U.S. Department of Labor

Office of Inspector General—Office of Audit

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

EBSA NEEDS TO MONITOR THE PROJECTED IMPACT OF THE QUALIFIED DEFAULT INVESTMENT ALTERNATIVE REGULATION

Date Issued:	March 31, 2011
Report Number:	09-11-002-12-121

U.S. Department of Labor
Office of Inspector General
Office of Audit

BRIEFLY…

Highlights of Report Number **09-11-002-12-121**, to the Assistant Secretary for Employee Benefits Security.

WHY READ THE REPORT

Approximately one-third of eligible workers do not participate in their employers' 401(k)-type plans. The Pension Protection Act (PPA), signed into law in 2006, removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws. These impediments had prevented many employers from adopting automatic enrollment, or had led them to invest workers' contributions in low-risk, low-return "default" investments.

The PPA directed the Department of Labor to issue a regulation to assist employers in selecting optimal default investments. The Department issued a proposed regulation on October 24, 2007.

The Department estimated the regulation would increase retirement savings from about $70 billion to $134 billion by 2034. The Department stated this increase would be accomplished through increased employee participation and increased average investment returns.

WHY OIG CONDUCTED THE AUDIT

We conducted an audit to determine what EBSA is doing to assess employee participation in retirement plans and average investment returns are increasing.

The audit covered EBSA's monitoring process for assessing, on a continuing basis, the impact of QDIA regulation. The audit period covered December 2007 through March 2011.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to:
http://www.oig.dol.gov/public/reports/oa/2011/09-11-002-12-121.pdf

March 2011

EBSA NEEDS TO MONITOR THE PROJECTED IMPACT OF THE QUALIFIED DEFAULT INVESTMENT ALTERNATIVE REGULATION

WHAT OIG FOUND

The OIG found EBSA needs to develop a process to determine whether the QDIA regulation is helping to increase employee participation and average investment returns in retirement plans through automatic enrollments.

EBSA estimated the regulation would increase retirement savings from about $70 billion to $134 billion by 2034. However, EBSA did not develop plans to determine whether automatic enrollments resulted in greater employee participation or increased retirement savings subsequent to issuing the regulation.

Since increased participation and investment returns are critical to the retirement savings of American workers, it is important to monitor these indicators. Without a monitoring process in place, increasing the retirement savings of employees is at risk because EBSA cannot know if the QDIA regulation is having its intended effects.

WHAT OIG RECOMMENDED

The OIG recommended the Assistant Secretary for Employee Benefits Security develop and implement a process to monitor if employee participation and average investment returns in retirement plans increase over time and take appropriate action if needed to determine if any modifications to the regulation is warranted.

In response to our draft report, the Assistant Secretary for Employee Benefits Security stated that EBSA does not plan to monitor the separate effect of the QDIA regulation, because its existing processes for monitoring retirement plan trends and assessing whether and when regulations should be amended are effective. We continue to believe that in order to make appropriate recommendations to policy makers, EBSA should evaluate whether the QDIA regulation is having its intended impact.

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U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

March 31, 2011

Assistant Inspector General's Report

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Approximately one-third of eligible workers do not participate in their employer-sponsored defined contribution plans (such as 401(k) plans). The Pension Protection Act (PPA), signed into law in 2006, removed some important impediments to increasing participation through automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws. These impediments had prevented many employers from adopting automatic enrollment or had led them to invest workers' contributions in low-risk, low-return "default" investments. Under the PPA, employers are relieved of certain legal liabilities if they invest the non-directed assets in a "qualified default investment alternative" (QDIA).

In response to the PPA, DOL issued a regulation to increase employee participation and average investment returns in retirement plans by assisting employers in selecting optimal default investments. DOL administers this regulation through the Employee Benefits Security Administration (EBSA).

We conducted an audit to determine what EBSA is doing to assess if employee participation in retirement plans and average investment returns are increasing.

To accomplish our objective, we reviewed EBSA's policies and procedures regarding the assessment of potential and actual impacts of the QDIA regulation. We interviewed EBSA officials, reviewed external reports obtained by EBSA from its Regulatory Impact Analysis, and interviewed officials from private employee benefits organizations.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

RESULTS IN BRIEF

EBSA needs to develop a process to determine whether the QDIA regulation is helping to increase employee participation and average investment returns in retirement plans through automatic enrollments.

EBSA estimated the regulation would increase retirement savings from about $70 billion to $134 billion by 2034. However, EBSA did not develop plans to determine whether automatic enrollments resulted in greater employee participation or increased retirement savings subsequent to issuing the regulation. The Form 5500, Annual Return/Report of Employee Benefit Plan, now includes data on automatic enrollment, but does not include data on employee participation or average investment returns. Alternatively, EBSA could use available private data to determine if, in the years since EBSA issued the regulation, either plan participation or average investment returns increased.

EBSA officials stated it would be difficult to attribute any actual increases in retirement savings or plan participation to the regulation and they do not believe it is necessary. Therefore, they did not develop a process to monitor the actual effect.

EBSA intended its QDIA regulation to help accomplish the goal of increasing participation and average investment returns through automatic enrollment and default investments. Since increased participation and investment returns are critical to the retirement savings of American workers, it is important to monitor these indicators. Without a monitoring process in place, increasing the retirement savings of employees, as EBSA intended, is at risk because EBSA cannot know if the QDIA regulation is having its intended effects.

We recommend the Assistant Secretary for Employee Benefits Security develop and implement a process to monitor if employee participation and average investment returns in retirement plans increase over time and take appropriate action to determine if any modifications to the regulation is warranted.

In response to our draft report, the Assistant Secretary for Employee Benefits Security stated that existing processes for monitoring retirement plan trends and assessing whether and when its regulations should be amended are effective and does not believe additional steps to monitor the separate effect of the QDIA regulation are necessary. Additionally, the Assistant Secretary stated that collecting the data required to correlate the regulation's impact on employee participation and investment returns in retirement plans would be cost prohibitive.

We continue to believe that EBSA needs to evaluate whether the QDIA regulation is having its intended impact. To clarify, we are not recommending that EBSA directly correlate such factors as rates of return to the regulation. We are recommending that EBSA assess such indicators as whether employee participation is increasing through automatic enrollment and whether default investments are moving from low return investments to more appropriate retirement vehicles. We believe EBSA has access to the data needed to perform these types of assessments, and believe the result of such assessments would be useful in evaluating the impact of the regulation and to identify possible ways to improve it.

RESULTS AND FINDING

Objective — What is EBSA doing to assess if employee participation in retirement plans and average investment returns are increasing?

EBSA does not know if QDIAs are achieving their intended economic impact.

Finding — EBSA Needs to Have a Process to Assess if the QDIA Regulation is Accomplishing its Purpose

EBSA has not assessed if employee participation in retirement plans and average investment returns are increasing.

Under automatic enrollment, an employer enrolls a worker into a retirement plan automatically unless they explicitly choose to opt out. In the past, under defined contribution plans, workers typically would decide whether to participate.

While EBSA had concerns about using private data, we believe it would be useful for EBSA to use available private data to determine if, in the years since EBSA issued the regulation, either plan participation or average investment returns increased. For example, in recent years, studies have shown that automatic enrollment in retirement plans increases both the number of workers participating in retirement plans and the amount of money saved. For example, a study by Fidelity investments showed that automatic enrollment increased worker participation in retirement plans from 53 percent to 81 percent. Additionally, the participation rate for eligible employees in their 20s earning less than $30,000 per year was 54 percentage points higher than for those without automatic enrollment.

Another study by Vanguard Center for Retirement Research showed that automatic enrollment increased worker participation from 45 percent to 86 percent. The Center's analysis of about 50 plans adopting automatic enrollment showed that automatic enrollment raises participation rates across most demographic groups, with its largest effect among low-wage and younger employees. Specifically, workers under 25 had a participation rate that increased from 30 percent to 81 percent when auto-enrollment was a plan feature. The study further noted that workers earning less than $30,000, and hired under automatic enrollment have a participation rate of 77%, but employees at the same income level hired under voluntary enrollment had a participation rate of 25%. The study pointed out that the DOL regulation was expected to encourage increased investment activity in diversified multi-asset-class portfolios, thus increasing retirement security.

Despite these benefits, an impediment to automatic enrollment has been the fiduciary liability attached to withholding funds from employees' paychecks and choosing where to invest the money absent specific directions from the employee. If plan officials invested the funds and the investments lost value, plan officials, as fiduciaries, could be liable for the losses. Thus, sponsors were hesitant to use automatic enrollment. When they did, they chose very safe investments that produced low returns. While reducing the risk of loss, these safe investments were generally not appropriate for long-term retirement investments.

The PPA tried to alleviate this situation by directing EBSA to develop a regulation that would define investments sponsors could utilize, but would shield them from fiduciary liability and increase the return employees received on their retirement investment.

In implementing the PPA, EBSA believed the QDIA regulation would be consistent with its mission to increase retirement security for American workers. In issuing the final rule, EBSA stated:

> This regulation is expected to have two major economic consequences. Default investments will be directed more toward higher-return portfolios, boosting average investment returns, and automatic enrollment provisions will become more common, boosting participation. Both of these effects will increase average retirement savings, especially among workers who are younger, have lower earnings and/or more frequent job changes.

EBSA also stated that it was confident the regulation would increase the incidence of automatic enrollment.

However, EBSA did not develop plans to monitor whether employee participation or overall retirement savings improved or to determine if any modification to the regulation was warranted. Although, EBSA recently revised the Form 5500 to collect information on automatic enrollment, this was not done in relation to the QDIA regulation and EBSA has not developed formal plans to use this data to evaluate whether the regulation is having the intended effect. In addition, EBSA did not collect data on employee participation or average investment returns.

EBSA officials stated it would be difficult to attribute any actual increases in retirement savings or plan participation to the QDIA regulation and do not plan to monitor the regulations impact.

Although it could be difficult to attribute any actual increases in retirement savings or plan participation to the QDIA regulation, EBSA should be able to determine whether the overall objectives, increases in employee participation and average investment returns, are being achieved. In addition to the Form 5500, there are other sources for data, some of which are currently available. For example, BLS issues a National

Compensation Survey that provides information on trends in retirement plan features and participation rates. In addition, private research studies, as noted earlier, have used information from retirement investment providers such as mutual fund companies, which have current data on retirement plans they serve. EBSA does not currently have plans to utilize this information to analyze the impact of the regulation.

RECOMMENDATION

We recommend the Assistant Secretary for Employee Benefits Security develop and implement a process to monitor if employee participation and average investment returns in retirement plans increase over time and take appropriate action if needed to determine if any modifications to the regulation is warranted.

We appreciate the cooperation and courtesies that EBSA personnel extended to the Office of Inspector General during this audit. OIG personnel who made major contributions to this report are listed in Appendix E.

Elliot P. Lewis

Elliot P. Lewis
Assistant Inspector General for Audit

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Appendices

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Appendix A

Background

The Pensions Protection Act (PPA) was enacted in 2006 and was the most comprehensive reform of the nation's pension laws since the enactment of the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406). The PPA directed the Department of Labor to issue a regulation to assist employers in selecting default investments[1] that best serve the retirement needs of workers who do not direct their own investments.

The Department issued 29 Code of Federal Regulations Part 2550 (29 CFR Part 2550), Default Investment Alternatives Under Participant Directed Individual Account Plans, on October 24, 2007. At that time, EBSA expected that the regulation would have two major economic impacts, increasing both average investment returns and employee participation in retirement plans through automatic enrollment. EBSA estimated the regulation would increase retirement savings from about $70 billion to $134 billion by 2034. The Department believed there was a substantial risk that savings would fall short relative to many workers' retirement income expectations, because of increasing health costs and stresses on defined benefit pension plans and the Social Security program. The Department believed the regulation would help reduce that risk.

[1] In the absence of employee directions on investing retirement contributions in a self-directed defined contribution plan, the contributions will be automatically enrolled in a QDIA.

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Appendix B

Objective, Scope, Methodology, and Criteria

Objective

Our audit objective was to answer the following question:

What is EBSA doing to assess if employee participation in retirement plans and average investment returns are increasing?

Scope

The audit covered EBSA's monitoring process for assessing, on a continuing basis, the impact of QDIA regulation. The audit period covered the effective date of the regulation, December 2007, to the exit conference in March 2011. We conducted our fieldwork at EBSA's headquarters in Washington, DC.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Methodology

To accomplish our objective, we reviewed applicable criteria, including 29 CFR Part 2550, the Pension Protection Act of 2006, and Field Assistance Bulletin 2008-3. We assessed EBSA policies and procedures regarding the QDIA regulation, specifically, those procedures regarding the potential and actual impact of the QDIA regulation. We interviewed EBSA officials from the Office of Policy and Research to obtain an understanding of EBSA's process for assessing the impact of the QDIA regulation. We obtained and reviewed the three external reviews EBSA obtained of its Regulatory Impact Analysis (RIA)[2].

Furthermore, we interviewed officials from EBSA's (1) Office of Enforcement concerning how the QDIA regulation is enforced, (2) Office of Regulations and Interpretations concerning how the QDIA regulation was developed and implemented, and (3) Office of Participant Assistance concerning how the regulation was incorporated into EBSA outreach efforts.

We also interviewed officials from the Profit Sharing/401(k) Council of America and the Employee Benefits Research Institute to obtain their views regarding EBSA's regulation

[2] The analysis that EBSA used to determine the regulation's impact.

and its potential effect on retirement plans. Additionally, we interviewed GAO officials and reviewed GAO reports as well as studies by Vanguard and Fidelity Investments.

In planning and performing our audit, we considered EBSA's internal controls that were relevant to our audit objective. We confirmed our understanding of these controls and procedures through interviews, observations, and inquiries. Our consideration of internal controls relevant to our audit objective would not necessarily disclose all matters that might be significant deficiencies. Because of inherent limitations in internal controls, misstatements or noncompliance may nevertheless occur and not be detected.

Criteria

29 CFR 2550 Default Alternatives under Participant Directed Individual Account Plans; Final Rule

Pension Protection Act of 2006

Field Assistance Bulletin 2008-3

Appendix C

Acronyms and Abbreviations

CFR	Code of Federal Regulations
DOL	Department of Labor
EBSA	Employment Benefit Security Administration
ERISA	Employment Retirement Income Security Act
PPA	Pension Protection Act of 2006
QDIA	Qualified Default Investment Alternatives
RIA	Regulatory Impact Analysis

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Appendix D

EBSA Response to Draft Report

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

MAR 3 0 2011

MEMORANDUM FOR: ELLIOT P. LEWIS
Assistant Inspector General for Audit

FROM: PHYLLIS C. BORZI
Assistant Secretary for Employee Benefits Security

Phyllis C Borzi

SUBJECT: EBSA Response to OIG Performance Audit
Draft Audit Report Number 09-11-002-12-121

Thank you for the opportunity to comment on the recommendation in your above referenced Audit Report on the Employee Benefits Security Administration's assessment of whether employee participation in retirement plans and average retirement savings are increasing.

OIG's Recommendation: Develop and implement a process to monitor if average investment returns and employee participation in retirement plans increase over time and to take appropriate action if needed and to determine if any modifications to the regulation of Qualified Default Investment Alternatives (QDIA)(29 CFR 2550.404c-5) is warranted.

EBSA believes its existing processes for monitoring retirement plan trends and assessing whether and when its regulations should be amended are effective and appropriately responsive to the Inspector General's (IG's) recommendations. No additional steps are warranted. For example, EBSA recently revised the Form 5500 to collect information on automatic enrollment, as the IG reports. EBSA also routinely produces statistics and carries out research on retirement plan trends, and makes use of statistics and research produced by others as illustrated by EBSA's production and publication of estimates of retirement plan participation and investment returns annually (see http://www.dol.gov/ebsa/pdf/1975-2007historicaltables.pdf). These are just some of myriad indicators EBSA follows to monitor and assess retirement plan trends.

As the IG reports, EBSA has no plan to monitor the separate effect of the QDIA regulation on retirement plan investment performance and participation. Isolating the QDIA regulation's effect from the effects of larger forces is infeasible and beyond the scope of the IG's recommendation. The data required to attempt to correlate the regulation's impact on investment returns and employee participation in retirement plans would be cost prohibitive to collect, and no pre-regulation baseline data exists for comparison.

EBSA continually evaluates the effectiveness of its existing regulations and the appropriateness of amendments to them. This evaluation is the basis for EBSA's regulatory agenda, which EBSA publishes semiannually pursuant to Executive Order 12866. The evaluation is informed by retirement plan trends, stakeholder input, experience gained through EBSA's enforcement and participant assistance programs, and various external factors such as legislative and technological developments. Such evaluation recently prompted EBSA to propose amendments to its QDIA regulation (See Federal Register: November 30, 2010 (Volume 75, Number 229), Proposed Rules, Page 73987-73995).

EBSA appreciates this opportunity to explain its processes for monitoring retirement plan trends and assessing whether and when its regulations should be amended.

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Appendix E

Acknowledgements

Key contributors to this report were Ralph McClane, Audit Director, Mary Stepney, Naomi Byberg, Samantha Cash-Johnson, Timothy Kerschen, and Mary Lou Casazza.

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