AMERICAN BENEFITS COUNCIL

TESTIMONY OF

JAMES M. DELAPLANE, JR.
PARTNER, DAVIS & HARMAN LLP

ON BEHALF OF THE AMERICAN BENEFITS COUNCIL

FOR THE

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WORKING GROUP ON
APPROACHES TO RETIREMENT SECURITY IN THE UNITED STATES

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Introduction

My name is Jamey Delaplane and I am a partner in the law firm of Davis & Harman LLP. I am here today on behalf of the American Benefits Council (the "Council"), which I serve as Special Counsel. 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.

We very much appreciate the opportunity to testify before you today about the adequacy and structure of today's employer-sponsored retirement system and whether today's plans and policy approaches can be improved. As your working group has noted, the current severe economic circumstances are leading all stakeholders in the retirement system – sponsors, participants, providers, policymakers – to take stock of where we are. We are all beginning to reflect on what is working, what may not be working as well, and what we can do to improve retirement outcomes for American families.

Today's Economic Challenges. I want to note at the outset, however, that most plan sponsor benefit professionals are today squarely focused on doing what it takes to help their companies and their employees survive the current recession. In the short term, this focus will understandably distract somewhat from their efforts to learn lessons from the current crisis and to implement new strategies and solutions. Indeed, some short-term steps that plan sponsors may take to ensure the viability of their firms and to preserve jobs (e.g., reducing 401(k) matching contributions) can even be viewed as counter-productive from a retirement security perspective. We can certainly assure you, however, that while our member companies are taking the steps they believe they must to weather the recession and preserve jobs, they remain committed to employer-sponsored retirement plans as the foundation of our private retirement system. They merely ask for some patience to get beyond today's fires before implementing tomorrow's innovations.

The Employer System: Successes and Improvements. The Council's overarching perspective is that the employer-sponsored retirement system has been a great success, serving today to deliver retirement benefits to more than 100 million Americans and their families. Employers in this system not only act as a source of significant benefit financing, design innovation, plan administration and participant education, but also deliver tremendous value for employees as a result of their fiduciary oversight and bargaining power. While plan sponsors certainly feel they have gained new insights about how to do better as a result of the current economic challenges, nothing in the current crisis has caused us to question this core judgment as to the success of the employer system. We do not see a need for radical, structural reform of this system, and in fact, are focused on how to grow this system so more Americans can enjoy its benefits.

Let me speak for a moment specifically about the defined contribution system, which has faced particular criticism in this crisis. At the outset, let me make clear that the present anxieties of 401(k) participants are absolutely legitimate and understandable given the account balance declines many have experienced. Indeed, for some in the near-retiree population, the effects of the market downturn have been devastating. We all must seek to learn lessons from these developments, and we at the Council are attempting to do so.

With that said, we do not believe the extremely unusual set of economic and financial circumstances we are living through today (not seen since the Great Depression) should be interpreted as a condemnation of the defined contribution system. This system should be judged on whether it serves workers' retirement interests over the long-term, and for many it has been a source of significant savings accumulation. Plan participants that remain in the system (and nearly all participants are continuing their deferrals despite today's economic environment) can expect their account balances to rebound and grow significantly over time. Moreover, the 401(k) system today is not the bare-bones supplemental savings system that came into being in the early 1980s. At least 95% of employers make either matching or profit-sharing contributions into defined contribution plans, and many design enhancements and policy improvements (auto enrollment and escalation, single fund diversified investment solutions, catch-up contributions, accelerated vesting, diversification rights, tax credits for retirement savings) have been adopted to improve retirement outcomes for participants.

As you can see, we are strong believers in the success of employer plans. However, we likewise feel strongly that improvements can and should be made to these plans and that policy changes are critical to facilitate these improvements. Throughout its history, the Council has partnered with policymakers to advance improvements to the employer system. Below, we discuss a number of recommended enhancements to both defined benefit and defined contribution plan policies. You will see that we begin with a discussion of fiduciary safe harbors, a topic of particular relevance for this working group and something we believe is critical to the continued health of the employer system.

Expanding Retirement Plan Coverage. We likewise believe more must be done to extend workplace retirement savings arrangements to those many millions of Americans who currently lack such access. As discussed in more detail below, the Council has developed a multi-pronged policy agenda to expand workplace retirement plan coverage. This agenda is built on several fundamental premises. The first is that in seeking to expand coverage we must not take steps that could undermine the existing employer-sponsored system. The second is that there is no single policy response or mandate that is likely to speak in a constructive manner to all the reasons some employers have shied from plan sponsorship. The third is that creation of a governmental system or structure to provide retirement plans or investments would create new and unwise governmental liabilities and would unnecessarily supplant private-sector activity. In this regard, we are extremely skeptical of proposals to have the federal government guarantee investment returns in defined contribution plans. Based on these premises, the Council's coverage agenda offers a range of recommended policy reforms that attempt to speak to the differing issues that impede plan sponsorship by employers -- and plan or IRA participation by workers. We believe a system that offers a range of retirement plan designs -- from simple arrangements with low contribution limits and relatively modest compliance requirements to more complex designs with higher contribution limits and rigorous compliance requirements -- will be best suited to growing workplace plan coverage rates.

Fiduciary Liability

One area about which we and our member companies are extremely concerned when it comes to the future stability of the employer-sponsored system is fiduciary liability. Anxiety about meeting fiduciary obligations and about the increasing prevalence and therefore risk of fiduciary litigation, with its attendant drain on time and resources, dominates the conversations we have with our plan sponsor members. Plan sponsors are particularly concerned in this regard with defined contribution plans given the increasing litigation faced by 401(k) plan sponsors. The market and economic conditions of the past 12 months -- and the attendant declines in participant account balances -- have only exacerbated this worry about defined contribution plan fiduciary vulnerability.

Not only do we worry about this understandable fiduciary anxiety eventually weakening the commitment of large employers to plan sponsorship, but we also know from our service provider members that fiduciary risks are a dominant concern of small businesses. We hear, in particular, that concerns about the complexity and burden of fiduciary obligations and about the risk of litigation are major deterrents to plan creation among small businesses.

With this in mind, one of the major recommendations we have both for Congress and the Department of Labor (the "Department") is to develop fiduciary safe harbors wherever and whenever possible to assist sponsors in meeting their legal obligations. Such safe harbors, which provide a clear and specific road map for sponsors as to how to carry out their fiduciary duties (and provide some measure of protection in the event of litigation on a specific matter), are extremely helpful.

The safe harbor for qualified default investment alternatives (QDIAs), which originated in the Pension Protection Act of 2006 (PPA) and was implemented through Department regulations, is one recent example. Another less recent but even more important example is the regime under ERISA Section 404(c) governing responsibility for investment outcomes in participant-directed plans. Building on approaches such as these, we have recommended that a number of fiduciary safe harbors be included in the defined contribution plan fee disclosure legislation currently being debated in Congress. Such safe harbors would address issues such as a sponsor's (1) reliance on service provider information, (2) duty to obtain fee disclosures beyond those specified in legislation, and (3) obligations with respect to review of unbundled service pricing information. Without such safe harbors, we fear that new disclosure requirements will contribute to sponsors' already significant fiduciary concerns and could threaten the commitment to plan sponsorship among some. To the extent Congress goes beyond fee disclosure to contemplate new required investment offerings, an unwise step in our view, fiduciary safe harbors will likewise be necessary to prevent new litigation about whether the selected investment adequately meets the governmental mandate.

In sum, fiduciary safe harbors will help encourage existing plan sponsors to remain in the system and can help address the hesitation of employers considering plan sponsorship. This is probably the most important recommendation we offer you today, one we see as critical to the stability and potential growth of the defined contribution plan system.

<u>Enhancements to Existing Defined Benefit Plan Rules</u>
The Council remains a strong proponent of defined benefit plans and continues to strive for a policy environment that will encourage the creation and maintenance of these plans. Recent market and economic conditions have increased the budgeting and financing challenges for defined benefit plan sponsors but have also highlighted the many advantages these plans offer participants from a retirement income security perspective. We feel strongly that policymakers must not give up on this important plan design.

Short-Term Funding Reforms. Much of the Council's work in recent months regarding defined benefit plans has been to seek to remedy the unfortunate confluence of the market downturn and the new funding regime instituted by PPA. This confluence has imposed unanticipated and extremely large funding requirements on many defined benefit plan sponsors, with the result that many companies are put to the choice of meeting plan funding obligations or making the expenditures and investments critical to economic recovery. Sadly, for a number of sponsors, meeting short-term plan funding obligations has meant laying off workers.

The Council is working with Congress to enact short-term defined benefit plan funding changes that will alleviate the economic dislocation caused by this unfortunate confluence of events. These changes would (1) provide additional time to amortize 2008 losses, (2) expand the asset smoothing corridor, (3) protect participants and sponsors from benefit and financing restrictions that would otherwise apply as a result of the market decline, (4) clarify that investment expenses are not included in a plan's normal cost, and (5) allow sponsors to make new interest rate elections. We hope these changes will be enacted quickly in order to stem the economic harm for companies and workers alike and prevent the additional defined benefit plan freezes that would otherwise inevitably result. Support from the working group for these important short-term reforms would be very helpful.

Longer-Term Defined Benefit Plan Reforms. At the same time, the Council is looking beyond the current economic crisis at reforms that will help keep the defined benefit plan design a vital and viable choice for employers into the future.

- *Predictability in the Funding Rules.* First, we believe the funding rules of PPA can and should be improved on a permanent basis to provide a greater measure of funding predictability and to limit volatility of required contributions from one year to the next. Simply put, more predictability and less volatility are absolutely required if we are to arrest the steady march of many U.S. employers away from the defined benefit system.

- *Hybrid Plan Certainty.* Second, policymakers must complete the process of eliminating the uncertainties and clarifying the rules surrounding hybrid defined benefit plans such as cash balance and pension equity. These plans continue to offer an important blend of features that make them attractive to employers and employees alike. PPA was an enormous step forward in eliminating the uncertainty surrounding these plans, and completion of the regulatory guidance under PPA's hybrid plan provisions by Treasury and IRS will be helpful. We hope to avoid what has occasionally happened in the recent past, which is the advancement of new and problematic interpretations of law regarding hybrid plans via the determination letter process. It is very important to the health of the defined benefit system that regulatory guidance on hybrid plans be practical and not trip up employers that sought to do right by their employees through choice, greater of and grandfathering transition techniques. We have seen increasing interest among small employers in cash balance designs in the wake of PPA, and it is our hope that this interest will grow among employers of all sizes once we have final regulatory interpretations. We believe the availability of hybrid plan designs about which there is legal and compliance certainty is an absolutely critical component of saving the defined benefit plan system.

- *Safe Harbor Credit for Defined Benefit Plan Accruals.* Third, we believe benefits accrued under defined benefit plans should be taken into account in determining whether an employer's defined contribution plan is eligible for a nondiscrimination testing safe harbor. Current law's disregard of defined benefit plan accruals is not logical given that employer retirement plan contributions are fungible, and recognition of the defined benefit plan accruals will provide a meaningful incentive for defined benefit plan maintenance, or even creation.

- *DB(k) Improvements.* Fourth, we believe the DB(k) combination defined benefit plan/401(k) design adopted in PPA, which is first available next year, can be improved in several respects. There are several outstanding technical questions regarding the intersection between cash balance and ESOP structures and the DB(k) design, and we recommend the DB(k) design be made available to employers with more than 500 employees.

We hope the working group will include these defined benefit plan recommendations in its report.

<u>Enhancements to Existing Defined Contribution Plan Rules</u>
Let me now turn to discussion of potential enhancements to defined contribution plan policy. Council members have made increasing use of automatic enrollment and automatic deferral escalation and believe these default systems enhance the ability of defined contribution plans to meet the retirement income needs of plan participants. We believe there are additional policy reforms in this area that would help broaden the reach of these successful approaches.

Promotion of Auto Escalation. With respect to auto escalation in particular, there are a number of policy changes that should be adopted to encourage more widespread use of this feature.

- First, we would recommend the elimination of the 10% cap on the maximum automatic escalation deferral level under the qualified automatic contribution arrangement (QACA) safe harbor established under PPA. We see no reason to artificially constrain auto escalation levels when participants can cease escalation at any time, and some of the early research on auto escalation shows that participants will often escalate to above 10%. Moreover, depending on life stage and prior savings levels, deferral levels of more than 10% may not only be appropriate but necessary to achieve retirement income adequacy.

- Second, to encourage more small employers to adopt QACAs (where adoption has been limited), we recommend both a tax credit and some alterations to the QACA design. We recommend provision of a tax credit to small employers that adopt a QACA in recognition of the fact that implementation of auto enrollment and escalation will increase employer contribution costs. We also recommend making the employer contribution and vesting requirements of the QACA (3% non-elective or 3.5% match and 2-year cliff, respectively) somewhat less demanding for small employers given that both requirements are expense drivers and have lessened adoption of the very pro-employee QACA by small firms. In an era when Congress is considering mandating payroll deduction IRAs with <u>no</u> employer contributions or fiduciary obligations, encouraging small employers to have plans with auto enrollment and escalation, employer contributions and fiduciary oversight seems particularly prudent.

- Third, we urge consideration of a new nondiscrimination testing safe harbor under which defined contribution plans would not be required to test if they (1) achieved 90% participation in the prior year, (2) adopted automatic enrollment of at least a 3% initial deferral rate on an annual basis for all employees, and (3) adopted auto escalation up to at least 10%.

We also believe the Department could help to promote the adoption of auto escalation. We urge the Department, working in conjunction with Treasury and IRS and the private sector, to develop an educational document for plan sponsors that would explain what auto escalation is, how it can be adopted and the design and operational issues it raises. We believe such a publication could be particularly helpful in encouraging smaller employers, which may not be as familiar with the auto escalation design, to adopt the feature.

Guidance on Plan Investments. The market decline of the past year has resulted in new scrutiny of defined contribution plan investments, and we wanted to briefly touch on several recommendations in this area.

- First, we reiterate our Council recommendations with respect to target date funds, which were contained in testimony delivered by Allison Klausner of Honeywell to the joint Department of Labor-Securities and Exchange Commission hearing on June 18th. We believe target date funds continue to provide an extremely helpful investment approach for large numbers of defined contribution plan participants, one that improves diversification and investment performance for many and that therefore continues to make good sense as a QDIA. We urge the Department not to mandate the features and characteristics of target date funds through restrictions on asset allocations or glidepaths, and thus constrain the choices of plan sponsors. We recognize, however, that further guidance for fiduciaries about the factors to evaluate in selecting and monitoring such funds could be constructive.

- Second, our members have been intrigued with the notion of "auto diversification" out of company stock and into a QDIA for participants nearing retirement with significant company stock exposure. We would recommend the adoption of administrative guidance by the Department removing existing impediments to adoption of these designs.

These auto diversification ideas are one response to the detrimental effect of the recent market downturn on near-retirees, particularly those who may have been unduly concentrated in equities. For these individuals, appropriate asset allocation is critical to their retirement prospects, and this concern about allocation is what has given rise to the recent scrutiny of target date funds. We at the Council recognize the importance of enhancing the defined contribution system to better support the objective of retirement income security, which is particularly important for near-retirees. In this regard, we direct this working group to the Council's September 10, 2008 testimony to the ERISA Advisory Council Working Group on Spend Down of Defined Contribution Plan Assets. In that testimony, we made a series of recommendations about steps the Department could take to facilitate participant education and advice about plan distribution decisions and to remove burdens that impede the adoption of installment and annuity distribution options by defined contribution plan sponsors.

<u>Proposals to Expand Workplace Savings Arrangements</u>
As noted above, the Council has had a working group that has spent significant time over the past twelve months developing recommendations for expanding workplace retirement plan coverage. In addition to recommendations for reform of existing defined contribution and defined benefit plan rules to encourage more adoption and better utilization of these plans (several of which we have discussed above), the task force also came forward with recommendations for (1) new simplified retirement plan

designs, (2) new tax incentives for both employers and individual savers, (3) expanded use of workplace IRAs, (4) improved promotion of retirement arrangements to small employers and (5) expanded financial education and literacy efforts. Let me discuss several of the component recommendations that may be of particular interest to this group.

Simplified Retirement Plan Designs. With respect to simplified retirement plans, we recommend the adoption of several new streamlined designs consistent with our belief that a range of choices will best meet the needs of the diverse set of employers that do not currently offer plans. First, we recommend the institution of a new multiple employer defined contribution plan with streamlined rules and lower contribution limits than today's 401(k) and SIMPLE plans. This will bring the cost-efficiency and other advantages of pooling across many small employers, and its simple rules should make it attractive as a starter plan. Second, we recommend a new career average defined benefit plan with a basic minimum benefit, the opportunity for employee pre-tax contributions and temporary accruals, and simplified, mechanical funding requirements. Such a design seeks to remedy a number of the features that have deterred employers from defined benefit plans. Both new designs are based on proposals (the Model T and Plain Old Pension Plan, respectively) initially made by the Conversation on Coverage, which was convened by the Pension Rights Center and in which the Council participated.

Tax Incentives. With respect to tax incentives, we recommend both an expansion of the tax credit for small employers for plan start-up costs as well as an expansion of the Saver's Credit for individuals saving for retirement in defined contribution plans and IRAs. In our view, making the start-up credit more robust will be particularly important if Congress passes one of the several proposals to encourage or mandate workplace payroll deduction IRAs, most of which include a new tax credit for auto IRA expenses. We want federal policy to be absolutely clear in its encouragement of qualified plan creation. Ensuring that the plan start-up credit remains substantially more robust than any auto IRA credit will both acknowledge the substantial additional expenses associated with plan creation and maintenance and signal the policy preference for qualified plan sponsorship. On the individual side, beyond expanding the Saver's Credit so it will reach more individuals, we also believe the credit can be promoted more effectively than it is today. For example, taxpayers are not able to claim the credit today on the Form 1040-EZ even though this is the form used by many of the individuals who are eligible for the credit. We also believe the Department could play a role in encouraging plan sponsors to communicate with their participants about the availability of the Saver's Credit. Working with the Treasury Department and IRS, we would recommend that the Department develop a publication on the Saver's Credit for plan sponsors that would focus on participant communication. This could build on the early model notices regarding the Saver's Credit issued by the IRS in Announcements 2001-106 and 120.

Promotion of Retirement Arrangements to Small Employers. We are appreciative that the Department has developed significant resources to educate small employers about the retirement plan designs and workplace IRA arrangements available to them. We would recommend that the Department undertake a joint effort with the Small Business Administration to disseminate these materials to small businesses around the country, and we believe additional partnerships with both public-sector and private-sector organizations would also help expand the reach of the information and resources the Department has developed.

Financial Education. The Council testified before the ERISA Advisory Council on July 10, 2007, on financial literacy, and this remains a significant interest of our membership. Rather than reiterating our recommendations from that testimony or speaking generally about our views on the matter, however, let me make a specific recommendation for the Department that our member companies believe would be of significant help. As you know, the Employee Benefits Security Administration maintains an investing education page on its website and the address (or a link) to this website must be included in participants' quarterly benefit statements pursuant to PPA. We believe the addition of information on four key topics would greatly enhance the benefit of this website for participants – (1) anticipated retirement expenses and the retirement savings balances needed to generate income sufficient to meet these expenses, (2) key issues to consider when spending down retirement plan assets, (3) the availability and operation of the Saver's Credit, and (4) an explanation of automatic enrollment and automatic escalation features. Our plan sponsors report that these are topics about which participant understanding is low and information on the EBSA website would help to supplement and reinforce the education efforts of plan sponsors and their service providers.

Conclusion

We appreciate the opportunity to appear today, and applaud the working group for stepping back and taking a broader look at our voluntary, employer-sponsored retirement system. We believe this system is working well but that reforms can make existing plans more effective and can extend the benefits of workplace savings to more Americans. We hope this working group will embrace the legislative recommendations we have made today and will urge the Department to issue the various guidance items we have suggested.