

# AMERICAN BENEFITS COUNCIL

YOUR ADVOCATE FOR EMPLOYER-SPONSORED BENEFITS SINCE 1967



July 17, 2017

The Honorable Orrin Hatch  
Chairman, Committee on Finance  
United States Senate  
Washington, DC 20510

Dear Chairman Hatch,

Thank you for the opportunity to provide input on the future of tax policy. Smart and effective tax policy is the foundation of American economic growth. Not coincidentally, it is also the basis of our employer-sponsored health and retirement benefits system, which helps hundreds of millions of American workers thrive.

The American Benefits Council (the Council) is a national association dedicated to protecting and fostering privately-sponsored health and retirement plans. In 2017, the Council is celebrating 50 years as an advocate for employer-sponsored benefits. The Council's approximately 425 members are primarily large, multistate U.S. employers that provide employee benefits to active and retired workers and their families. Collectively, the Council's members sponsor directly or provide services to health and retirement plans covering more than 100 million Americans.

## **EMPLOYER-SPONSORED BENEFITS: A POWERFUL FORCE**

Human capital – the American worker – is a critical element of our nation's dynamic economy. One of the key reasons American employers are able to recruit and retain the best and brightest talent from around the world is because the employer-sponsored health and retirement benefits system offers workers the opportunity to live healthy, financially secure lives.

Comprehensive tax reform represents a valuable opportunity to spur economic growth by supporting and building on programs that work effectively. It also serves as an exercise in evaluating our priorities. The employer-sponsored benefits system has proven both successful and popular and now constitutes the primary source of health and financial security for the vast majority of Americans.

While it is true that the tax incentives for health and retirement plans are typically scored as the largest income tax expenditures in the federal budget, it is vitally important not to lose sight of two essential facts.

First, the tax “expenditure” for employer-provided health plans – attributable to the exclusion of employer contributions from individuals’ income and payroll tax – is a relative bargain compared to the enormous federal expenditures on the Medicare and Medicaid programs, even though employer plans offer far superior coverage. Incentivizing employers to maintain health coverage reduces the financial consequences to the government of providing direct subsidies to many individuals who would otherwise obtain coverage through these government programs or the ACA exchanges.

Although the tax expenditure for employer-sponsored health coverage is often viewed as regressive because the “tax benefit” favors higher-income individuals, in fact, the expenditure is quite progressive because the value of the “health benefit” it provides is more significant for lower-income individuals – for whom it would be a greater financial burden to purchase coverage absent an employer-sponsored plan.

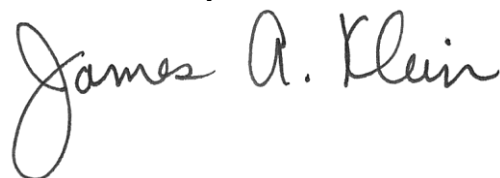
Second, the tax “expenditure” for employer-provided retirement plans is not actually an expenditure at all – it is a tax *deferral*. Tax revenue is eventually collected on retirement plan contributions (and any earnings) upon distribution or withdrawal. So the “loss” is largely a matter of timing. Furthermore, like employer-sponsored health plans, retirement plans ultimately mitigate the cost burden on public programs such as Social Security.

If the employer-sponsored system is to endure, it must continue to be supported by stable tax policy that upholds a long-term view beyond temporary budget windows. To ensure all individuals can obtain needed security for health, retirement and other income protection needs, we believe that favorable tax treatment should be provided for individuals outside the employer system as well.

In an environment where government-based proposals are not possible politically nor practically, the employer-sponsored system is not just indispensable, it is emblematic of American exceptionalism.

As you and your fellow lawmakers take on the challenging task of tax reform, we urge you to keep the employer-sponsored system squarely in mind. Attached as appendices to this letter are specific policy recommendations that will help preserve and strengthen employer-sponsored health and retirement benefits for millions of hardworking Americans. We stand ready to work with you toward these shared goals.

Sincerely,

A handwritten signature in black ink that reads "James A. Klein". The signature is written in a cursive style with a large, looping initial "J".

James A. Klein  
President



## APPENDIX A: TAX POLICY RECOMMENDATIONS TO PRESERVE AND STRENGTHEN EMPLOYER-SPONSORED HEALTH COVERAGE

Employers currently provide health coverage to more than 177 million Americans,<sup>1</sup> *nearly ten times more people* than are covered by the individual market. Employers typically pay, on average, 82 percent of the cost of coverage.<sup>2</sup> This is popular, affordable, high-quality coverage that leads to better health outcomes, lower costs and more satisfied and productive employees. Taxing these benefits could undermine the core of Americans' health coverage system.

Employers contribute over \$668 billion annually<sup>3</sup> – more than the federal government spends on Medicare – to their employees' group health insurance costs. The following policy proposals will help preserve vital employer-sponsored coverage:

### ADDRESS THE UNDERLYING PROBLEMS WITH HIGH HEALTH CARE COSTS

Repeated efforts to reform the health care system have typically been evaluated on the single metric of health care coverage. But these laws and proposals have not resulted in meaningful advances in lowering the cost of health care, which remains the source of many challenges today.

Economic gimmicks like the “Cadillac Tax” and capping the current tax exclusion for employees are unlikely to make a serious difference in the cost of health care, but delivery system reform has the potential to effect measurable change. Value-based purchasing and value-based insurance design, in which consumers and purchasers ultimately pay for care based on quality outcomes, are much more direct ways to

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<sup>1</sup> [Health Insurance Coverage in the United States: 2015](#), U.S. Census Bureau, September 2016

<sup>2</sup> [Employer Health Benefits 2016 Annual Survey](#), Kaiser Family Foundation/ Health Research & Educational Trust, 2016

<sup>3</sup> [US Bureau of Economic Analysis data](#) (Table 6.11D. Employer contributions for employee pension and insurance funds), revised Aug. 3, 2016

address the key elements of high costs: unit price and chronic conditions. As such, the Council supports efforts to improve the transparency of price and performance data to enable individuals to become better consumers and to encourage continuous quality improvement.

## **FULLY REPEAL THE 40 PERCENT “CADILLAC TAX” ON EMPLOYER PLANS**

As you are aware, the “Cadillac Tax,” enacted as part of the ACA, imposes a 40 percent tax on the cost of employee health plans above a threshold set by the federal government. The “Cadillac Tax” was intended to address only overly generous plans, but the facts make clear that the tax will disproportionately affect certain populations and should be repealed.

Health plans are often costly for reasons unrelated to the generosity of benefits. As a result, the “Cadillac Tax” will apply to employer-sponsored health plans that may be expensive solely because they cover large numbers of older or disabled Americans, women, families suffering catastrophic health events or chronic conditions, or those who live in high-cost areas.<sup>4</sup>

Instead of reducing the actual cost of health care, the “Cadillac Tax” is forcing employers to shift costs to workers to avoid exceeding the ACA’s arbitrary thresholds. Americans already know this tax will increase their health care costs: in a survey earlier this year, when given arguments to keep or repeal the “Cadillac Tax,” voters – regardless of their political affiliation – favored repeal by a 2-to-1 margin. Voters recognize the tax will compel employers to drop or reduce health benefits and they are skeptical that employers will raise their workers’ taxable wages to make up for these reductions.<sup>5</sup>

Additionally, full repeal legislation introduced in the previous Congress garnered 350 cosponsors from both sides of the aisle, and [90 Senators voted](#) on the Senate floor to repeal the tax during the 2015 budget reconciliation debate – we appreciate your support for this amendment as well as your cosponsorship of Senator Dean Heller’s [Middle Class Health Benefits Tax Repeal Act \(S. 58\)](#) to repeal the tax from the 114<sup>th</sup> Congress. **We look forward to working with you and your tax and health teams to achieve permanent repeal of this 40 percent “Cadillac Tax”.**

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<sup>4</sup> [New Analysis: Capping the Employee Tax Exclusion for Employer Health Coverage](#), Mercer, February 23, 2017

<sup>5</sup> [Key Research Findings: Cadillac Tax](#), American Benefits Council and Public Opinion Strategies, January 2017

## REJECT NEW PROPOSALS TO TAX EMPLOYEES' HEALTH BENEFITS

Some policymakers in Congress have suggested replacing the “Cadillac Tax” with a tax on working Americans with employer-provided health insurance. These proposals would tax health benefits provided by employers, meaning higher income and payroll taxes for millions of hardworking people.

When Americans obtain their health care coverage through an employer, the cost of that coverage is “excluded” from an employee’s taxable income. “Capping” this exclusion – thereby subjecting the cost of coverage above the cap to payroll and income taxes – constitutes a direct tax increase on employees and their health benefits.

In the 114<sup>th</sup> Congress, the Congressional Budget Office estimated that capping the exclusion at levels just below those outlined in the Empowering Patients First Act would increase taxes on working Americans by an average of \$3,860 per taxpayer in 2026<sup>6</sup> and would result in higher deductibles and greater out-of-pocket costs for working Americans.<sup>7</sup> Because a cap looks at the cost of coverage rather than the actual generosity of a plan, it also suffers from many of the same flaws as the “Cadillac Tax,” disproportionately affecting employer plans in high-cost locations or with older workers, to name just two factors other than plan design that affect health plan cost. In fact, capping the exclusion is essentially the “Cadillac Tax” under a different name.

We know you are committed to tax reform that results in a middle-class tax cut. Capping the exclusion would not achieve this goal and could in fact be a significant tax increase on working families. A recent study estimates that a cap on the exclusion would increase income taxes on families making between \$20,000 and \$30,000 annually by nearly 25 percent.<sup>8</sup> Voters seem to recognize this, rejecting arguments for a cap on the exclusion by a two-to-one margin and predicting that the *worst* potential outcomes of the cap are the *most likely* to happen, and vice-versa.<sup>9</sup>

The concern about taxation of employees is not just manifested by the individuals, themselves, but also by their employers. A survey by Lockton of its corporate clients revealed *overwhelming* employer opposition (92% opposed) to a cap on the employee

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<sup>6</sup> [Options for Reducing the Deficit: 2017-2026](#), Congressional Budget Office, December 2016

<sup>7</sup> [Benefits of the Tax-Preferred Status of Employer-Sponsored Health Insurance](#), American Health Policy Institute, 2016

<sup>8</sup> [New Analysis: Capping the Employee Tax Exclusion for Employer Health Coverage](#), Mercer, February 23, 2017

<sup>9</sup> [Key Research Findings: Capping the Exclusion](#), American Benefits Council and Public Opinion Strategies, January 2017

exclusion.<sup>10</sup>

**We greatly appreciate your support for not including a proposal like this in health care reform, and we urge you to extend this same position to tax reform.**

#### **FULLY REPEAL THE EMPLOYER MANDATE AND REDUCE EMPLOYER REPORTING BURDENS**

As noted above, over 177 million Americans are covered by employer-sponsored health plans. It is expected that the vast majority of large employers will continue to sponsor coverage for their employees even if the employer mandate is repealed, just as they did prior to enactment of the ACA. The employer mandate is not needed and has added costs and complexities for large employers who have been longstanding providers of health coverage.

Complying with burdensome tracking requirements necessitated by the mandate consumes time and resources of employers and increases the costs of providing coverage to employees. The ACA added Internal Revenue Code sections 6055 and 6056, which established complex reporting requirements for employers regarding the health coverage they offer. These requirements provide the Internal Revenue Service with information needed to determine individuals' eligibility for ACA's premium tax credits. These reporting obligations require substantial time and resources to implement and overlap with the implementation of the law's employer mandate obligations, which separately require complex tracking of employee hours and coverage.

If Congress passes a bill that eliminates the employer mandate penalty, we urge significant simplification of the employer reporting obligations related to the offer of coverage to employees.

#### **EXPAND THE AVAILABILITY AND FLEXIBILITY OF CONSUMER-DIRECTED PLAN DESIGNS**

Since their inception, health savings accounts (HSAs) have been used to help make health coverage more affordable and encourage a wiser consumption of health services. We strongly support proposals that would increase the flexibility afforded to HSA plans, health reimbursement arrangements (HRAs) and flexible spending accounts (FSAs) including the following provisions, many of which are included in your legislation, the Health Savings Act of 2017:

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<sup>10</sup> [The Consequences of Taxing Healthcare Benefits: Survey of Businesses Shows Overwhelming Opposition and Disagreement with Policy Analysts](#), Lockton, March 22, 2017

- Create an HSA eligible High Deductible Health Plan (HDHP) safe harbor allowing plans the option of covering drugs and services used to treat chronic conditions on a pre-deductible basis.
- Allow employers to provide care at on-site medical clinics or via telemedicine providers on a pre-deductible basis to employees and eligible dependents enrolled in HSA-eligible HDHPs.
- Permit individuals and families to use HSA funds to pay for medical expenses for nondependent adult children under age 26.
- Permit employees age 65 and over to contribute to an HSA regardless of Medicare enrollment.
- Permit those with TRICARE coverage to contribute to an HSA.
- Permit early retirees to use HSA funds to pay premiums for retiree health insurance coverage.
- Permit individuals to purchase Medigap coverage with HSA funds.
- Permit an employee to contribute to an HSA, even if his/her spouse has a health FSA.
- Permit HSA-compatible HDHPs to begin paying benefits, on behalf of individual family members enrolled in family coverage under the HDHP, once the individual has satisfied the minimum *statutory* HDHP deductible for *single coverage*.
- Clarify that excepted benefit coverage, as defined under HIPAA, does not disqualify someone from having an HSA. Changing HSA/MSA definitions to cross reference the HIPAA definition will eliminate confusion and simplify the law.
- Repeal the prohibition on the use of HSA and health FSA funds for over-the-counter medications unless prescribed by a physician.
- Increase the HSA contribution limits.
- Eliminate the \$2,500 cap on salary reduction contributions to FSAs.
- Allow employer contributions to an HSA that is equal to the employee's balance in an embedded HRA when an employee moves to the employer's HSA option from the employer's option that includes an embedded HRA (i.e. rollover).
- Expand upon provisions enacted in the 21<sup>st</sup> Century Cures Act that created Qualified Small Employer Health Reimbursement Arrangements by permitting large employers to establish stand-alone HRAs (or similar, tax-favored accounts) that can be used to purchase individual coverage. To ensure a viable, individual insurance market, there must be adequate protections to safeguard against adverse selection or risk segmentation.

## **PRESERVE ERISA'S UNIFORM STANDARD FOR PLAN ADMINISTRATION**

Innovation in employer-sponsored health coverage thrives in an environment of regulatory certainty. This is due in large part to Congress' wisdom more than 40 years ago when it enacted the Employee Retirement Income Security Act (ERISA), to include a provision that ensures ERISA plans are free from most state and local regulation, and we applaud the Finance Committee's, and your personal, legacy of strong support for the law. ERISA's federal framework helps employers provide affordable and consistent health benefits to employees wherever they may live or work. Without ERISA uniformity, employers would have to comply with a patchwork of varying state laws and also would need to monitor and adapt to constant state-level changes.

This is not directly a "tax" issue. So in that spirit we urge Congress to ensure that changes to the tax code not inadvertently weaken or circumvent ERISA; and that Congress consider including language strengthening ERISA uniformity to help ensure states cannot impose any requirements or taxes on self-funded employer-sponsored health plans.





APPENDIX B:  
TAX REFORM AND REMOVING IMPEDIMENTS  
AND DISINCENTIVES FOR SAVINGS AND INVESTMENT  
THAT EXIST IN THE CURRENT TAX SYSTEM

The American Benefits Council (the “Council”) thanks the Senate Finance Committee for the opportunity to provide a written statement regarding tax reform and removing impediments and disincentives for savings and investment that exist in the current tax system.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

Retirement security is a critical issue for this country. Hard-working Americans deserve a system that will help them achieve a secure retirement. Although the current system has served us extremely well, this system can be improved upon, so that more can be done to provide the help Americans deserve. We applaud the leadership role that this Committee has played in furthering this goal.

Before we continue our comments, we would like to make the following two points:

First, budget scorekeeping conventions require that pre-tax deferred compensation (as opposed to Roth contributions) held in tax qualified retirement plans be scored as a “revenue loss” despite the fact that such deferred compensation does not represent a *permanent “loss”* to the Treasury. Retirement savings are very long term in nature, usually lasting decades. Amounts paid at the end of a working American’s career will be includable in gross income at that time with taxes due at ordinary income tax rates. We ask that the Committee bear in mind that the majority of the tax revenue on the \$29 trillion of deferred compensation held in retirement savings plans that appears to be “lost” in a typical ten-year revenue table will be recovered outside of the scorekeeping period.

Second, retirement plans are an important source of investment capital. Amounts held in these plans have an economic impact that extends well beyond the retirement security of individuals who save in the plans. From all sources, retirement plans held more than \$29 trillion in assets as of the fourth quarter of 2016<sup>1</sup> and these assets are expected to grow in the future. This includes amounts in defined contribution plans that accounted for approximately \$6.7 trillion with another estimated \$7.9 trillion in IRAs<sup>2</sup> (much of which is attributable to rollovers from employer-sponsored plans, including defined contribution plans).

Today, we would like to provide our perspective on the success of the current system and to provide suggestions for further refinements of the system drawn from the Committee-passed Retirement Enhancement and Savings Act of 2016 (“RESA”); from the [Secure Annuities for Employee \(SAFE\) Retirement Act \(S. 1270\)](#) sponsored by Senate Finance Committee Chairman Hatch (the “SAFE Act”); from the discussion draft of the Retirement Improvements and Savings Enhancements Act (“RISE”) released by Ranking Member Wyden on September 8, 2016; from the Retirement Security Preservation Act of 2017 (S. 852) (“Cardin/Portman”); from the Retirement Security Act of 2017 (S. 1383) (“Collins/Nelson”); from the Receiving Electronic Statements To Improve Retiree Earnings Act (S. 3417 from the 114<sup>th</sup> Congress) (“Brown/Enzi”); from S. 674, introduced by Senators Cardin, Crapo, and Roberts; from the 2015 report of the Finance Committee’s Savings and Investment Working Group (“Working Group Report”); from our own long-term public policy strategic plan, “A 2020 Vision: Flexibility and the Future of Employee Benefits,” and from additional issues that have arisen more recently.

## THE CURRENT VOLUNTARY EMPLOYER-BASED SYSTEM IS WORKING

Voluntary employer-sponsored defined contribution and defined benefit retirement plans are the foundation of our nation’s retirement system. Workplace retirement plans, like those sponsored and administered by the Council’s members, successfully assist tens of millions of families in accumulating retirement savings, allowing for a more financially secure retirement and providing sustainable health and financial well-being. Data from the U.S. Department of Labor indicates that more than 132 million active and retired workers (and their spouses) are now covered by nearly 700,000 employer-sponsored retirement plans nationwide.<sup>3</sup> In addition, more than 42 million households now own some kind of Individual Retirement Account (IRA),<sup>4</sup> many comprised of

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<sup>1</sup> Federal Reserve Board, [Flow of Funds Accounts of the United States](#), Table L.117, June 8, 2017

<sup>2</sup> Id.

<sup>3</sup> U.S. Department of Labor and Employee Benefits Security Administration, [Private Pension Plan Bulletin: Abstract of 2014 Form 5500 Annual Reports](#), September 2016.

<sup>4</sup> Investment Company Institute, 2017 Investment Company Fact Book, [Figure 7.17, 2017](#).

assets that have been “rolled over” from employer plans.<sup>5</sup> The role of employers in ensuring workers’ retirement security, therefore, should not be underestimated.

Employer-sponsored plans provide tangible economic value to American workers saving for retirement. Employers lower administrative costs by achieving economies of scale and simplify participation by offering workers a carefully vetted selection of investment choices, while fiduciary requirements offer security and peace of mind. Simply put, employer retirement plans lower the cost of savings by reducing numerous burdens for individuals.

Payroll deduction has proven to be an effective means of enhancing savings behavior. By pooling resources and offering a collective vehicle for the investment of savings, employers are also able to foster a culture of saving throughout the workplace.

The voluntary employer-sponsored system is important because it gives companies the flexibility to tailor their plans to diverse and evolving employee populations. Employers have a unique understanding of the retirement needs of their employee population and provide innovative solutions to help employees. For example, companies are increasingly providing their employees with access to education that enhances their understanding of savings principles and helps address the financial stresses that impair overall financial well-being. In the future, successful employee benefits systems will reject “one-size-fits-all” mandates in favor of a flexible approach that allows employees to adjust their goals and behavior according to their own changing needs.

To meet this challenge, employers are continually innovating to improve participation rates and outcomes. Bipartisan legislation has brought many of these innovations into the mainstream. For example, the Pension Protection Act of 2006 (“PPA”) includes several landmark clarifications to the defined contribution plan rules that encourage voluntary automatic enrollment and automatic contribution escalation, which are improving retirement savings by moderate- and lower-income workers beyond what could otherwise be expected. According to a report by Vanguard, 64 percent of new plan entrants in 2016 were enrolled via automatic enrollment and slightly more than 60 percent of all contributing participants in 2016 were in plans with automatic enrollment.<sup>6</sup>

It is a testament to the effectiveness of these programs that these innovations have been emulated around the world in both public and private pension systems. In the next sections of this document, we suggest some new ways to build on the

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<sup>5</sup> According to the 2014 Investment Company Fact Book, Figure 17.7, May, 2014 “of U.S. households owning traditional IRAs in May 2013, 49 percent (or nearly 18 million) had traditional IRAs that included rollover assets.”

<sup>6</sup> Vanguard, How America Saves 2017, June, 2017.

employer-sponsored system, but such measures will only be effective if the system remains viable.

Employers have an interest in the continued success of the system because they also enjoy certain advantages of plan sponsorship. Having a strong retirement plan benefits employers by helping them attract and retain talent and by providing their employees with financial security and confidence as they prepare for retirement.

## **WE HAVE GREAT OPPORTUNITIES TO FURTHER IMPROVE ON THE CURRENT SYSTEM, BUILDING ON DECADES OF SUCCESS**

Promoting retirement savings must remain one of our nation's top policy priorities. Any changes made should preserve and build upon our existing and successful tax incentive structure so it works even more effectively to facilitate retirement plan coverage and savings for American families.

Harnessing behavioral economics, through features like automatic enrollment and automatic escalation, has proven to be an effective approach for improving outcomes for many employee populations. In many cases, however, additional action from lawmakers will be required.

## **PROPOSALS FROM A 2020 VISION**

As noted, the Council recently issued a long-term public policy strategic plan, [\*A 2020 Vision: Flexibility and the Future of Employee Benefits\*](#), in which we made specific policy recommendations, many of which would empower individuals to save for a secure financial future in retirement. The recommendations include the following:

### ***1) Improve opportunities for small businesses to maintain retirement plans.***

As noted above, it is important to acknowledge that employee access to employer-sponsored retirement plans remains a challenge in some segments, including small businesses. We strongly support proposals to help small businesses join multiple employer plans ("MEPs") and other initiatives that would help expand private sector employer-sponsored retirement coverage. RESA contains many such proposals, including the following:

- *Open MEPs:* Today, a MEP must consist of employers that share a nexus other than maintaining the same plan. RESA includes a proposal that, under certain circumstances, would eliminate the nexus requirement so that completely unrelated employers could participate in the same MEP. This could allow small employers to band together more easily to achieve some of the economies of

scale that larger employers enjoy. This proposal is even more appropriate now after the Department of Labor (“DOL”) has allowed states to establish open MEPs. DOL’s guidance demonstrates its recognition of the value of open-MEPs in addressing access needs and the need for supportive policy. However, DOL’s actions have created an un-level playing field, and unless corrected, would give states an unfair and unnecessary competitive advantage in offering retirement plans to private sector employers, even though private sector efforts may be more likely to offer greater innovation and flexibility if allowed.

- We should further explore means to reduce or eliminate fiduciary burdens on employers that participate in such MEPs, since such burdens can discourage broader coverage among small employers. Specifically, if independent boards oversee the MEP and take on fiduciary responsibility for overseeing the MEP service providers, participating employers could be exempted from fiduciary responsibility for selecting and monitoring the MEP.
- We also believe that MEPs may be very attractive to larger employers that find the above relief from fiduciary responsibility appealing. In this way, MEPs could achieve extensive economies of scale and make plans far less expensive. Opening up MEPs to larger employers may be facilitated by (1) protecting the MEPs from liabilities attributable to plans merged into the MEP, and (2) protecting the plans being merged into the MEP from pre-existing liabilities of the MEP.
- *One bad apple rule:* Under a MEP, the failure of one participating employer to satisfy the qualification rules can cause the entire plan to be disqualified, often referred to as the “one bad apple rule.” RESA would modify that rule, so that only the noncompliant portion of the MEP is subject to disqualification, and may be spun off from the MEP.
- *Start-up credit for small employers:* RESA would increase the small employer tax credit for establishing a plan. The credit is currently capped at \$500 per year; RESA would increase the cap to \$5,000.
- *Auto enrollment credit for small employers:* Under RESA, small employers that adopt automatic enrollment provisions are eligible for an additional \$500 credit, regardless of whether the automatic enrollment provisions are adopted when the plan is first effective or the provisions are adopted later.
- *Reporting simplification for small business retirement plans:* DOL and Treasury should be directed to revise the rules to permit a single Form 5500 to be filed by the common plan administrator of defined contribution plans that also have a common named fiduciary, administrator, investment menu, plan year, and

trustee. Current law requires duplicative information to be filed on multiple Form 5500s, which is inefficient and an unnecessary obstacle to small business plan growth. See the bipartisan Senate bill, S. 695, as well as RESA section 202.

**2) *Increase public awareness of the financial risks associated with increased longevity.***

The average time spent in retirement has increased from 9.6 years in 1970 to 18 years for men and from 14 years to 20.5 years for women.<sup>7</sup> This reality underscores the imperative for policies that meet the retirement income needs brought about by longer life expectancies. The federal government should undertake efforts to increase employees' understanding of the value of delaying Social Security benefits and the importance of planning for longer life expectancies.

**3) *Increase catch-up contribution limits and lower eligibility to age 45.***

Considering current longevity trends and the need to start saving for retirement as early and to as great an extent as possible, the establishment of higher limits (as described below) and a younger start date for "catch-up" contributions will help individuals who begin saving later in their career, as well as those with inconsistent participation in the workforce or in retirement programs over the course of their lives, achieve greater personal financial security.

**4) *Increase the compensation and contribution thresholds for retirement plans and index the limits to ensure they keep pace with inflation.***

Increased limits and more appropriate indexing will allow individuals to save more effectively. While some may advocate reducing the tax incentives on retirement plans in an attempt to increase revenue, doing so would reduce the flexibility that employees need to save effectively over their working lives when there will be large variations in their ability to set aside money for retirement.

**5) *Reduce or combine the number of retirement plan information disclosure requirements.***

The volume and redundancy of disclosures not only dissuade retirement plan sponsorship, they adversely affect transparency for participants, as the excessive amount of information often leads to employees reading none of it. Transparency would be better served by the delivery of more concise, well-organized information. Notices could be shortened and consolidated to maximize effectiveness and eliminate repetitiveness and redundancy. For example, all notices provided at enrollment and annually could be combined into a single "Quick Start" notice. This would require

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<sup>7</sup>U.S. Centers for Disease Control, [Health: United States, 2015](#), 2015, updated June 22, 2017.;

harmonization and streamlining of timing requirements. Certain duplicative and irrelevant notices should be eliminated.

**6) *Establish an alternative automatic escalation safe harbor for retirement plans.***

As provided in the SAFE Act and Collins/Nelson, an alternative automatic escalation safe harbor should be established with higher default rates and, as under RESA also, employers should be allowed to escalate employee contributions beyond the current 10 percent cap. Default mechanisms such as automatic enrollment and escalation, lifestyle funds and retirement target date funds may help individuals who decline to enroll in a retirement plan to become savers and invest assets appropriately for their age and risk level. A new safe harbor should be adopted with higher minimum default contribution rates that start at 6 percent. This structure was also discussed in the Working Group Report.

**7) *Support voluntary, simple, portable model plans for retirement income or retiree health coverage.***

A model plan could accept differing levels of employee and voluntary employer contributions via payroll deduction and could accommodate a range of investment vehicles. These savings could be either pre- or post-tax, and fiduciary liability for the employer would be appropriately limited. Such a plan could be offered to workers who lack access to an employer-based plan or those who want to supplement one – ideal for workers who may not expect to stay with a single employer.

**8) *Enable employers to better provide financial education and investment advice.***

Employees' knowledge and understanding of financial and retirement savings principles could be improved by providing incentives and removing barriers that deter employers from arranging for workers to receive financial education or advice. In this regard, we urge Congress to establish clear and workable safe harbors under which employers can, including through their service providers, educate employees regarding investment and distribution issues without concerns about fiduciary liability, even if in the course of countless discussions with employees, a line is occasionally and inadvertently crossed from education to advice.

**9) *Exclude current retirement plan assets and future retirement plan benefits from eligibility calculations for state or federal housing and food subsidies.***

Effective retirement saving can facilitate income mobility and improve overall health and financial well-being, but this can sometimes jeopardize qualification for other kinds of federal assistance. Even the fear of losing assistance can prevent participation. Individuals and their families should not be penalized for preparing for retirement. Accounting of income eligibility for subsidized food or housing should exclude

retirement assets. Clear protection against losing assistance for participation would directly increase participation in retirement programs.

These recommendations and others incorporated in *A 2020 Vision* are intended to empower individuals to achieve health and financial well-being in retirement. Our member companies sponsor retirement plans with strong participation levels and we want to ensure that American workers tap into the full value of their retirement plans.

## DISCUSSIONS OF “ROTHIFICATION”

In the last several months, in the context of tax reform, there has been an informal public policy discussion regarding the possibility of requiring some or all contributions to retirement plans or IRAs to be made on an after-tax Roth basis, rather than on a pre-tax basis – a concept often referred to as “Rothification.” This public policy discussion requires consideration of a complicated set of factors, such as:

- How will employees react to losing the ability to make pre-tax contributions in terms of savings levels?
- Even if some employees do not react adversely because of their circumstances, how will the new Roth rule affect small employers’ willingness to set up plans?
- What are the comparative tax advantages attributable to pre-tax and Roth contributions?
- How do these advantages differ based on the circumstances of the employee, such as the employee’s current tax bracket, the employee’s expected tax bracket in retirement, and the employee’s amount of prior pre-tax and Roth savings?

All of the above questions raise challenging issues and are not susceptible to easy answers that apply across the board to everyone. We are very concerned that in the search for revenue, Rothification could be included in tax reform without a full understanding of the possible adverse effects on savings levels and on the willingness of small business owners to adopt and maintain plans.

The initial input we have received from our members indicates that savings levels would indeed likely be adversely affected, as would small business owners’ willingness to adopt and maintain plans. We also understand that Rothification would be coupled with reduced individual marginal tax rates. For most taxpayers, Rothification would result in even lower tax rates in retirement, creating a far less advantageous tax incentive than the current deferred compensation approach.

In other words, many individuals would be making contributions and paying tax at high tax brackets and then receive a tax break on distribution when they would be in a



low tax bracket. This would be systematically inadvisable, undermining the incentive to contribute to a retirement plan.

Some have indicated that the adverse effects of Rothification could be addressed by increasing the Saver's Credit sufficiently to incent employees to save regardless of the Roth treatment. This is possible theoretically, but there are two major concerns. First, according to an annual survey by the Transamerica Center for Retirement Studies, only 26% of those with household income under \$50,000 are aware of the Saver's Credit. The low awareness of the Saver's Credit poses an independent set of concerns, but until awareness is increased, it seems problematic to rely on the Credit to solve the Rothification problem. Second, regardless of the expansion, there will be many middle-class individuals who do not qualify for the Credit. And without refundability, which is not likely to be enacted, there will be many low-income individuals who do not qualify.

In short, we do not believe that tax reform should be financed by taxing the retirement contributions of tens of millions of Americans, especially in light of the real potential for this change to do great harm to the private retirement system.

#### **ADDITIONAL ISSUES MERITING CONSIDERATION**

There is much in, for example, RESA, the SAFE Act, RISE, Cardin/Portman, Collins/Nelson, and the Working Group Report that would expand access, participation, and coverage in retirement savings plans, and we support the pursuit of legislation based on all of these. We would also like to highlight certain other key issues.

**1) *Ensure protection of employer-based plans from state mandates so that the State plan proposals do not undermine the employer-based plans.***

We understand that states are attempting to improve retirement incomes by developing mandated retirement arrangements. However, a patchwork of state mandates is not workable and will undermine the robust employer plan system, thereby reducing retirement security. If employers are subject to 50 or more different state and political subdivision mandates regarding retirement coverage, that would create such significant burdens on the employer-based system that many smaller employer plans will be terminated, leaving employees without employer contributions and thus with far less retirement security.

In this context, the Congressional Review Act disapproval of DOL regulations supporting state mandates was very much needed and appreciated. But in light of continued efforts by the states to impose mandates, we may need additional legislative or regulatory help to protect the employer-based system:

- Any employer with any plan, including a payroll deduction IRA or other non-ERISA payroll deduction arrangements, needs to be fully exempted from any state mandates.
- The states should not be permitted to set standards for plans for the plan sponsor to be exempted from the mandate; this would lead to a patchwork of different state rules that would sharply decrease employer-based coverage.
- The states should be prohibited from maintaining conflicting and overlapping rules for the same employees.
- The states should not be given competitive advantages over the private sector in terms of how to structure their plan offerings; even after the Congressional Review Act disapproval, current DOL guidance explicitly provides states with the ability to sponsor open MEPs, which private sector sponsors may not do.

ERISA preemption is a cornerstone of our private pension system. It needs to be protected against the very serious threat posed by the states. The private pension system cannot function effectively under a patchwork system of 50 or more uncoordinated rules.

## **2) *Establish fiduciary safe harbors and outsourcing rules for plan sponsors.***

We are increasingly hearing concerns from large employers about the spiraling costs and potential liabilities associated with employer-based plans and the recent explosion of plan litigation. Some large employers have even indicated that if there were a viable way to exit the system completely, they would do so. If large employers start leaving the system, it will cause a rapid movement out of the system, just as has happened with defined benefit plans. Accordingly, we need to reverse the trend toward greater liabilities and litigation, which leads to ever greater incentives to leave the system.

In this regard, we need controls on the proliferation of cookie cutter lawsuits being filed to obtain a settlement that benefits the trial lawyers and severely harms the retirement system. *From the period of 2009 to 2016, attorneys representing plaintiffs in breach of fiduciary duty lawsuits are estimated to have collected roughly \$204 million for themselves, while only securing an average per participant award of \$116.8*

In addition to controls on plan litigation, we need a best practices set of fiduciary safe harbors for employers to follow, so as to avoid potential liabilities. We also need to explore means for employers to outsource their fiduciary liabilities, such as through the MEP proposals discussed above. Such outsourcing could produce a tremendous incentive for employers to retain and maintain plans.

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<sup>8</sup>Tom Kmak, [\*Fiduciary Benchmarks: Protect yourself at all time\*](#), DC DIMENSIONS (Summer 2016).

### 3) *Establish updated uniform rules for electronic communication.*

Retirement plan communications are subject to different Code and ERISA rules regarding electronic communication to participants, which causes additional costs and confusion for both plan sponsors and participants. Equally concerning is the fact that these rules are very old, having been written well before technological advances, such as the smartphone. This is costing the retirement plan system many millions of dollars of unnecessary expense every year, expenses that ultimately are borne by plan participants. Moreover, paper communications are less efficient and effective, as they are so easily lost and are not nearly as user friendly as short electronic postings with links to more details.<sup>9</sup>

We need a uniform set of updated rules for communicating electronically with participants that allows electronic communication to be the default mode of communication, along with a right to paper at no charge. And electronic communication needs to be flexible enough to include posting to a secure website, along with a notice of such posting or postings. We support important initiatives in this regard like the Brown/Enzi bill.

### 4) *Prevent acceleration in the decline in the defined benefit system.*

There are many issues that could accelerate the decline in the defined benefit system, but which can be easily fixed. For example:

- *Closed plan nondiscrimination testing:* Many companies have closed their defined benefit plans to new hires, but have preserved ongoing benefits for employees employed at the time of the closing. Unfortunately, this favorable treatment of existing employees will in most cases eventually result in a violation of the nondiscrimination rules, triggering a need to completely freeze the plan. The Council has been working on this set of issues for over a decade with both Treasury and Congress. We strongly support the provisions on this issue in RESA and in the bill introduced this year by Senators Cardin and Portman (S. 852). These bills address the problem very appropriately by deeming a closed plan to meet the nondiscrimination rules indefinitely if the plan meets those rules for a short period starting on the date of closing.
- *PBGC premiums:* The recent increases in single employer plan PBGC premiums (1) have been unnecessary, being driven by general revenue needs, not policy concerns, (2) exacerbate the volatility of the funding rules by increasing premium volatility, (3) divert assets away from benefits to PBGC, which has more than

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<sup>9</sup> See, e.g., “Delivering ERISA Disclosure for Defined Contribution Plans, Why the Time has Come to Prefer Electronic Delivery, Swire and Ahmad.

enough assets to cover expected liabilities despite not having invested its assets well, and (4) are driving plan sponsors out of the defined benefit system, which will severely threaten PBGC's long-term financial viability. Single employer plan premiums need to be reduced dramatically, and the budget scoring system that double counts PBGC premiums should be repealed. Since the federal government does not stand behind the PBGC single employer program, it is inappropriate to score premium increases or decreases as helping or harming the federal budget.

- *Mortality assumptions:* Treasury is working on new mortality assumptions that could apply starting as early as 2018 for purposes of determining a company's pension funding obligations, the applicability of benefit restrictions (such as on the payment of lump sums), the amount of lump sum distributions payable, and the level of PBGC variable rate premiums. These new assumptions, which will likely be based to a large extent on the new assumptions published by the Society of Actuaries ("SOA"), are expected to increase pension liabilities materially for many plans.

SOA's assumptions overstate life expectancy (and correspondingly would overstate pension liabilities) and thus should not be followed in whole. It is critical that either Congress or Treasury address this problem, so that the new Treasury tables are not based on SOA's incorrect assumptions.

- *Targeted funding relief:* Broad funding reform, like the reform adopted in the pension stabilization bills of 2012 and 2014, is not needed now, as funding ratios have generally improved, primarily due to the commitment of businesses to make contributions far in excess of the minimum amount required. However, due to particularly challenging circumstances, pockets of employers that could not afford to make excess contributions are facing business-threatening pressures from excessive funding obligations.

Targeted funding relief is needed for companies for which the legacy costs of a pension plan are excessive compared to the size of the business itself. If an employer qualifies for this relief during any plan year during a temporary period, the employer should be permitted to elect to apply the rule described in the next paragraph for such plan year.

The entire funding shortfall for any plan year for the first year for which an election is made would be amortized over 15 years. This means that all shortfall amortization bases for all preceding plan years (and all shortfall amortization installments determined with respect to such bases) would be reduced to zero. During the remaining years of the temporary period, the shortfall amortization base, determined in the normal manner, would also be amortized over 15 years.

- *Stretch IRA legislation:* There have been numerous “Stretch IRA legislative proposals” that would raise revenue by limiting the ability of post-death beneficiaries to “stretch out” distributions from a plan or IRA. The concerns underlying these proposals have been focused on IRAs, but the proposals apply to all plans, including defined benefit plans.

These proposals would inadvertently create serious problems for defined benefit plans by effectively prohibiting many common distribution forms, such as life annuities with a term certain longer than five years. As was very appropriately done in RESA, defined benefit plans should be exempted from such proposals since none of the concerns giving rise to the legislation relate to defined benefit plans.

Other modifications of these proposals are needed to protect lifetime income payouts under defined contribution plans and IRAs.

- *PBGC interference in business transactions and operations:* PBGC has had a long history of intervening in business transactions and operations to negotiate for, for example, larger funding contributions, above the levels specified by Congress. Formerly, the PBGC used ERISA section 4062(e) in unintended ways to do this. However, Congress enacted very effective legislative reforms of section 4062(e) in 2014.

Now the PBGC is using the Early Warning Program, apparently to make up for the Congressional restrictions on its use of section 4062(e). Under the Early Warning Program, PBGC intervenes in business transactions to force employers to take certain actions, such as contributing much more to the pension plan than has been required by Congress. PBGC achieves its objectives by threatening involuntary termination of the plan, which would be extremely harmful to the plan sponsor, if the plan sponsor does not concede to PBGC’s demands. PBGC has been using the Early Warning Program inappropriately, just as it used section 4062(e) inappropriately. Congress needs to take action here, just as it did so well with respect to section 4062(e). We recommend giving plan sponsors the right to have Early Warning Program disputes resolved through binding confidential arbitration, including, in the case of pending transactions, arbitration on an extremely expedited basis to fit the timing of the pending transaction.

- *Parity for employers that provide more generous lump sum benefits:* Code section 417(e) provides a ceiling on the interest rates that can be used to value distributions, such as lump sum distributions. The ceiling is generally based on the interest rates required for funding purposes. In determining these interest rates, employers are permitted to use a “lookback month” that is up to five months before the beginning of the year. So for 2018, the lookback month can be any month during the August to December of 2017 period. Generally, the

anti-cutback rules prohibit changing the lookback month, but a special rule permits a change in the lookback month if for the next year the plan compares the new and old lookback month and uses the more generous interest rate.

Although section 417(e) provides a ceiling on interest rates, employers are permitted to establish lower interest rates by, for example, providing that distributions will be valued using the lesser of the “applicable interest rate” (as defined in Code section 417(e)(3)(C)) or a specified other rate. Some employers have used this ability to use a lower interest rate to, for example, grandfather benefits from changes in the applicable interest rate under Code section 417(e).

Employers in these situations may want to change the lookback month for determining their non-417(e)(3) interest rates, such as the 30-year Treasury rate to, for example, an earlier date so as to facilitate communications to participants well before the beginning of the plan year. Although this is permitted for 417(e) interest rates, as discussed above, it is not permitted for the more generous non-417(e) interest rates, which does not make policy sense.

The option to change the lookback month should be permitted for not just the 417(e) rates, but also the 30-year Treasury rate, PBGC-based rates, or any other rates used by the plan, as long as the amendment has a delayed effective date of at least one year, so as to protect participants from sudden changes.

- *Cash balance reform:* For a cash balance plan that credits interest based on market-returns, we ask that the law be clarified to state that the current or most recent rate of return is not a relevant factor, and projections should be made on a reasonable basis in light of historical data. Currently, the IRS takes the position that the prior year’s rate of return should be used to project benefits, which leads to strange and unworkable results when the prior year’s rate of return was low or high.
- *Updating actuarial assumptions:* It can be difficult for plan sponsors to adopt more modern actuarial equivalence assumptions due to the anti-cutback rules. Even though many optional forms (e.g., joint and survivor options) would increase using updated assumptions, some other options could decrease. As a result, plan sponsors may not be able to update their assumptions. Greater flexibility here would enable plan sponsors to keep their plans up-to-date and provide appropriate lifetime income benefits to retirees and spouses. Proposals combining greater flexibility to update assumptions with important participant protections would allow plans to eliminate anomalous and out of date assumptions.

- *Termination issues:* If plans cannot be terminated or shrunk efficiently, that will have a very adverse effect on decisions by others to establish a plan. Two issues deserve attention in this regard:
  - The law needs to be clarified regarding how to treat section 401(h) accounts for terminating pension plans (where the 401(h) account continues to hold assets for post-retirement health benefits). Such amounts should be permitted to be transferred, without a tax consequence, to an alternative retiree health funding vehicle, such as a VEBA.
  - In July of 2015, the IRS issued [Notice 2015-49](#), which announced the IRS' intent to issue regulations under which the acceleration of annuity payments being made by a defined benefit plan would violate the required minimum distribution rules under Code section 401(a)(9). This Notice did not make sense from a technical perspective: the IRS relied on a Code section prohibiting excessive deferral in order to prohibit acceleration of benefits. The object of the Notice was based on a policy objective to slow down the de-risking of pension plans. Pension plans had been offering lump sums to participants in pay status, which is now illegal under the Notice because *the Notice announced the IRS' intent to make the regulatory amendments retroactively effective as of the date the Notice was issued in July of 2015*. Congress needs to step in and void the notice as far beyond IRS' authority.

**5) *Concerns about complexities and burdens of plan consolidation and/or eliminating unique plan features:***

**Consolidation would create large burdens.** In recent years, some have suggested consolidating the different types of workplace retirement savings plans that now exist. These proposals have been offered largely as a means of reducing the complexity of the current retirement tax system.

Consolidating retirement savings plans might appear at first glance to be an obvious choice for reducing complexity. On closer review, however, it is clear that plan consolidation would actually create substantial complexity and burdens for the government, church, educational, and nonprofit employers that voluntarily offer retirement savings plans, and add further complexity for the employees who participate in these plans.

Others have suggested that instead of consolidating retirement savings plans, the rules for the different types of plans should be "streamlined" to be more uniform. As discussed further below, some forms of streamlining would be very problematic, while other forms could be very helpful.

Currently, there are several different types of retirement savings plans. Most common is the 401(k) plan, which generally may be maintained by any employer. Certain nonprofit organizations and public educational institutions may maintain 403(b) plans. State and local governments sponsor 457(b) and grandfathered 401(k) plans. Because the plans are similar, many have proposed “simplifying” the Code by replacing 403(b) plans, governmental 457(b) plans, and 401(k) plans with a single type of plan with one set of rules.<sup>10</sup> But despite many similarities, there are also a number of important differences among plan types – differences that Congress intended to address unique characteristics of workers in the governmental, church, educational, and nonprofit sectors. For example:

- *Exempt from early distribution tax:* Participants in governmental 457(b) plans are not subject to the 10% early distribution tax that generally applies to retirement plan distributions received before age 59 ½. Penalty-free early distributions from 457(b) plans can be critical in helping government early retirees bridge the income gap before pension or Social Security benefits are available, particularly first responders who retire early and, in many cases, are transitioning to new careers.
- *Catch-up contributions:* Because employees of nonprofits, churches, and governments—who are eligible to participate in 403(b) and/or 457(b) plans—are often paid less than those working in the private for-profit sector, they frequently cannot afford to save as much early in their career. Accordingly, the rules governing 403(b) and 457(b) plans allow special “catch-up” contributions by older employees, enabling them to make up for years when they were contributing less.
- *Right to buy pension credit:* Participants in 403(b) and governmental 457(b) plans have special options to purchase service credit under a governmental defined benefit plan (in addition to the options available to participants in 401(k) plans). These options provide important portability for employees who over their careers provide services to multiple nonprofit, church, and/or governmental entities.
- *Different nondiscrimination testing rules:* Governmental 457(b), 401(k), and 403(b) plans are exempt from nondiscrimination testing rules. That is because public oversight of governments already ensures fairness with respect to benefits. Meanwhile, nonprofit 403(b) plans are subject to different nondiscrimination testing rules that reflect their unique workforce characteristics.

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<sup>10</sup> Some of the proposals go further and would eliminate SIMPLEs and SEPs, which are generally savings plans designed for small businesses. This would severely hurt small businesses and we would hope that this aspect of the proposals is not being considered.



- *Protection for governmental 457(b) plans:* Unlike non-governmental plans, a governmental 457(b) plan cannot be disqualified for operational failures unless (1) the IRS provides the employer with notice of the operational failure, and (2) the employer fails to correct the failure. This reflects appropriate federal deference to state and local governments.
- *Definition of compensation:* The limits on contributions under the different types of plans are based in part on a participant's compensation. For this purpose, compensation is defined slightly differently with respect to 403(b) plans. The differences are attributable to special rules that should be retained, such as the ability to treat former employees as having compensation for five years (Code section 403(b)(3)), and the treatment of ministers (Code section 414(e)(5)(B)). From a policy perspective, there is no reason to harm either ministers or former employees of charities or public schools who may need additional retirement savings.

On the surface, consolidating similar types of plans would appear to simplify the Internal Revenue Code. But on closer examination, consolidation does exactly the opposite and would have especially detrimental effects on governmental 457(b) plans and 403(b) plans if the consolidated plan structure is largely based on the 401(k) structure.

**New plan costs and confusion:** There are thousands of 403(b) and governmental 457(b) plans in existence today covering millions of employees of nonprofits, governments, and churches. For these millions of employees and thousands of employers, plan consolidation provides no simplification. *On the contrary, changes in the rules governing their retirement security will require the creation and maintenance of a new type of plan, and will inevitably lead to substantial confusion and increased cost for both plan sponsors and plan participants.* The confusion would be even more significant prior to regulations—which could be years away—that implement the new rules.

**Maintaining a new type of plan is far from simple or inexpensive:**

- New administrative systems will be needed, with substantial technological costs.
- Employers and employees will need education regarding the new plan.
- Legal and compliance costs will rise sharply as employers and providers struggle with new rules.
- Many of these plans will need to work through difficult state law compliance challenges that arise whenever a public plan is modified.

**Transition costs and challenges:** Moreover, the mechanics of the consolidation will

create a new set of problems. For example, if distributions from governmental 457(b) plans become subject to the 10% early distribution penalty, will existing account balances be grandfathered? If the answer is yes, the maintenance of separate accounting for the grandfathered accounts will be burdensome and complex, especially in cases of partial distributions. On the other hand, failing to grandfather existing account balances would be unfair, as employees had contributed under one set of rules and expectations, and those rules would be changed after the fact.

**Streamlining can be helpful or harmful.** As noted above, certain simplifications can be achieved without consolidation. Key examples of such simplifications are set forth below.

**Helpful streamlining:**

- The different withdrawal rules applicable to 401(k), 403(b), and 457(b) plans could be conformed to the 401(k) withdrawal rules. This was done in section 305 of bills introduced in 2005 by then Representatives Rob Portman (R-OH) (H.R. 1960) and Ben Cardin (D-MD) (H.R. 1961).
- The different timing rules for 457(b) deferral elections could be conformed to the 401(k) timing rules as in the 2005 Portman and Cardin bills referenced above.
- As discussed above, the out of date inconsistent DOL and IRS rules governing electronic delivery of participant communications could be updated and made uniform, as under the Brown/Enzi bill.
- As discussed above, there is a great need to consolidate redundant notices and eliminate unnecessary notices. On the consolidation issue, see section 222(a) of the Hatch bill.

**Harmful streamlining proposals:** The differences among the plans highlighted above were enacted to reflect the unique nature of the workforces of churches, charities, public schools, and state and local governments. Eliminating those differences to achieve uniformity would be unfair and would harm the employees doing such important work for these critical institutions.

**6) *Reform and update the required minimum distribution rules.***

We support three reforms of the required minimum distribution rules. As under RISE, the required beginning date of 70 ½, which was originally set in 1962 when life expectancies were far shorter, needs to be raised, so that all rules currently applicable at age 70 ½ would be applicable at the new higher age. Second, as under the SAFE Act, the legislation should require Treasury to similarly update the life expectancy assumptions underlying the rules on the amount required to be distributed under an account-based

plan. Third, Congress should reduce the punitive 50% tax on inadvertent violations of the RMD rules.

**7) *Extend and reform the Section 420 rules for retiree health transfers.***

It is respectfully suggested that Congress extend Section 420 through December 31, 2027, *i.e.*, for the two additional years created in the 10-year budget window since the prior extension of the provision in the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015*. In addition, it is respectfully suggested that the funded-status requirement for both single-year transfers and qualified future-year transfers be modified to 110% of the plan's funding target and target normal cost from the current 125% and 120%, respectively. The extension will allow for continued use of Section 420 transfers for an additional two years, and the reduction in the funded-status requirement will enable more employers to make use of surplus pension assets in their generously-funded pension plans to secure continued funding for retiree medical and life insurance benefits in a financially prudent manner.

Since Section 420 was enacted, changes in the mandated interest rate and mortality assumptions used to determine pension liabilities have produced larger pension liabilities and thereby have suppressed funded-status ratios. The mandated interest rate assumptions have fallen significantly from the 9% range in 1990 to today's mandated rates of about 4%. As a general rule of thumb for mature pension plans (those most likely to be in a position to utilize Section 420), a 1 percentage point decrease in interest rates leads to an increase in pension liability of approximately 10%, which means that the 500 basis point decline in interest rates since 1990 produces (with all other things being equal) pension liabilities that are approximately 50% larger today than they were for the same pension benefits promised in 1990. In addition, the mandated mortality assumptions used to determine pension liabilities have also changed since Section 420 was enacted, similarly increasing pension liabilities. Since 2008 alone, updated mortality assumption requirements have increased the value of pension liabilities (by some estimates, approximately 5%). For both reasons, a plan that is funded at over 110% today is significantly better funded than it would have been in 1990.

**8) *Portability:***

We ask the Committee to continue working with the community to facilitate portability of benefits, including from a former employer's plan to a new employer's plan. This can be done by permitting default consents to rollovers to a new employer's plan, by providing greater protection for plans accepting a rollover, and by directing the agencies to facilitate the use of technology to streamline rollover processes. Portability advances can help employees better consolidate and manage their retirement assets and reduce instances of "lost benefits" that a participant loses track of.

**9) *Parity between certain plan and IRA rules:***

Retirement plans should be treated in at least as favorable manner as IRAs with respect to certain distribution rules, so that there are not incentives for leakage out of plans. Specifically, plans should have the same exclusion for charitable distributions as IRAs do under Code Section 408(d)(8). In addition, spousal beneficiaries may elect to treat a deceased IRA owner's account as their own, but may not do the same for an inherited retirement plan account. This special rule permits IRA spousal beneficiaries to "stretch" the required minimum distribution payments over a longer period of time, and could create an incentive for participants to roll over retirement accounts to IRAs.

**10) *Eliminating unnecessary burdensome requirements.***

We look forward to working with the Committee on simplifying the Code and eliminating unnecessary plan requirements. For example, in situations where a participant has not elected a form of distribution and the source is subject to the qualified joint and survivor rules, the current required minimum distribution rules require the plan to purchase an annuity for the participant, but it can be difficult (if not impossible) to find an annuity for very small amounts. The law could be changed, so if the annuity payout were less than, for example, \$250 per month, an annuity would not be required. This rule should also apply to participants in defined benefit plans that are not earning new benefits.

**11) *Expand IRS' plan correction program ("EPCRS").***

The IRS has established a very effective and workable correction program for plan qualification errors. This excellent program should be expanded to permit loan errors to be corrected through self-correction, rather than through costly and time-consuming submissions to the IRS. In addition, the correction program should be expanded to cover IRAs, with a focus on inadvertent errors for which the IRA owner was not at fault but is nevertheless subject to sanctions under the law. In this regard, we strongly support the provisions on this issue in the SAFE Act.

**12) *Facilitate innovative ways to permit employers to help employees with their student debt and avoid shortfalls in retirement contributions.***

Increasingly, employees are entering the workforce with very burdensome amounts of student debt. The loan repayments may be so significant that they render the employees unable to also make contributions to a plan. This is not good from a policy perspective, since the employees may be missing out on matching contributions; this is particularly troubling since contributions at younger ages produce the greatest retirement benefit (attributable to the fact that they grow with earnings over the longest period).

To address this problem, employers and the RISE Act have raised the possibility of a

law change permitting employers to make matching contributions with respect to student loan repayments. This would allow employees overburdened by student debt to still receive matching contributions. Some employers see this as a potentially valuable recruiting and retention tool.

We support innovative proposals like this and look forward to continued discussions about this proposal and others as we strive to address two important issues: retirement security and student debt burdens.

### 13) *Lifetime income issues:*

**Fiduciary safe harbor for annuity provider selection:** With the shift from pension plans to 401(k) plans, there is a critical need for retirees to have access on a low-cost institutional basis to guaranteed income for life to protect themselves against the risk of outliving their private retirement savings. One significant obstacle to that access is that employers are hesitant to offer guaranteed income for life under their 401(k) plans due to the fiduciary liability in choosing an annuity provider. To address this issue, we support the fiduciary safe harbor provided under RESA section 204.

**Managed payouts:** There is a need for both guaranteed income for life and managed payouts during retirement. Each form of distribution has attributes that are essential in some contexts. In this context, Treasury and DOL should be directed to identify issues for managed payouts that are comparable to those identified in the previous paragraph for guaranteed income for life. For example, to the extent that managed payouts face fiduciary challenges, a comparable fiduciary safe harbor may be needed. Or to the extent that current rules do not treat managed payouts as a single stream of payments for purposes of various rules, such as consent to a distribution, such rules should be updated to provide such treatment.

**Lifetime income portability:** We support RESA section 113 under which plan participants would be allowed to take a distribution of a “lifetime income investment” without regard to the restrictions on plan withdrawals prior to a “distributable event,” i.e., death, disability, age 59 ½, termination of employment, *etc.* The distribution would be allowed only if (1) the “lifetime income investment” is no longer authorized to be held under the plan, and (2) the distribution is made *via* a direct rollover to an IRA or other retirement plan or through distribution of the lifetime income product. The distribution also would not be subject to the 10 percent penalty tax.

One impediment to offering lifetime income options within defined contribution plans is a concern that employees invested in an annuity investment available within a plan have limited options if the employer decides to remove the annuity investment option from the plan (for example, because a new trustee or recordkeeper will not support the annuity investment or the annuity product is no longer available on favorable terms). This proposal would address that issue by making lifetime annuity

products within defined contribution plans more portable.

#### **14) QLAC proposals:**

In 2014, the Treasury Department and IRS published final regulations on qualifying longevity annuity contracts (“QLACs”). QLACs are generally deferred annuities that begin payment at the end of an individual’s life expectancy. Because payments start so late, QLACs are a very inexpensive way for retirees to hedge the risk of outliving their savings in defined contribution (“DC”) plans and IRAs.

The minimum distribution rules were an impediment to the growth of QLACs in DC plans and IRAs because those rules generally require payments to commence at age 70 ½, before QLACs begin payments. The 2014 regulations generally exempted QLACs from the minimum distribution rules until payments commence. However, due to a lack of statutory authority to provide a full exemption, the regulations imposed certain limits on the exemption that have prevented QLACs from achieving their intended purpose in providing longevity protection.

The QLAC regulations limit the premiums an individual can pay for a QLAC to the lesser of (1) \$125,000 and (2) 25% of the individual’s account balance under the plan or IRA. The \$125,000 limit applies across all types of arrangements, whereas the 25% limit applies separately to each DC plan and collectively to all IRAs that an individual owns. For purposes of the 25% limit, the account balance of an IRA is determined as of December 31st of the previous calendar year. According to the regulatory preamble, the 25% limit was included because Treasury lacked the authority to exempt more than 25% of any account.

It is rare for a DC plan to offer a QLAC option directly. As a result, generally the only way for a DC plan participant to obtain a QLAC is by rolling money out of the plan to an IRA. QLACs are readily available in the IRA market.

Here is the problem:

Assume that an individual has a \$250,000 account balance in her former employer’s DC plan. She wants to use 20% of that balance, or \$50,000, to purchase a QLAC, but her plan does not offer one. She decides to roll the money from the plan to an IRA to purchase a QLAC. However, because the 25% limit on QLAC premiums applies based on her IRA account balance (which is zero), she will need to roll \$200,000 from her plan just to facilitate the \$50,000 QLAC purchase. Moreover, because the regulations measure her IRA account balance as of the prior year-end (which, again, was zero), she will need to roll the \$200,000 from the plan to an IRA, wait

until the next year, then transfer \$50,000 from the IRA to a QLAC that qualifies as an IRA annuity. After the transaction, the individual would own a QLAC that clearly complies with the intent of the premium limits, but would have unnecessarily moved \$150,000 from her plan to an IRA.

**Proposal to repeal the 25% limit:** In practice, this cumbersome process is severely slowing the growth of QLACs, and for no policy reason. The only reason for the 25% limit was Treasury's lack of statutory authority. Moreover, the adverse effects of the 25% limit are limited to low and middle-income individuals because for higher income individuals with bigger accounts, the applicable limit is the \$125,000 limit, not the 25% limit. Because there is no policy rationale for the 25% limit, and because it is having a very adverse effect on the growth of this helpful hedge against longevity, Congress should provide that the 25% limit is void and direct Treasury to amend its regulations accordingly.

**Proposal to raise the \$125,000 limit to \$200,000:** At age 65, \$125,000 would purchase a QLAC (with a 2% COLA and a return of premium death benefit) paying approximately \$18,049 annually starting at age 80. This is not sufficient to protect a middle-income individual from the longevity risk. Under our proposal, the limit would be increased to \$200,000, which would increase the annual payment to \$29,047.

**15) *Clarify non-QCCO eligibility to participate in Code section 403(b)(9) retirement income account plans.***

Since Congress added section 403(b)(9) to the Internal Revenue Code in 1982, the church benefits community has operated under the understanding that certain church-associated organizations that are not described in Code section 3121(w)(3)(B) – commonly referred to as “non-QCCOs” – are eligible to participate in 403(b)(9) plans. This understanding was unexpectedly challenged last year, when the church benefits community learned of the IRS' recent interpretation that non-QCCOs are ineligible to participate in 403(b)(9) retirement income accounts. We believe this interpretation is inconsistent with Congress' intent and section 403(b)(9) itself. We urge that this Code section be clarified to definitively resolve this conflict, so employees of non-QCCOs may continue to participate in such plans. The current IRS interpretation burdens the church plan community, and if this issue is not resolved, non-QCCOs would need to transfer existing retirement income accounts to an alternative type of retirement plan, which is not as well suited to their needs. We support the proposals in S. 674 and H.R. 2341 to resolve this issue.

**16) *Using enforcement in lieu of guidance to establish new rules:***

Over many years, we have grown concerned that at times the enforcement process is used to establish new rules, in lieu of the formal notice and comment process that has

important safeguards. Recently, DOL has begun doing exactly this, establishing very problematic rules for “missing participants” through the enforcement process. For example, in enforcement cases, DOL is taking some new and seriously problematic positions, such as:

- Not distributing benefits to missing participants is a prohibited transaction under certain circumstances.
- Forfeiting missing participants’ benefits subject to reinstatement is a prohibited transaction.
- That prudence requires different search procedures year-by-year, e.g., if a commercial search does not find a good address the first year of a search for a missing participant, the plan needs to try something different the next year and something different yet again the following year.

(We have also been told that the audits are excessive, requiring large amounts of burdensome information not needed with respect to the issue at hand.)

These are new positions that we have never heard of before. And we have been told that the IRS and DOL are not coordinating in this area, and that some employers are being compelled by the IRS to take actions that DOL believes are illegal.

DOL and the IRS should take only positions on missing participants for which there is specific authority, pending a coordinated review of the missing participant issues by DOL and the IRS.

#### ***17) Taxation of nonqualified deferred compensation:***

Past proposals would change the taxation of nonqualified deferred compensation by imposing income tax on the employee when the compensation vests without regard to whether the compensation is currently payable. We urge against such proposals. Taxing compensation at vesting rather than at payment would overturn the federal income tax principles that have long applied to most employees and employers. If enacted, such a rule would place a severe constraint on longer term compensation and retirement programs because of the difficulty of having employees pay federal income tax on amounts that they have not received. Taxation at vesting would make it hard for employers to provide compensation in a form other than current cash except, perhaps, for the very highest paid employees in the organization who can fund their own taxes in advance of receiving compensation payments. Employers would find it much harder to design plans for their management that defer their compensation payments after vesting even though “locking up” compensation until retirement or another future date may be optimal for their business. Certain industries are being encouraged by their regulators to have more, not less, deferral of compensation because of the risk



mitigation tool that deferral of payment provides. Deferring compensation payouts beyond vesting may help employers discourage short term behavior and retain employees. Taxation of all compensation at vesting would make deferred compensation plans difficult to continue in the future, which is neither good tax policy nor good business policy.

There are some limited examples in existing law where taxation occurs prior to the payment of compensation and those cases are instructive in considering how a change in the law would affect business. Today, there is an obligation under section 3121(v)(2) to impose FICA taxation of deferred compensation at vesting; however, the categories of deferred compensation to which this rule applies are limited and the regulations include numerous exceptions and administrative rules that allow employers in many cases to delay FICA taxation until payments come due (or until a period that is relatively close to the payment commencement date.) Where FICA taxation at vesting does apply, it is difficult to administer, especially in a defined benefit pension plan context, because changes in the present value valuation of a retirement or pension benefit can result in overpayments. Nonetheless, because of the fairly limited scope of section 3121(v)(2) and the administrative exceptions provided, early FICA taxation has not radically changed compensation design.

A more telling and contrasting example is the application of Section 457(f) for tax-exempt employers, which imposes income tax at vesting and, as a result has severely limited longer-term arrangements for these entities. When enacted in 1986, the application of Section 457 to tax exempt employers was intended to address the lack of “tax-tension” between tax exempt organizations and their employees since the tax exempt would seemingly be indifferent to the timing of federal income tax deductions. But, the reality of this rule is that tax exempt employers are effectively precluded from providing longer-term compensation programs to their employees.<sup>11</sup> It has proven extremely difficult for individuals to pay tax on amounts they have not received and have no right to receive for many years.

Based on the experience for the employers subject to Section 457, it is not an exaggeration to conclude that a change in law imposing income taxation of deferred compensation at vesting for all employers would put an end to many types of deferred compensation programs that employers have developed to incent and retain their employees. Taxing long-term retirement benefits, stock option grants and other types of deferred compensation at vesting would simply mean that they would no longer be issued in the vast majority of cases. This runs counter to non-tax regulatory and business initiatives that have encouraged employers to pay less current cash up front and adopt more deferred compensation as a mechanism to control enterprise risk.

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<sup>11</sup> The same concept applies under Section 457A, but this provision applies to a limited class of taxpayers who are performing services for employers in tax-indifferent countries.

We question the policy rationale for undoing the basic tax principle that individuals pay tax on compensation when it is paid. The deferral of the employee's income inclusion in a deferred compensation arrangement is matched by the corresponding delay in the employer's deduction. Any perceived "control" of the timing of payments by employees was addressed with the enactment of Section 409A. The fundamentals of tax reform are built upon the idea of ensuring business competitiveness, promoting fairness, and simplification. The proposal to tax deferred compensation at vesting meets none of those tax policy standards. Moreover, it would significantly diminish a tool that employers use to retain and align employees with longer term goals, which is not good business policy.

**18) *Transit benefits:***

Our members emphasize to us how important transit pass benefits are to their employees. These benefits enable employers to recruit and retain employees, especially in areas where the cost of maintaining and parking a car is prohibitive for many employees and public transportation is not inexpensive. These benefits have become integral to generations of employees who rely on public transportation. Eliminating this benefit may seem like a small thing in the scope of the Code, but our members make it clear to us that this benefit is very important to employees across the country.

**19) *Paid leave laws:***

In addition to the tax issues regarding retirement and employee benefits, there are a host of important issues confronting plan sponsors. For example, employers are being subjected to a patchwork of uncoordinated paid leave laws by state and local governments. For a multi-state employer, this is unworkable, particularly for employees working in multiple jurisdictions. This issue needs to be addressed through the establishment of a voluntary federal minimum that would be deemed to satisfy all state and local requirements.

We thank the Committee for the opportunity to submit this statement and for a long history of dedicated work on protecting and enhancing the private retirement system. We look forward to continuing to work with this Committee on improving retirement savings in this country.