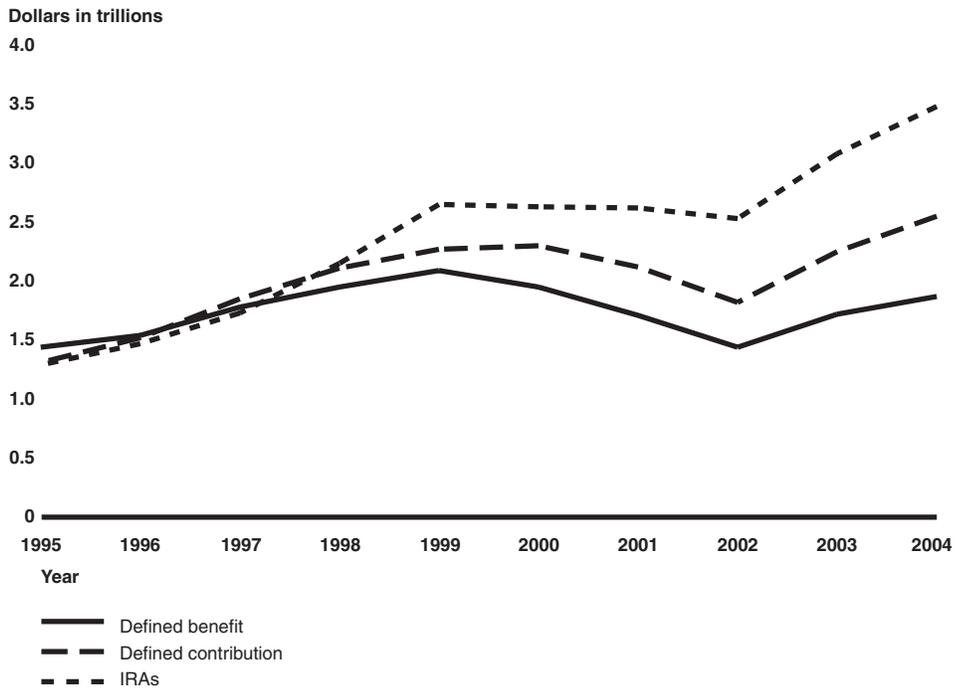
Source: Investment Company Institute.

Note: IRA contributions include those made to traditional IRAs, Roth IRAs, and employer-sponsored IRAs. Figures for 2003 and 2004 include estimates and projections.

Since 1998, IRA assets have comprised the largest portion of the retirement market. As shown in figure 3, IRA assets in 2004 totaled about \$3.5 trillion compared to DC assets of \$2.6 trillion and DB assets of \$1.9 trillion.¹⁹

¹⁹Craig Copeland, "Individual Account Retirement Plans: An Analysis of the 2004 Survey of Consumer Finances," *Issue Brief*, no. 293 (Washington D.C., Employee Benefit Research Institute, May 2006).

Figure 3: Retirement Plan Assets, 1995 to 2004



Source: Employee Benefit Research Institute.

More households own traditional IRAs, which were the first IRAs established, than Roth IRAs or employer-sponsored IRAs. In 2007, nearly 33 percent of all households owned traditional IRAs, and about 15 percent owned Roth IRAs. In contrast, about 8 percent of households participated in employer-sponsored IRAs.²⁰

Ownership of traditional and Roth IRAs is associated with higher education and income levels. In 2004, 59 percent of IRA households were headed by an individual with a college degree, and only about 3 percent were headed by an individual with no high school diploma.²¹ Over one-

²⁰Sara Holden and Michael Bogdan, "Appendix: Additional Data on IRA Ownership in 2007," *Research Fundamentals*, vol. 17, no. 1A (Washington D.C., Investment Company Institute, January 2008).

²¹Additional analysis of the Federal Reserve's Survey of Consumer Finance by the Employee Benefit Research Institute. Craig Copeland, "Individual Account Retirement Plans: An Analysis of the 2004 Survey of Consumer Finances," *Issue Brief*, no. 293 (Washington D.C., Employee Benefit Research Institute, May 2006).

third of these IRA households earned \$100,000 or more; about 2 percent earned less than \$10,000. Households with IRAs also tend to own their homes. Research shows that higher levels of education and household income correlate with a greater propensity to save.²² Therefore, it is not surprising that IRA ownership increases as education and income levels increase. However, despite the association of IRA ownership to individuals with higher incomes, data show that lower- and middle-income individuals also own IRAs. A study by the Congressional Budget Office (CBO) found that in 2003, 4 percent of workers earning \$20,000 to \$40,000 (in 1997 dollars) contributed to traditional IRAs and 3 percent of these workers contributed to Roth IRAs. In the same year, 7 percent of workers earning between \$120,000 and \$160,000 contributed to a traditional IRA and 8 percent contributed to a Roth IRA.²³ The study also found that 33 percent of individuals earning \$20,000 to \$40,000 who contributed to a traditional IRA contributed the maximum amount allowed, and 35 percent made maximum contributions to their Roth IRAs.²⁴ By contrast, 87 percent of individuals earning \$120,000 to \$160,000 who contributed to a traditional IRA made the maximum contribution, and 61 percent made the maximum contribution to their Roth IRAs.

A study by the Investment Company Institute (ICI) that included data on contributions by IRA owners shows that more households with Roth IRAs or employer-sponsored IRAs contribute to their accounts than households with traditional IRAs.²⁵ For example more than half of households with Roth, SIMPLE, or Salary Reduction Simplified Employee Pension IRA (SAR-SEP IRA) contributed to their accounts in 2004, but less than one-

²²Sara Holden, Kathy Ireland, Victoria Leonard-Chambers, and Michael Bogdan, "The Individual Retirement Account at Age 30: A Retrospective," *Perspective*, vol. 11, no. 1 (Washington D.C., Investment Company Institute, February 2005).

²³Congressional Budget Office, *Utilization of Tax Incentives for Retirement Savings: Update to 2003* (Washington, D.C., March 2007). The eligibility rules for Roth IRAs and for tax-deductible contributions to traditional IRAs may influence IRA participation rates. For example, an individual's eligibility to contribute to Roth IRAs is based on their modified adjusted gross income (AGI) and their tax filing status. Eligibility for a full or partial deduction for traditional IRA contributions depends on whether a taxpayer or spouse is covered by an employer-sponsored retirement plan, as well as limits on modified AGI and filing status.

²⁴The income categories in the CBO study are reported in 1997 dollars. Some workers may have both a traditional and Roth IRA.

²⁵Sandra West and Victoria Leonard-Chambers, "The Role of IRAs in Americans' Retirement Preparedness," *Research Fundamentals*, vol. 15, no. 1 (Washington D.C., Investment Company Institute, January 2006).

third of households with traditional IRAs did so. This, again, may be partly attributed to the emerging role of traditional IRAs as a means to preserve rollover assets rather than build retirement savings. The ICI study also stated that the median household contribution to traditional IRAs was \$2,300 compared to the median contribution to Roth IRAs of \$3,000. The median contribution to SIMPLE and SAR-SEP IRAs was \$5,000. The study noted that this difference may be related to higher contribution limits for employer-sponsored IRAs than for traditional and Roth IRAs.

Worker Access to Employer-Sponsored and Payroll-Deduction IRAs Appears Limited, and Several Barriers May Discourage Employers from Offering These IRAs

According to experts and available government data, worker access to employer-sponsored and payroll-deduction IRAs appears limited. To address the issue of low retirement plan sponsorship among small employers, Congress created SEP and SIMPLE employer-sponsored IRAs. Labor issued a regulation under which an employer could maintain a payroll-deduction program for employees to contribute to traditional and Roth IRAs without being considered a pension plan under ERISA. Although employer-sponsored IRAs have few reporting requirements to encourage small employers to offer them, and payroll-deduction IRAs have none, worker access to these IRAs appears limited. Increased access to payroll-deduction IRAs could help many workers to save for retirement, but several barriers, including costs to employers, may discourage employers from offering these IRAs to their employees. Retirement and savings experts offer several proposals to encourage employers to offer and employees to participate in payroll-deduction IRAs.

Worker Access to Employer-Sponsored and Payroll-Deduction IRAs Appears Limited

The majority of employers with fewer than 100 employees do not offer an employer-sponsored retirement plan for their employees. In 2006, almost half of all U.S. private sector workers were employed by firms with fewer than 100 employees, and only 1 in 4 of these employees worked for an employer sponsoring a retirement plan.²⁶ To address the issue of low retirement plan sponsorship among small employers, Congress created SIMPLE and SEP employer-sponsored IRAs with less burdensome reporting requirements than 401(k) plans to encourage their adoption by small employers. In addition, under a regulation issued by Labor, employers may also provide payroll-deduction IRA programs, which allow

²⁶See Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006," with additional data from the 2007 March Current Population Survey provided by the author.

employees to contribute to traditional or Roth IRAs through payroll-deductions by their employer, without employers being considered a pension plan sponsor under ERISA and becoming subject to various ERISA fiduciary and reporting requirements.²⁷ In order to encourage their adoption, employer-sponsored and payroll-deduction IRAs offer a variety of features designed to appeal to small employers (see table 2).

Table 2: Features of Employer-Sponsored and Payroll-Deduction IRAs

IRA features	Employer-sponsored IRAs		
	SIMPLE IRAs ^a	SEP IRAs ^b	Payroll-deduction IRAs
Employee contributions allowed	✓		✓
Employer contributions allowed	✓	✓	
Mandatory annual employer contributions	✓		
No employer financial reporting requirements	✓	✓	✓
Employer tax credit available for partial start-up costs	✓	✓	
Available to all employers		✓	✓
Available to all employer's workers			✓

Source: GAO analysis of Labor and IRS Publication 3998.

^aSIMPLE IRAs are limited to employers with fewer than 100 employees. Employers sponsoring SIMPLE IRAs must offer the IRAs to all employees who have earned income of at least \$5,000 in any prior 2 years and are reasonably expected to earn at least \$5,000 in the current year.

^bEmployers sponsoring SEP IRAs must offer the IRAs to all employees who are at least 21 years of age, employed by the employer for 3 of the last 5 years, and had compensation of \$500 for 2007.

Data on the number of employers offering employees employer-sponsored IRAs and payroll-deduction IRAs is limited. However, based on available data, employee access to SIMPLE and SEP IRAs appears limited. Under ERISA Title I, there is no reporting requirement for SIMPLE IRAs, and there is an alternative method available for reporting of employer-

²⁷See 29 C.F.R. § 2510.3-2(d).

sponsored SEP IRAs.²⁸ Payroll-deduction IRA programs are not subject to ERISA requirements for employer-sponsored retirement plans and have no reporting requirements. Because there are very limited reporting requirements for employer-sponsored IRAs and none for payroll-deduction IRAs, information on employers who offer these IRAs is limited and we were unable to determine how many employers actually do so. For example, the Bureau of Labor Statistics provides some data on the percentage of employees participating in employer-sponsored IRAs, but no data on the percentage of employers sponsoring them. The Bureau of Labor Statistics reported that 8 percent of private sector workers in firms with fewer than 100 employees participated in a SIMPLE IRA in 2005, and 2 percent of these workers participated in a SEP IRA.²⁹ An IRS evaluation of employer-filed W-2 forms estimated that 190,000 employers sponsored SIMPLE IRAs in 2004.³⁰ IRS did not provide an estimate of the number of employers sponsoring SEP IRAs, and we were unable to determine how many employers make these IRAs available to employees.

Few employers appear to offer their employees the opportunity to contribute to IRAs through payroll deductions, but data are insufficient to make this determination. Through payroll-deduction IRA programs, employees may contribute to traditional or Roth IRAs by having their employer withhold an amount determined by the employee and forwarded directly to the employee's IRA. Although any employer can provide payroll-deduction IRAs to their employees, regardless of whether or not they offer another retirement plan, retirement and savings experts told us that very few employers do so. Because employers are not required to

²⁸Section 101(h)(1) of ERISA Title I provides that no report shall be required for qualified salary reduction arrangements under section 408(p) of the Internal Revenue Code (SIMPLE IRAs). In addition, Labor provides an alternative method of compliance for reporting SEP arrangements through IRS Form 5305-SEP.

²⁹U.S. Department of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2005*, Bulletin 2589 (May 2007). SIMPLE IRAs are only available to firms with 100 employees or fewer who do not already offer another retirement plan; SEP IRAs are available to employers of any size, including those who may offer either a DC or DB plan.

³⁰However, officials told us that this figure was likely understated, as it does not include accounts that may be owned by sole proprietors or individuals who own unincorporated businesses by themselves, who are not required to file W-2 forms.

report this activity to the federal government, neither Labor nor IRS is able to determine how many employers offer payroll-deduction IRAs.³¹

Employer-Sponsored and Payroll-Deduction IRAs Could Help Workers to Save, but Several Barriers May Discourage Employers from Offering These IRAs

According to experts and economics literature that we reviewed, individuals are more likely to save for retirement through payroll deductions than they are without payroll deductions. Both SIMPLE IRAs and payroll-deduction IRA programs allow workers to contribute to their retirement through payroll deductions.³² Payroll deductions are a key feature in 401(k) and other DC plans. Economics literature that we reviewed identifies payroll deduction as a key factor in the success of 401(k) plans, and participation in these plans is much higher than in IRAs, which do not typically use payroll deduction. The Congressional Budget Office reported that 29 percent of all workers contributed to a DC plan in 2003—where payroll deductions are the norm—while only 7 percent of all workers contributed to an IRA.³³

Saving for retirement in the workplace through payroll deductions helps workers save by providing a “commitment device” to make automatic contributions to retirement savings before wages are spent.³⁴ Such a commitment device helps some workers overcome a common tendency to procrastinate or not take action to save based on the choices associated

³¹Labor and IRS officials told us data are limited on how many employers offer payroll-deduction IRAs; however, Labor and IRS have taken steps to promote these plans. For example, in 1975, Labor issued a regulation describing the conditions under which payroll-deduction IRA programs offered by employers are not considered a pension plan under Title I of ERISA. See 29 C.F.R. § 2510.3-2(d). In 1999, Labor issued Interpretive Bulletin 99-1, which set the conditions under which employers could offer payroll-deduction IRAs and remain clear of the reporting and disclosure requirements, fiduciary duties, and enforcement rights under ERISA Title I that apply to employer-sponsored pensions. See 29 C.F.R. § 2509.99-1, and 64 Fed. Reg. 33000 (June 18, 1999). In 1999, IRS issued an announcement providing information to employees and employers on payroll-deduction contributions for Roth and traditional IRAs. See Internal Revenue Bulletin 1999-2, at 44 (Jan. 11, 1999).

³²SEP IRAs do not offer this feature. Only employers may contribute to SEP IRAs and employee contributions to these IRAs are not permitted.

³³Congressional Budget Office, “Utilization of Tax Incentives for Retirement Saving: Update to 2003,” *Background Paper* (Washington, D.C., March 2007).

³⁴Steven F. Venti, “Choice, Behavior, and Retirement Saving,” in *The Oxford Handbook of Pensions and Retirement Income*, Eds. Gordon C. Clark, Alicia H. Munnell, and J. Michael Orszag (Oxford, Great Britain, 2006) 603-17; and Olivia Mitchell and Stephen Utkus, “Lessons from Behavioral Finance for Retirement Plan Design,” *Pension Research Council Working Paper*, PRC WP 2003-6 (Philadelphia, Pa., 2003).

with investing or selecting a retirement savings vehicle. Payroll deductions allow workers to contribute to retirement savings automatically before wages are spent, relieving them of making ongoing decisions to save. According to Labor's guidance on payroll-deduction IRAs and several experts we interviewed, individuals are more likely to save in IRAs through payroll deductions than they are without these automatic deposits.

Payroll-deduction IRA programs could provide a retirement savings opportunity at work for the millions of workers without an employer-sponsored retirement plan. In theory, all workers under age 70½ who lack an employer-sponsored retirement plan could be eligible to contribute to a traditional IRA through payroll deduction, should their employer offer such a program.³⁵ Further, based on the contribution rules for traditional and Roth IRAs, many of these individuals would be eligible to claim a tax deduction for their traditional IRA contributions,³⁶ and most low- and middle-income workers would be eligible to contribute to Roth IRAs.³⁷ Experts told us payroll-deduction IRAs are the easiest way for small employers to offer their employees a retirement savings vehicle. Payroll-deduction IRAs have fewer requirements for employee communication

³⁵Individuals who have already established an IRA on their own and who currently contribute at the maximum would not be eligible to contribute to payroll-deduction IRAs. Others who already have an IRA but contribute less than the maximum could contribute additional amounts in a payroll-deduction IRA, but could not go over the overall limit.

³⁶Any individual under the age of 70½ with taxable compensation may contribute to a traditional IRA, and many individuals could receive a tax deduction for their contribution. Eligibility for a full or partial deduction for traditional IRA contributions depends on whether a taxpayer or spouse is covered by an employer plan, as well as limits on modified adjusted gross income (AGI) and filing status. For example, a single worker not covered by an employer plan is eligible for the full deduction regardless of income, and a married taxpayer filing jointly whose spouse is covered by an employer plan can take the full deduction if the couple's modified AGI is \$159,000 or less for 2008. Other individuals may be eligible for partial deductions, and even those ineligible for any deduction can still make nondeductible contributions to a traditional IRA.

³⁷An individual's eligibility to contribute to Roth IRAs is based on their modified AGI and their tax filing status. For example, in 2008, single, head-of-household and married individuals filing separately with a modified AGI of less than \$101,000 could contribute up to \$5,000 (\$6,000 if age 50 or older). Individuals with an AGI that is more than \$101,000 but less than \$116,000 could contribute at reduced limits. Individuals making \$116,000 or more could not contribute to Roth IRAs. Individuals that are married, filing jointly, or qualified widowers, with a modified AGI less than \$159,000 could contribute up to the \$5,000 limit (\$6,000 if age 50 or older). Couples with income between \$159,000 and \$169,000 could contribute at reduced limits. Those making more than \$169,000 cannot contribute.

than SIMPLE and SEP IRAs,³⁸ and employers are not subject to ERISA fiduciary responsibilities as long as they meet the conditions in Labor’s regulation and guidance for managing these plans.³⁹

Employer-sponsored IRAs may also help employees of small firms save for their retirement. For example, the higher contribution limits for SIMPLE and SEP IRAs offer greater savings benefits than payroll-deduction IRAs.⁴⁰ In 2007, individuals under age 50 were able to contribute up to \$10,500 to SIMPLE IRAs—more than twice the amount allowed in 2007 for payroll-deduction IRAs.⁴¹ Since SIMPLE IRAs require employers to either match the contributions of participating employees or make nonelective contributions to all employee accounts, employees are able to save significantly more per year in SIMPLE IRAs than they are in payroll-deduction IRAs.

As we previously reported, we found that several factors may discourage employers from establishing employer-sponsored SIMPLE and SEP IRAs. For example, small business groups told us that the costs of managing SIMPLE and SEP IRAs may be prohibitive for small employers. Experts also pointed out that certain contribution requirements for these plans may, in some cases, limit employer sponsorship of these plans. For example, because SIMPLE IRAs require employers to make contributions to employee accounts, some small firms may be unable to commit to these

³⁸For example, SIMPLE IRAs require employers to provide employees with a summary plan description and an annual election notice. SEP IRAs require employers to provide employees with written statements that explain the terms of the pension, how changes are made, and when employees will receive information about contributions to their accounts.

³⁹Further, employers are not required to determine an employee’s eligibility status for Roth contributions or tax-deferred contributions to traditional IRAs, which vary based on the employee’s modified adjusted gross income or tax filing status. These responsibilities fall on the employee.

⁴⁰SIMPLE IRAs require that employers contribute to their employee’s IRAs by making “nonelective” 2 percent contributions to the accounts of all employees or by matching the salary-reduction contributions of participating employees up to 3 percent of the employee’s compensation with a limit of \$10,500 in 2007. Individuals over age 50 at the end of the 2007 calendar year could make an additional “catch-up” contribution of up to \$2,500 to their SIMPLE IRAs. Under a SEP, employers contribute directly to SEP IRAs for all employees, including the employer, with contributions up to 25 percent of each employee’s pay, but no more than \$45,000 in 2007.

⁴¹In 2008, SEP IRAs allowed employers to contribute the lesser of 25 percent of an employee’s compensation or up to \$46,000. Compensation generally does not include contributions to the SEP.

IRAs. Small business groups and IRA providers told us that small business revenues are inconsistent and may fluctuate greatly from year to year, making required contributions difficult for some firms. In addition, employers offering SIMPLE IRAs must determine before the beginning of the calendar year whether they will match employee contributions or make nonelective contributions to all employees' accounts. According to IRA providers, this requirement may discourage some small employers from offering these IRAs, and if employers had the flexibility to make additional contributions to employee accounts at the end of the year, employers may be encouraged to contribute more to employee accounts.

With regard to SEP IRAs, two experts said small firms may be discouraged from offering these plans because of the requirement that employers must set up a SEP IRA for all employees performing service for the company in 3 of the past 5 years and with more than \$500 in compensation for 2007. These experts stated that small firms are likely to hire either seasonal employees or interns who may earn more than \$500, and these employers may have difficulty finding an IRA provider willing to open an IRA small enough for these temporary or low-earning participants.

We also found that several barriers may discourage small employers even from offering payroll-deduction IRAs, including: (1) costs to employers for managing payroll deductions, (2) a perceived lack of flexibility to promote payroll-deduction IRAs to employees, (3) lack of incentives to employers, and (4) lack of awareness about how these IRAs work.

- **Costs to employers.** Additional administrative costs associated with setting up and managing payroll-deduction IRAs may be a barrier for small employers, particularly those without electronic payroll processing. Small business groups told us that costs are influenced by the number of employees participating in the program and whether an employer has a payroll processing system in place for automatic deductions and direct deposits to employee accounts. Several experts told us many small employers lack electronic, or automatic, payroll systems, and these employers would be subject to higher management costs for offering payroll-deduction IRAs. According to Labor, costs to employers also are significantly influenced by the number of IRA providers to which an employer must remit contributions on behalf of employees.⁴²

⁴²As such, Labor's guidance allows employers to select a single IRA provider for all employees. Also, under Labor's guidance, an IRA sponsor may reimburse the employer for the actual costs of operating a payroll-deduction IRA as long as such costs do not include profit to the employer.

Although experts reported that payroll-deduction IRAs represent costs to employers, we found varied opinions on the significance of those costs. Experts advocating for expanded payroll-deduction IRAs reported that most employers would incur little or no costs since they already make payroll deductions for Social Security and Medicare, as well as federal, state, and local taxes. According to these experts, payroll-deduction IRAs function like existing payroll tax withholdings, and adding another deduction would not be substantial. However, other experts and one report we reviewed indicated that employer costs may be significant, particularly for employers without electronic payrolls. The report did not estimate actual costs to employers on a per account basis.⁴³ In our review, we were unable to identify reliable government data on actual costs to small employers.

- **Flexibility to promote payroll-deduction IRAs.** According to IRA providers, some employers are hesitant to offer a payroll-deduction IRA program because they find Labor’s guidance limits their ability to effectively publicize the program to employees for fear of being subject to ERISA requirements.⁴⁴ IRA providers told us employers need greater flexibility in Labor’s guidance on payroll-deduction IRAs if they are to encourage employees to save for retirement. However, Labor told us that it has received no input from IRA providers as to what that flexibility would be, and Labor officials note that Interpretive Bulletin 99-1 specifically provides for flexibility.
- **Lack of savings incentives for small employers.** Small business member organizations and IRA providers said contribution limits for payroll-deduction IRAs do not offer adequate savings incentives to justify the effort in offering these IRAs.⁴⁵ Because the contribution limits for these IRAs are significantly lower than those that apply to SIMPLE and SEP

⁴³Mary M. Schmitt 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?” *Preliminary Report Prepared for AARP*, Optimal Benefit Strategies, LLC (Mar. 8, 2007.)

⁴⁴Labor officials told us they issued this guidance to make it easier for employers to understand the guidelines to maintain the safe harbor that applies to payroll-deduction IRAs. This guidance explains the conditions under which employers can offer payroll-deduction IRAs and not be subject to ERISA reporting and fiduciary responsibilities, which apply to employer retirement plans like 401(k) plans.

⁴⁵In 2008, eligible individuals were allowed to contribute a total of \$5,000 to one or more traditional and Roth IRAs, and individuals older than age 50 could contribute \$6,000.

IRAs, employers seeking to provide a retirement plan to their employees would be more likely to choose other options. Those options also allow business owners to contribute significantly more to their own retirement account than payroll-deduction IRAs.

- **Lack of awareness.** Representatives from small business groups said many small employers are unaware that payroll-deduction IRAs are available or that employer contributions are not required. However, Labor has produced educational materials describing the payroll-deduction and employer-sponsored IRA options available to employers and employees.

Some Proposals Encourage Employers to Offer and Employees to Participate in IRAs

Retirement and savings experts told us that several legislative proposals could encourage employers to offer and employees to participate in IRAs. Several bills have been introduced in Congress to expand worker access to payroll-deduction IRAs.

- **Employer incentives to offer IRAs.** Several retirement and savings experts said additional incentives should be in place to increase employer sponsorship of IRAs. For example, experts suggested tax credits should be made available to defray start-up costs for small employers of payroll-deduction IRAs, particularly for those without electronic or automatic payroll systems. These credits should be lower than the credits available to employers for starting SIMPLE, SEP, and 401(k) plans to avoid competition with those plans, these experts said.⁴⁶ IRA providers and small business groups said increasing contribution limits for SIMPLE IRAs to levels closer to those for 401(k) plans would encourage more employers to offer these plans. Other experts said doing so could provide incentives to employers already offering 401(k) plans to switch to SIMPLE IRAs, which have fewer reporting requirements.
- **Employee incentives to participate in IRAs.** Experts offered several proposals to encourage workers to participate in IRAs, including: (1) expanding existing tax credits for moderate- and low-income workers, (2) offering automatic enrollment in payroll-deduction IRAs, and (3) increasing public awareness about the importance of saving for retirement and how to do so. Several experts said expanding the scope of the

⁴⁶The currently available “Tax Credit for Small Employer Pension Plan Startup Costs” applies to eligible employers who offer SEP, SIMPLE, and qualified plans. This credit is intended to cover costs to set up, administer, and educate employees about the plan for up to a maximum of \$500 per year for each of the first 3 years of the plan. It should be noted that providing a similar tax credit for employers offering payroll-deduction IRAs would have revenue implications for the federal budget.

Retirement Savings Contribution Credit, commonly known as the “saver’s credit,” could encourage IRA participation among workers who are not covered by an employer-sponsored retirement plan.⁴⁷ They said expanding the saver’s credit to include more middle-income earners and making the credit refundable—available to tax filers even if they do not owe income tax—could encourage more moderate- and low-income individuals to participate in IRAs. However, an expanded and refundable tax credit would have revenue implications for the federal government. Other experts told us that automatically enrolling workers into payroll-deduction and SIMPLE IRAs could increase employee participation; however, small business groups and IRA providers said that mandatory automatic enrollment could be burdensome to small employers.⁴⁸ In addition, given the lack of available income for some, several experts told us that low-income workers may opt out of automatic enrollment programs or be more inclined to make early withdrawals. Experts also said increasing public awareness of the importance of saving for retirement and educating individuals about how to do so could increase IRA participation.

⁴⁷Currently, the saver’s credit provides a nonrefundable tax credit to low- and moderate-income savers of up to 50 percent of their annual IRA or 401(k) contributions up to \$2,000. In 2007, the credit was available to single and married individuals filing separate income tax returns who make no more than \$26,000 and to married couples filing jointly who make no more than \$52,000. Depending on income and filing status, taxpayers may claim a credit as high as 50 percent or as low as 10 percent of their contributions. The saver’s credit was designed to provide a greater savings incentive to low- and moderate-income workers who, because of their lower marginal tax rates, receive lower tax subsidies by saving in tax-preferred accounts, such as IRAs, than higher income individuals.

⁴⁸Several studies show that 401(k) plans with automatic enrollment features have increased participation rates, especially among young and lower income workers who are less likely to participate in these plans. However, as previously mentioned, 401(k) plans are different from IRAs with different incentives. One study of a large firm found that automatic enrollment increased participation by eligible employees from 57 percent to 86 percent in 1 year for new hires. Brigitte C. Madrian and Dennis F. Shea, “The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior,” *The Quarterly Journal of Economics*, vol. 116, issue 4 (November 2001).

Changes at Labor and IRS Could Help Encourage Employers to Offer IRAs and Improve IRA Information and Oversight

Earlier this month, we reported that changes at IRS and Labor could encourage employers to offer IRAs and improve IRA information and oversight.⁴⁹ We found that regulators lack information about employer-sponsored and payroll-deduction IRAs that could help determine whether these vehicles help workers without employer-sponsored pension plans build retirement savings. For example, IRS collects information on employer-sponsored IRAs but does not share the information collected with Labor, which has oversight responsibility for employer-sponsored IRAs. We also found that certain oversight vulnerabilities need to be improved. Currently, Labor has no process in place to monitor employer-sponsored IRAs, and has no jurisdiction over payroll-deduction IRAs. As a result of our findings, we made recommendations to Labor and IRS to improve IRA information and oversight and suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight.

Regulators Lack Information and Consistent Reporting on Employer-Sponsored and Payroll-Deduction IRAs

Because employer-sponsored IRAs have few employer reporting requirements and payroll-deduction IRAs have none, regulators lack information on these IRAs. Under Title I of ERISA, there is no reporting requirement for SIMPLE IRAs, and there is an alternative method available for reporting employer-sponsored SEP IRAs. Employers who offer payroll-deduction IRAs have no reporting requirements, and consequently, there is no reporting mechanism that captures how many employers offer payroll-deduction IRAs. Although IRS receives information reports for all traditional and Roth IRAs, those data do not show how many were for employees using payroll-deductions. In our discussions with Labor and IRS officials, they explained that the limited reporting requirements for employer-sponsored IRAs were put in place to try to encourage small employers to offer their employees retirement plan coverage by reducing their administrative and financial burdens.

Although the reporting requirements for employer-sponsored IRAs are limited, IRS does collect some information on these IRAs through several “information” forms provided by financial institutions and employers. These forms provide information on salary-reduction contributions to employer-sponsored IRAs, as well as information on IRA contributions, fair market value, and distributions. For example, information on retirement plans are reported annually by employers and others to IRS on

⁴⁹ [GAO-08-590](#).

its Form W-2. The Form W-2 contains details on the type of plan offered by the employer, including employer-sponsored IRAs, and the amounts deducted from wages for contributions to these plans.⁵⁰

According to agency officials, IRS cannot share the information it receives on employer-sponsored IRAs with Labor because it is confidential tax information. Labor also does not receive relevant information from employers, such as annual financial reports, as it does from private pension plan sponsors. For example, pension plan sponsors must file Form 5500 reports with Labor on an annual basis, which provide Labor with valuable information about the financial health and operation of private pension plans.⁵¹ Although Labor's Bureau of Labor Statistics National Compensation Survey surveys employee benefit plans in private establishments, receiving information on access, participation, and take-up rates for DB and DC plans, the survey does not collect information on the number of employers sponsoring employer-sponsored IRAs. Consequently, Labor does not receive important information on employers who have established employer-sponsored IRAs, over which it has oversight responsibilities.

Ensuring that regulators obtain information about employer-sponsored and payroll-deduction IRAs is one way to help them and others determine the status of these IRAs and whether those individuals who lack employer-sponsored pension plans are able to build retirement savings through employer-sponsored and payroll-deduction IRAs. However, key information on IRAs is currently not reported, such as information that identifies employers offering payroll-deduction IRAs and the distribution by employer of the number of employees that contribute to payroll-deduction IRAs. Experts that we interviewed said that, without such information, they are unable to determine how many employers and employees participate in payroll-deduction IRAs and the extent to which

⁵⁰ In addition to information collected through employer-filed W-2 forms, the financial institution/trustee handling the employer-sponsored IRA provides the IRS and participants with annual statements containing contribution and fair market value information on IRS Form 5498. Distributions from that same plan are reported by the financial institution making the distribution to both IRS and the recipients of the distributions on IRS Form 1099-R.

⁵¹ The Form 5500 provides basic information to identify the plan and type of plan as well as more detailed information, including data on assets, liabilities, insurance, and financial transactions. Form 5500 contains information on the financial condition of the plan and the benefits that the plan expects to pay out.

these IRAs have contributed to the retirement savings of participants. In addition, the limited reporting requirements prevent information from being obtained about the universe of employers that offer employer-sponsored and payroll-deduction IRAs, which affects Labor's ability to monitor employer-sponsored IRAs. This information also can be useful when determining policy options to increase IRA participation among uncovered workers because it provides a strong foundation to assess the extent to which these IRAs are being utilized.

Although IRS does publish some of the information it receives on IRAs through its Statistics of Income program, IRS does not produce IRA reports on a consistent basis. IRS officials told us that they are currently facing several challenges that affect their ability to publish IRA information more regularly. First, IRS relies, in part, on information returns to collect data on IRAs: such returns are not due until the following year after the filing of the tax return. IRS officials said that these returns have numerous errors, making it difficult and time-consuming for IRS to edit them for statistical analysis. They also said that the IRA rules, and changes to those rules, are difficult for some taxpayers, employers, and trustees to understand, which contributes to filing errors. Also, in the past, one particular IRS employee, who has recently retired, took the lead in developing a statistical analysis on IRAs. Since IRS does not have a process in place to train another employee to take over this role, a knowledge gap was created that IRS is trying to fill. IRS officials told us that they recognize this problem and are in the early stages of determining ways to correct it. In addition, IRS officials told us they had problems with the IRA data for tax year 2003, which prevented them from issuing a report for that year. The result has been that IRS has published IRA data for tax years 2000, 2001, 2002 and 2004, but none for tax year 2003.

Labor officials and retirement and savings experts told us that without the consistent reporting of IRA information by IRS, they use studies by financial institutions and industry associations for research purposes, which include assessing the current state of IRAs and future trends. These experts said that although these studies are helpful, some may double-count individuals because one person may have more than one IRA at different financial institutions. They also said that more consistent reporting of IRA information could help them ensure that their analyses reflect current and accurate information about retirement assets, such as the fair market value of IRAs. Since IRS is the only agency that has data on all IRA participants, consistent reporting of these data could give policymakers and others a more comprehensive view of the IRA landscape.

Labor Has No Process in Place to Monitor Employer-Sponsored IRAs

Given the limited reporting requirements for employer-sponsored IRAs and the absence of requirements for payroll-deduction IRAs, as well as Labor's role in overseeing employer-sponsored IRAs, a minimum level of oversight is important to ensure that employers are acting in accordance with the law and within Labor's guidance on payroll-deduction IRAs. Yet, Labor officials said that they are unable to monitor (1) whether all employers are in compliance with the prohibited transaction rules and fiduciary standards, such as by making timely and complete employer-sponsored IRA contributions or by not engaging in self-dealing;⁵² and (2) whether all employers who offer a payroll-deduction IRA are meeting the conditions of Labor's guidance.

- **Employer-sponsored IRAs.** Labor officials said that they do not have a process for actively seeking out and determining whether employer-sponsored IRAs are engaging in prohibited transactions or not abiding by their fiduciary responsibilities, such as by having delinquent or unremitted employer-sponsored IRA contributions. Instead, as in the case of Labor's oversight of pension plans, Labor primarily relies on participant complaints as sources of investigative leads to detect employers that are not making the required contributions to their employer-sponsored IRA.
- **Payroll-deduction IRAs.** Payroll-deduction IRAs are not under Labor's jurisdiction; however, Labor does provide guidance regarding the circumstances under which an employer may provide a payroll-deduction IRA program without being subject to the Title I requirements of ERISA. As long as employers meet the conditions in Labor's regulation and guidance, employers are not subject to the fiduciary requirements in ERISA Title I that apply to employer-sponsored retirement plans, such as 401(k) plans.⁵³ IRS, also, does not have direct oversight over payroll-deduction IRA programs. IRS oversees the rules associated with the traditional and Roth IRAs that payroll-deduction programs may fund

⁵²Section 406(b) of ERISA and §4975 of the Internal Revenue Code prohibit a plan fiduciary from engaging in self-dealing, which is described as conduct by fiduciaries that consists of taking advantage of their position in a transaction and acting for their own interests rather than for the interests of the beneficiaries of the plan.

⁵³According to Labor officials, if they become aware of an employer operating a payroll-deduction IRA that may not be following agency guidance, Labor will conduct an investigation to determine if the IRA should be treated as an ERISA pension plan. The IRA may become subject to the requirements of Title I of ERISA, which includes filing a detailed annual report (Form 5500) with Labor. Labor officials said this was done in an effort to ensure that plans are being operated and maintained in the best interest of plan participants.

through employee contributions. However, IRS does not have oversight over employer management of these programs.

Labor officials told us that they are not aware of employers improperly relying on the safe harbor regarding payroll-deduction IRAs. However, without a process to monitor payroll-deduction IRAs, Labor cannot be certain of the extent or nature of certain employer activities that may fall outside of the guidance provided by Labor.

Recent Recommendations Regarding IRAs

In order to improve oversight and information available on IRAs, we recently made several recommendations to Congress, Labor, and IRS, which are summarized in table 3.

Table 3: Recent GAO Recommendations Regarding IRAs

Target	Recommendations
Congress	Given the absence of direct oversight of payroll-deduction IRAs, we suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight.
Labor	Examine ways to better encourage employers to offer and employees to participate in payroll-deduction IRA programs that could include <ul style="list-style-type: none"> determining the costs to employers for establishing such programs, developing policy options to help employers defray these costs, and evaluating whether modifications to its guidance are needed to encourage employers to offer payroll-deduction IRA programs. <p>Evaluate ways to determine whether employers who establish employer-sponsored IRAs and offer payroll-deduction IRAs are in compliance with the law and the safe harbor provided under Labor's regulations and Interpretive Bulletin 99-1, while taking employer burden into account.</p> <p>Evaluate ways to collect additional information on employer-sponsored and payroll-deduction IRAs, such as adding questions to the Bureau of Labor Statistics National Compensation Survey that provide <ul style="list-style-type: none"> information sufficient to identify employers that offer payroll-deduction and employer-sponsored IRAs, and the distribution by employer of the number of employees that contribute to payroll-deduction and employer-sponsored IRAs. </p>
IRS	Provide Labor with summary information on IRAs and information collected on employers that sponsor IRAs. Release its reports on IRA contributions, accumulations, and distributions on a consistent basis, such as annually.

Source: GAO

We reported that neither IRS nor Labor have direct oversight of payroll-deduction IRAs and that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. Although Labor provides guidance regarding the circumstances under which employers may offer payroll-deduction programs without being subject to the Title I requirements of ERISA, Labor does not have jurisdiction to monitor

whether employers are managing such programs within the bounds of Labor's safe harbor. Similarly, IRS has responsibility over tax rules for establishing and maintaining traditional and Roth IRAs that may be funded through employee contributions from payroll-deduction programs; however, IRS also does not have authority to monitor employers offering these programs. We have reported that without direct oversight of payroll-deduction IRAs, employees may lack confidence that payroll-deduction IRAs will provide them with adequate protections to participate in such programs, which is particularly important given the increasing role that IRAs have in retirement savings. As such, we have suggested that Congress consider whether payroll-deduction IRAs should have some direct oversight.

We have also reported that it is important for Labor to have an accurate accounting of the costs to employers for managing payroll-deduction IRAs. In our review, we were unable to determine the actual costs to employers for managing a payroll-deduction IRA program. Some experts reported that such costs were significant, while others reported that they were minimal. Further, under Labor's guidance on payroll-deduction IRAs, employers may receive reasonable compensation for the cost of operating payroll-deduction IRA programs as long as such compensation does not represent a profit to employers. However, because the information on costs of managing such programs is lacking, Labor may be unable to readily determine if employers are receiving excessive compensation and if such programs fall outside the safe harbor and may be considered to have become ERISA Title I programs. Furthermore, without accurate cost estimates and a determination of what constitutes "reasonable compensation" to employers, employers may be reluctant to seek compensation from IRA service providers to defray the costs of operating a payroll-deduction IRA program.

Conclusions

Currently, IRAs play a major role in preserving retirement assets but a very small role in creating them. Although studies show that individuals find it difficult to save for retirement on their own, millions of U.S. workers have no retirement savings plan through their employer. Employer-sponsored and payroll-deduction IRAs afford an easier way for workers, particularly those who work for small employers, to save for retirement. They also offer employers less burdensome reporting and legal responsibilities than defined benefit pension plans and defined contribution plans, such as 401(k) plans. Yet, barriers exist, such as administrative costs, that may discourage employers from offering payroll-deduction IRAs. As federal agencies begin to determine the true cost of establishing payroll-deduction

IRAs, employers will have a better understanding of the costs and will be in a better position to evaluate whether they will be able to offer payroll-deduction IRAs to their employees.

Encouraging employers to offer IRAs to their employees can be much more productive if Congress and regulators ensure that there is adequate information on employer-sponsored IRAs and payroll-deduction IRAs. Although the limited reporting requirements for employer-sponsored IRAs and the absence of reporting requirements for payroll-deduction IRAs were meant to encourage small employers to offer retirement savings vehicles to employees, there is also a need for agencies that are responsible for overseeing retirement savings vehicles to have the information necessary to do so. Providing complete and consistent data on IRAs would help ensure that regulators have the information they need to make informed decisions about how to increase coverage and facilitate retirement savings. In addition, ensuring that Labor has a process in place to monitor employer-sponsored IRAs will help ensure that there is a structure in place to help protect individuals' retirement savings if they choose employer-sponsored IRAs. If current oversight vulnerabilities are not addressed, future problems could emerge as more employers and workers participate in employer-sponsored IRAs.

Steps must also be taken to improve oversight of payroll-deduction IRAs and determine whether direct oversight is needed. Without direct oversight, employees may lack confidence that payroll-deduction IRAs will provide them with adequate protections to participate in these programs, which is particularly important given the current focus in Congress on expanding payroll-deduction IRAs. However, any direct oversight of payroll-deduction IRAs should be done in a way that does not pose an undue burden on employers or their employees.

We are continuing our work on IRAs, and are beginning to examine the fees that are charged IRA participants. We are pleased that the Committee on Ways and Means and this subcommittee are interested in retirement savings, particularly IRAs, and look forward to continuing our work with you.

Mr. Chairman and Members of the subcommittee, this completes my prepared statement and I would be happy to respond to any questions the subcommittee may have at this time.

Contacts and Acknowledgments

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