



AMERICAN BENEFITS COUNCIL

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"20/20" CAP ON RETIREMENT SAVINGS WOULD UNDERMINE RETIREMENT SECURITY

One option for deficit reduction previously considered by the National Commission on Fiscal Responsibility and Reform (co-chaired by Erskine Bowles and Senator Alan Simpson) would cap annual total employer and employee retirement plan contributions at the *lesser* of 20% of the employee's compensation or \$20,000. This approach should be rejected. The serious harm to retirement security that would result from this tax increase greatly exceeds any benefits from short-term deficit reduction, which are largely illusory. This dramatic cutback in the incentive to save would also send a clear message to employers and the public that the government's commitment to workplace retirement plans is waning.

THE 20/20 PROPOSAL WOULD UNDERMINE INCENTIVES FOR EMPLOYERS TO ESTABLISH AND MAINTAIN RETIREMENT PLANS.

Today, total employee and employer contributions to 401(k) and other defined contribution plans generally cannot exceed the lesser of 100% of compensation or \$50,000 per year. And those contribution levels can only be reached for owners and higher-paid employees (*i.e.*, those earning above \$115,000) if the plan satisfies tough non-discrimination rules, which ensure broad participation and contributions for rank-and-file workers. These tax incentives play a critical role in encouraging key decision-makers to sponsor and maintain plans.

When a typical small business owner evaluates the significant legal responsibilities, risks, and costs of voluntarily sponsoring a retirement plan, the promise of meaningful tax benefits for key employees often is the deciding factor in choosing to establish and maintain a retirement plan. But if tax benefits to decision-makers are substantially diminished, businesses that would have considered plan sponsorship may no longer do so, and existing plan sponsors. And employers that currently sponsor plans might reduce

employer matching contributions (to ensure compliance with requirements against discriminating in favor of certain employees) or stop offering retirement plans altogether.

In fact, in a 2011 study by Harris Interactive, nearly all plan sponsors (92 percent) said the ongoing tax deferral for employees is important in their decision to offer a defined contribution/401(k) plan. And nearly two-thirds (65 percent) said that if the ability for employees to deduct any amount of the 401(k) contribution from taxable income were eliminated, their desire to continue offering the plan would decrease.

If employers decide not to maintain plans, *all* employees would suffer because employer sponsorship offers considerable advantages for workers, including strict fiduciary standards; participation rules that ensure that benefits are delivered across all income groups; easy payroll withholding; lower fees from group participation; access to financial education; and often significant employer contributions.

THE 20/20 PROPOSAL WOULD SEVERELY DEPRESS AGGREGATE RETIREMENT SAVINGS FOR ALL INCOME LEVELS.

The nonpartisan, independent Employee Benefit Research Institute (EBRI) found that only 5% of workers save for retirement in an individual retirement account on their own without the benefit of an employer sponsored plan. By contrast, 70% of workers earning between \$30,000 and \$50,000 participate in employer-sponsored retirement plans when those plans are offered. An EBRI analysis of the 20/20 proposal projects reductions in 401(k) balances at retirement of between 4% and 15.1% across *all* income levels. Notably, among income quartiles, the second-highest average reduction would be felt among the lowest-income group. And younger savers with the lowest income would be hit particularly hard, with projected savings at retirement dropping by about 10% for individuals under age 45 in the bottom income quartile. This EBRI analysis does not even take into account the fact, as discussed above, that the 20/20 proposal would cause many plans to be terminated and would cause other employers to eliminate or reduce matching and other employer contributions.

EROSION OF THE RETIREMENT SAVINGS TAX INCENTIVES WOULD HARM LOW- AND MIDDLE-INCOME PARTICIPANTS.

Nearly three-fourths of participants in defined contribution plans have annual family incomes under \$100,000. Today, those families receive 62% of the tax benefits associated with qualified retirement plans – despite paying only 26% of the total personal income taxes received by the federal government. In other words, lower- and middle-income taxpayers receive more than twice as large a share of savings tax breaks as the share of income taxes they actually pay.

Plan design features referenced above enhance the progressivity of the benefit. For instance, nondiscrimination rules ensure that plans do not “discriminate” in favor of highly compensated employees and limit the amount of compensation that can be included in determining benefits and testing for nondiscrimination. And beyond plan design features, economic evidence shows that market factors further enhance progressivity. As a recent analysis by Boston College’s Center for Retirement Research found, to the extent employers reduce money wages to pay for a plan, “additional employer contributions to [defined contribution] plans reduce money wages much less for low-income than for high-income workers.”

Many people (including in particular women and minorities) move in and out of the work force as a result of caring for children (or parents), health issues, or the inability to obtain steady employment. In order to achieve retirement security, they need the flexibility to be able to contribute at higher rates when they are employed. The 20/20 cap (including the repeal of catch-up contributions currently available to those over age 50) would make it difficult for many millions of Americans to make up for the inability to save during those periods when they are not in the work force.

DEFICIT REDUCTION THROUGH CUTS IN RETIREMENT SAVINGS IS ILLUSORY.

The “scorekeepers” at the Treasury Department and the Joint Committee on Taxation generally produce estimates in five- and ten-year budget windows, using a cash-flow analysis. Under that methodology, the taxes an employee will pay when they retire and start taking taxable plan distributions generally occur outside the budget window. But proposals like the “20/20” limit that reduce retirement savings today will mean the government actually collects less revenue in years outside the budget window. As a result, any overall budgetary savings that might result would be considerably smaller than the short-term revenue estimates might suggest. In fact, a recent study completed by former staff of the Joint Committee on Taxation finds that the present value of tax benefits attributable to current-year retirement savings contributions is as much as 77% less than estimates of revenue loss under Treasury’s methodology. In short, claiming deficit reduction from proposals that reduce retirement savings is actually increasing the burden on future generations, not decreasing it. That type of short-sighted thinking will not help the nation address its structural budget deficits.

THE 20/20 PROPOSAL COULD DESTABILIZE THE SUCCESSFUL RETIREMENT SYSTEM.

The current retirement savings tax incentive structure efficiently produces ultimate retirement benefits. The system provides much needed retirement security for workers and their families at all income levels and should not be tampered with unnecessarily.

Over 75 million employees work for an employer sponsoring a plan, and 68% of private-sector workers had access to a defined contribution plan in 2011. Private employer retirement plans pay out almost \$500 billion in retirement benefits each year. Surveys of defined contribution sponsors found that at least 95% make some form of employer contribution. And repeated analyses have shown that for every dollar of tax expenditure devoted to tax-preferred workplace retirement plans, these plans deliver between four and five dollars in ultimate retirement benefits to plan participants. Moreover, modeling suggests that, when combined with Social Security, defined contribution plans help participants receive income in retirement that approximates their income earned during working years. Specifically, the model shows that the replacement ratio is over 100% for the lowest income quartile, and well over 80% for all other income quartiles.

Yet, a sweeping change like the 20/20 proposal would require each employer to reevaluate and completely redesign their retirement plan offerings and many would be forced to consider eliminating their plans entirely. Reducing the limit on how much can be saved in a plan could reduce total coverage because small employers will not start a plan or may terminate the plan that they have.

CHANGES IN RETIREMENT POLICY MUST BUILD ON THE SUCCESSFUL EXISTING SYSTEM.

Even under the current levels, many Americans are at risk of a financially insecure retirement. Recent data find that nearly half of the Baby Boom Generation (born between 1948 and 1964) and Gen Xers (born between 1965 and 1974) are “at risk” of running short of money in retirement. We *do* need policies that will bolster retirement security for future generations – policies that build upon the existing successful structure to generate greater retirement savings. But the proposal to reduce saving limits, as in the “20/20” proposal, will erode retirement security and should be rejected.