AMERICAN BENEFITS COUNCIL

TESTIMONY OF

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ON BEHALF OF

AMERICAN BENEFITS COUNCIL

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON WAYS AND MEANS

HEARING ON

TAX REFORM AND TAX-FAVORED RETIREMENT ACCOUNTS

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Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to speak with you today on the issues involved in tax reform and tax-favored retirement accounts.

My name is Randy Hardock and I am testifying on behalf of the American Benefits Council (the "Council"). I am a partner in the law firm of Davis & Harman LLP specializing in employee benefit issues and have been a Member of the Council's Board of Directors for the last 15 years. During that time, I have advised the Council and numerous employers that sponsor retirement plans, plan administrators, plan service providers, and individuals with respect to a wide range of retirement plan issues. I also served as Benefits Tax Council in the Department of the Treasury's Office of Tax Policy (from 1993-1995) and as Tax Counsel to the Senate Committee on Finance (from 1986-1993) (including during the Senate's consideration of the Tax Reform Act of 1986).

The Council and I appreciate the opportunity to participate in today's critical and timely hearing on retirement. 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 covering more than 100 million Americans.

The House Ways and Means Committee has been directly responsible for the enactment of every major improvement in the employment-based retirement system over the last two decades. Most notably, it was the tireless work of this Committee in 1999 and 2000 that led to the enactment of the Retirement Security Act early in 2001. That legislation established a sensible and successful framework for defined contribution (DC) plans and IRAs that is still in place today. Significantly, the Retirement Security Act was cosponsored by every senior Republican still serving on this Committee today. It was also cosponsored by Ranking Member Levin, and by 10 of the 15 Democrats now serving on this Committee. Other cosponsors of that bill included Speaker Boehner, Majority Leader Cantor, Minority Leader Pelosi, and Minority Whip Hoyer. In short, the importance of encouraging retirement savings has been one area where Republicans and Democrats have long been able to agree and we urge this Committee to continue to support policies that promote retirement savings.

SUMMARY

Employer-sponsored DC plans and defined benefit (DB) retirement plans are an indispensable building block of our Nation's retirement system. Retirement plans, like those sponsored and administered by the Council's members, successfully assist tens of millions of families in accumulating retirement savings and will provide trillions of dollars in retirement income and a more financially secure retirement. Congress has adopted rules that encourage employers to voluntarily offer these plans, encourage

employees' participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. Understandably, individuals have heightened retirement income concerns resulting from the recent economic downturn. But those concerns only serve to reemphasize the vital role workplace-based retirement plans play in ensuring personal financial security and in generating savings to fuel the type of capital investment the economy needs to generate long-term growth.

With about 100 million active and retired workers (and their spouses) accumulating retirement savings under employment-based retirement plans and IRAs, today's retirement policies are working. Those rules enable Americans – with support from their employers – to accumulate savings and generate retirement income. For that reason, the first, and most important, principle we urge this Committee to consider in the context of tax reform is: do no harm. We urge policymakers to avoid any actions that would make it more difficult for individuals to save for retirement or that would discourage employers from starting or continuing to maintain retirement plans. Thus, the wisest course in most instances will be to *not* enact new laws or new regulations that would disrupt the success of the current system.

Dramatic changes in the rules and incentives governing retirement plans are perilous and unintended consequences are likely. Major restructuring of the current system is a gamble we cannot afford to take when we are dealing with the retirement security of working and retired Americans. That is especially true now, with the Baby Boom generation reaching retirement age. In this context, it is important to remember that the employer-sponsored retirement system is premised on its voluntary nature – employers can choose to provide retirement plans to their workers, but they are not required to do so. That voluntary system is built to supplement the safety net provided by Social Security. Changes in the retirement plan tax incentives would require each plan sponsor to reevaluate and completely redesign its retirement plan offerings and could force them to consider eliminating their plans entirely. Even seemingly small changes in laws and regulations often generate confusion and enormous costs for individuals and employers.

As this Committee considers retirement issues (in a tax reform context or otherwise), it is critical to focus on policies that will help individuals and employers generate retirement income sufficient for employees to maintain their standard of living. Too often, retirement policy is driven by extraneous considerations, such as the need to generate revenue for the federal government. When these revenue considerations are at the forefront, the result has often been unnecessary complexity and cost, or worse yet, direct harm to Americans' retirement prospects. Proposals that purport to increase short-term federal tax receipts by redirecting, eliminating, or eroding the existing retirement savings incentives achieve those additional taxes *largely because individuals are saving less for retirement.* Making matters worse, any short-term revenue gain that might be derived from changes in the retirement savings incentives is largely illusory

because when a worker saves less money today it will mean smaller distributions (and less tax revenue) when the individual retires. That is a lose/lose situation for the retiree and the government.

Still, the retirement system can and should be improved. Even at current savings levels, too many Americans are at risk of a financially insecure retirement. More must be done to increase retirement security (and overall financial security) for all American families, especially those with lower incomes who find it the most difficult to save. Tax reform offers the opportunity to do just that with relatively modest targeted changes that build upon the existing successful structure to generate greater retirement savings. In particular, in light of the clear evidence of dramatic increases in retirement plan coverage and savings that result when employers implement automatic enrollment and automatic increase designs, we urge the Committee to explore incentives that will accelerate the trend toward utilization of those mechanisms.

THE CURRENT EMPLOYMENT-BASED RETIREMENT SYSTEM IS WORKING FOR MILLIONS OF AMERICAN WORKERS AND RETIREES

Today, the vast majority of large employers offer a DC plan and an increasing number of small employers do as well. According to the Bureau of Labor Statistics, 73% of full-time and 64% of all private industry workers had access to retirement benefits as of May 2011.[1] Over the past three decades, 401(k) and other DC plans have grown dramatically in number, asset value, and employee participation. Private-sector DC plans cover more than 70 million active and retired workers, with millions more participating in 403(b), 457, and the Thrift Savings Plan – types of DC plans maintained in connection with employment by tax-exempt and governmental employers. While not the topic of today's hearing, DB plans also remain vital to the retirement security of many millions of Americans. Ensuring that workable DB plans remain an option for employers must also be a critical priority.

This broad coverage and participation results from the unique advantages employment-based plans bring to bear for employees when it comes to retirement savings and income. These advantages would likely not be available for millions of working Americans if it were not for the existing tax incentives that motivate employee saving and that encourage employers to maintain and contribute to retirement plans.

When discussing retirement plans, media focus is often on employee deferrals into 401(k) plans. Yet, many employers make matching, non-elective, and profit-sharing contributions to complement employee deferrals – thus choosing to share the responsibility for financing employees' retirement. Other employers fund DB plans that

[1] See Bureau of Labor Statistics, Employee Benefits in the United States, March 2011, *available at* http://www.bls.gov/ncs/ebs/sp/ebnr0017.pdf

further add to the retirement security of their employees. Recent surveys of DC plan sponsors found that at least 95% make some form of employer contribution.[2] While certain employers suspended matching and profit sharing contributions due to the recent economic downturn (and, in some cases, because of a dramatic spike in their defined benefit plan funding obligations), the vast majority have not, and in most cases the suspended matches have already been reinstated.[3]

Employees participating in employment-based plans also benefit from enhanced bargaining and purchasing power resulting from economies of scale, fiduciary decision-making and oversight, and access to beneficial products and services. Moreover, Congress has established detailed rules to ensure that benefits in DC plans are delivered across all income groups. For example, extensive coverage, nondiscrimination, and top-heavy rules promote fairness regarding which employees are covered by a DC plan and the contributions made to these plans.

Employers are also in a strong position to know the retirement needs of their employee populations and can tailor retirement programs to these needs. With the growth in DC plan coverage, those plans have continued to evolve and improve, with plan sponsors and service providers developing many features, including automatic contribution escalation, single-fund investment solutions, and investment education programs. Legislative changes and market innovations (often supported by legislative clarifications) have improved both employee participation rates and employee outcomes. For example, the Pension Protection Act of 2006 (PPA) included several landmark changes to the DC system that are already beginning to assist employees. PPA encouraged automatic enrollment (which studies demonstrate significantly increases participation rates, particularly among lower-income, younger, and minority workers) and automatic contribution escalation. With the PPA changes, adoption of these features has increased dramatically. In PPA, Congress also provided new rights to diversify contributions made in company stock, accelerating existing trends toward greater diversification of 401(k) assets.

The evidence is clear: The DC system works and the incremental changes adopted in recent years have made them even more effective. There are still gaps (especially for lower income workers); more can and should be done to expand coverage and to increase contributions. But one of the most important advantages of the current

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[2] Diversified Investment Advisors, Report on Retirement Plans – 2007, (Nov. 2007). Vanguard reports that in 2010, for DC plans it services, 95% of participants were in plans that include an employer contribution. See Vanguard, How America Saves, 2011, figure 5, *available at* https://institutional.vanguard.com/VGApp/iip/site/institutional/clientsolutions/dc/howamericasaves/ See also: Plan Sponsor Council of America, 54th Annual Survey, Reflecting 2010 Experience, p. 23 (reporting 93.4% of surveyed companies make contributions to the plan).

[3] See, e.g., *Vishal Apte and Brendan McFarland, Towers Watson Newsletter (October 2011).* Of 260 companies that discontinued or reduced their 401(k) matching contributions in the downturn, 75% have now restored them.

retirement savings tax incentive structure is that it efficiently produces retirement benefits for millions of American families. Analyses have shown that the tax expenditure more than pays for itself. This multiplier effect produces a remarkable amount of benefits for retirees, with the Department of Commerce reporting that in 2010 employer-sponsored retirement plans paid out $836 billion in benefits,[4] substantially more than the $577 billion in retirement benefits paid by Social Security in the same year.[5]

The importance of the current system is demonstrated by the fact that retirement plans held approximately $17.9 trillion in assets as of December 31, 2011.[6] These trillions of dollars in assets, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American businesses.[7] This capital permits greater production of goods and services and makes possible additional productivity-enhancing investments – investments that help companies grow and add jobs to their payrolls and raise employee wages.

THE CURRENT TAX INCENTIVE STRUCTURE IS THE FOUNDATION OF OUR SUCCESSFUL RETIREMENT SAVINGS SYSTEM

The U.S. retirement savings system successfully encourages individuals to save for retirement by providing tax incentives – including income tax exclusions or deductions – for contributions to employer-sponsored retirement plans and IRAs, up to statutory limits. This tax structure provides a strong and effective incentive for individuals at all income levels to save for retirement and encourages employers to sponsor plans that deliver meaningful benefits to Americans up and down the income scale. The fundamental building blocks of the current tax incentive structure are:

Contributions are Excludible or Deductible From Income: Contributions to qualified workplace retirement plans, both those made by employees and those made by employers, are generally excludable from employees' taxable income, and contributions to traditional Individual Retirement Accounts (IRAs) are tax-deductible in some instances. This pre-tax treatment allows individuals to save more from each paycheck

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[4] 91 Bureau of Economic Analysis, U.S. Dep't of Commerce, Survey of Current Business 8, National Income and Product Accounts Table 6.11D (Aug. 2011).

[5] Social Security Trustees Report 2011.

[6] See Investment Company Institute, *Retirement Assets Total $17.9 Trillion in Fourth Quarter 2011*, *available at* http://www.ici.org/research/retirement/retirement/ret_11_q4.

[7] At year-end 2010, 48% of mutual funds' assets were held in a tax-deferred household account. See Investment Company Institute, *2011 Investment Company Fact Book*, Figure A.2, *available at* http://www.ici.org/pdf/2011_factbook.pdf.

than would be the case with after-tax contributions.[8] For a worker in the 25% income tax bracket, for example, a $20 deferral into a 401(k) plan will only reduce take home pay by $15, making saving into the plan an efficient economic proposition.

Employer Contributions are Exempt from Payroll Tax: Because employer contributions to plans are not regarded as "wages," neither employees nor employers owe payroll taxes on these amounts. These payroll tax savings are most significant for modest-income employees earning amounts below the Social Security wage base ($110,100 in 2012) since payments in cash rather than into the plan would be fully subject to payroll taxes.

Taxes on Investment Gains are Deferred: There is no tax on investment gains while funds remain inside the retirement plan. This deferral is critical for incenting savings as workers know they will not have to divert income year-by-year to pay tax on their retirement savings. It is critical to remember that pre-tax contributions made to DC plans and IRAs – and the earnings on these contributions – do not escape taxation but rather are taxed when withdrawn. Thus, the federal tax incentives devoted to spur savings are not lost but are reclaimed as additional tax revenue when individuals make withdrawals.

Saver's Credit Supplements Exclusion/Deduction: The Saver's Credit, which provides a credit of up to $1,000 ($2,000 if married and filing jointly) to low- and middle-income individuals[9] who contribute to DC plans and IRAs, provides a more robust savings tax incentive for eligible individuals than would be provided by the exclusion or deduction alone. Between availability of the underlying income tax exclusion/deduction for contributions, payroll tax savings on employer contributions and the supplemental Saver's Credit, eligible individuals are provided with a very significant tax incentive to contribute to retirement accounts. It is one that far exceeds mere proportionality to their income tax bracket.

Contributions Are Limited and Rules Promote Fairness: Congress has imposed maximum dollar limits on individual contributions to DC plans and IRAs. In 2012, the maximum individual contributions are generally $5,000 to IRAs ($6,000 if 50 or older) and $17,000 to DC plans ($22,500 if 50 or older). Separate limits also apply to total combined employer and employee contributions for any employee and to the maximum benefit a worker can accrue at retirement in a defined benefit plans. These limits act to constrain the tax-preferred savings of upper-income savers while allowing robust tax-preferred savings by low- and middle-income households, and retaining

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[8] Contributions to Roth 401(k) Accounts and Roth IRAs are not deductible or excludable, but they derive a comparable tax benefit when the taxpayer withdraws assets in the form of an exclusion from tax on earnings while the funds were in the account.

[9] In 2012, the Saver's Credit is available to married couples filing jointly with adjusted gross income (AI) of up to $57,500 and single individuals with AGI of up to $28,500.

enough of a personal incentive for business owners and decision-makers to set up and maintain plans for their workforce. In addition, a substantial statutory and regulatory regime requires employer plans to adhere to coverage, nondiscrimination and top-heavy rules, which are designed to ensure that individuals at all income levels receive fair benefits.

THE FIRST PRINCIPLE OF RETIREMENT TAX POLICY: DO NO HARM

Today's retirement laws and policies are working well and are helping many millions of families (supported by their employers) accumulate savings and generate retirement income. For that reason, the first, and most important, principle we urge this Committee to consider in the context of tax reform is to **do no harm**. Policymakers should avoid actions that make it more difficult to accumulate savings and generate sufficient retirement income. Since the employment-based retirement system is the most effective and significant source of retirement saving, any changes in that area should in particular be approached with extreme caution. The wisest course in most instances will be to *not* enact new laws or implement expansive new regulations that would disrupt the successes of the current system.

The American people agree with that assessment. In a study published in 2012, 84% of U.S. households said that continuing to provide incentives to encourage retirement saving should be a national priority. In spite of recent stock market volatility, 89% of households expressing an opinion had favorable impressions of 401(k) plans. Nine out of 10 households with DC accounts agreed that these plans helped them think about the long term and made it easier for them to save. More than 80% of DC-owning households said the immediate tax savings from their retirement plans were a big incentive to contribute. With almost half of DC-owning households stating that they probably would not be saving for retirement at all if it weren't for their DC plans.[10]

Dramatic changes in the rules and incentives governing retirement plans are not warranted and would be perilous. Unintended consequences are likely, and we simply cannot afford to gamble with the retirement security of working and retired Americans; especially when retirement assets are 36% of total household financial assets.[11] In this context, it is important to remember that the employer-sponsored retirement system is premised on its voluntary nature – employers can choose to provide retirement plans to their workers, but they are not required to do so. Changes in the tax incentives would require each employer to reevaluate and potentially redesign retirement plan offerings

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[10] Holden, Sarah, and Bass, Steven, *America's Commitment to Retirement Security: Investor Attitudes and Actions*. Washington, DC: Investment Company Institute (January 2012).

[11] Investment Company Institute. 2012. "The U.S. Retirement Market, Fourth Quarter 2011" (April), Table 3. http://www.ici.org/info/ret_11_q4_data.xls.

and could lead to eliminating the plans entirely. Even seemingly small changes in laws and regulations generate confusion and enormous costs for individuals and employers.

RETIREMENT TAX INCENTIVES LEAD TO LONG-TERM REVENUE GAINS

The retirement savings tax expenditures should not be reduced or tinkered with to pay for other initiatives, whether inside or outside a tax reform process. Significantly, the bulk of the existing "tax expenditure" for retirement plans is attributable to the deferral of tax provided to already saved retirement assets, not to future annual permitted contributions. True, there are trillions of dollars in existing retirement plans and IRAs, but those funds are the primary retirement nest eggs of millions of American families. Those existing savings should not be taxed in order to finance more government spending, deficit reduction, or to offset other tax initiatives (including lower marginal tax rates). Similarly, proposals that purport to increase short-term federal tax receipts by redirecting, eliminating, or eroding the existing retirement savings incentives would realize those additional tax revenues *largely because individuals would be saving less for retirement*. We cannot afford to let Americans save less for retirement; we need to encourage them to save more.

Particularly troublesome is that any short-term revenue gain that might be derived from changes in the retirement tax incentives is largely illusory and cannot responsibly be used to offset costs of reducing tax rates or other long-term government initiatives. The revenue scoring that is performed by the Treasury Department and the Joint Committee on Taxation generally produces estimates in five- and ten-year budget windows, using a cash-flow analysis. Under that methodology, the taxes an employee will pay when he or she retires and starts taking taxable plan distributions generally occur *outside* the budget window. Proposals that reduce retirement savings today will mean the government actually collects less revenue in years outside the budget window because retirees will have less taxable retirement income. As a result, total long-term budgetary savings that might result from scaling back the existing retirement savings tax incentives 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.[12] In effect, proposals that reduce retirement savings would actually increase the burden on future generations. That type of shortsighted thinking will not help the Nation address its structural budget deficits, nor would it offset the long-range costs of other changes in the tax law. In that regard, it is important to bear in mind that the assets saved in the employment-based retirement system

[12] Judy Xanthopoulos and Mary M. Schmitt, *Retirement Savings and Tax Expenditure Estimates*, American Society of Pension Professionals & Actuaries, May 2011, *available at* http://www.asppa.org/Document-ault/pdfs/GAC/2011/RetirementSavingsAndTaxExpenditures_ASPPAMay2011.pdf.aspx

supplement and help reduce pressure on other government programs, like Social Security.

RECENT PROPOSALS COULD SERIOUSLY UNDERMINE THE RETIREMENT SAVINGS SYSTEM

Two sweeping proposals that have gained some recent attention illustrate the dangers that could flow from even well intentioned rewriting of the current retirement rules.

One illustrative option for deficit reduction that was explored in the National Commission on Fiscal Responsibility and Reform Report was to lower the cap on annual total employer and employee retirement plan contributions to the *lesser* of 20% of the employee's compensation *or* $20,000 (the 20/20 proposal). This proposal and any similar proposal to further limit the incentives to save (or discourage business owners from establishing plans) would, over time, do irreparable harm to the retirement security of Americans at all income levels.

Today, total employee and employer contributions to 401(k) and other DC plans cannot exceed the lesser of 100% of compensation or $50,000 per year (in 2012).[13] Even those contribution levels can only be reached for owners and higher-paid employees if the plan satisfies tough non-discrimination rules that ensure participation and contributions for rank-and-file workers. The existing 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 plan sponsorship, it is often the promise of meaningful tax benefits for key employees that is the deciding factor in choosing to maintain a retirement plan. If tax benefits to decision-makers are substantially diminished, businesses that would have considered plan sponsorship will no longer do so and existing plan sponsors will reduce matching contributions or stop offering retirement plans altogether. All employees will suffer.

The 20/20 proposal would severely depress aggregate retirement savings *for all income levels*. The Employee Benefit Research Institute (EBRI) found that only 5% of workers save for retirement 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 they are offered. Preliminary EBRI analysis of the 20/20 proposal projects reductions in 401(k) balances at retirement of between 5% and 14% across *all* income levels. Younger savers with the lowest income would be hit particularly hard, with projected savings at retirement dropping by about 10% for

[13] In many cases, key employees of small businesses do not reach these levels every year. Many contribute more during years their business is doing well and less in other years.

individuals under age 45 in the bottom income quartile.[14] And this EBRI analysis does not take into account the fact that the 20/20 proposal could cause many plans to be terminated and would cause other employers to eliminate or reduce matching and other employer contributions.

Retirement tax incentives are not like other tax incentives, and changes in that structure can very easily harm the very people who are most in need. Today, 79% of the federal tax incentives for DC plans are attributable to taxpayers with less than $150,000 of adjusted gross income.[15] Under current limits, working families with less than $100,000 in income 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.[16] 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.[17] As a practical matter, those low- and middle-income plan participants would suffer the most under the 20/20 proposal when they lose access to employment-based retirement plans and the employer contributions that go with them.

Another recent proposal, by Brookings Economist William Gale, suggests replacing all exclusions and deductions for retirement savings with a flat 18% tax credit that would be deposited directly into the individual's retirement savings account (the "18% match proposal").[18] This restructuring of the current system (and previous proposals like it) would also be disruptive, counterproductive, and potentially catastrophic. It would cause a steep decline in retirement plan sponsorship and would lead directly to a significant reduction in retirement savings across all income classes.

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[14] *Capping Tax-Preferred Retirement Contributions: Preliminary Evidence of the Impact of the National Commission on Fiscal Responsibility and Reform Recommendations 32 EBRI NOTES No. 7* (July 2011) at 2-6.

[15] American Society of Pension Professionals and Actuaries, Estimated Benefits of Tax Expenditure Estimates for Defined Contribution Plan Participants and Retirees with Account Balances (Aug. 2009) (analyzing IRS data), *available at* http://www.asppa.org/document-vault/pdfs/mediaroom/LTENYT082509.aspx

[16] ASPPA Release May 31, 2011, *available at* http://www.asppanews.org/2011/05/31/asppa-research-shows-savings-from-cutting-retirement-savings-plan-incentives-are-dramatically-exaggerated/

[17] A recent study published by the Center for Retirement Research at Boston College provides further evidence that the DC plan incentives are more progressive than traditional income distribution analysis would predict. The study found "evidence that additional employer contributions to 401(k) plans reduce money wages much less for low-income than for high- income workers" and concluded that: "[b]ecause of non-discrimination rules, employers must induce participation of low-income employees in order to provide qualified benefits to high-income employees. Therefore, employers who wish to contribute to plans in order to attract high-income employees may be unable to reduce money wages to low-income workers in exchange for compensation in the form of retirement plan contributions. See, Eric Toder and Karen E. Smith, *Do Low-Income Workers Benefit from 401(k) Plans? available at* http://www.policyarchive.org/handle/10207/bitstreams/96517.pdf

[18] See, William G. Gale, Testimony to the United States Senate Committee on Finance Sept.15, 2011.

As with the 20/20 proposal, the 18% match would substantially reduce the incentive for key business decision-makers to have a plan. Even where the business did keep a plan in place, it is likely that any employer matching contributions would be curtailed substantially or eliminated. The fact is that the 18% tax credit provides so little benefit to a business owner (especially when compared to other available investment options) that there would often not be sufficient incentive for a business owner to take on the many costs, responsibilities, and risks of maintaining a retirement plan. As indicated above, when plan sponsorship declines, all employees suffer.

A March 2012 study by EBRI confirms that the 18% match proposal will reduce retirement security for workers at all income levels, not just high-income workers. Specifically, the study revealed that some employers would decide to no longer offer a plan to their workers and some participants would decrease their contributions. The combined effect of these changes would result in reduced savings balances at retirement between 6% and 22% for workers currently age 26-35, with the greatest reductions for those in the lowest income quartile. Lowest-income participants in small business plans would see final retirement savings reductions as high as 40%.[19]

For those employers who might still continue to maintain plans under the 18% match, most other employer contributions to retirement plans, like profit-sharing contributions, could well become a distant memory. The reason is simple. Under the 18% match proposal, if an employer were to contribute $1,000 to each employee's retirement account, the government would then contribute $180 to the individual's account. The $1,180 in the employee's account would be locked in. The employee could not access the $1,000 employer contribution without incurring substantial taxes and penalties, and the $180 government match could not be withdrawn for any reason for some period of time (perhaps not until retirement). The problem is that employees would immediately owe income tax on the $1,000 employer contribution, even though they may not even have the money to pay the tax. Employers will not want to put their employees in a situation where they are forced to pay income tax today on wages they never saw, in order to get a small government match that they may not be able to access until retirement.

Furthermore, the majority of 401(k) plans that include matching contributions provide for a match of at least 50% with respect to employee contributions.[20] This provides a powerful incentive for employees to save. Employers have found that the match must be sufficiently large to get the employees' attention. It is not at all clear that the "government match" under the 18% match proposal would be a sufficient incentive to save. Younger employees, in particular – the very people who should be encouraged

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[19] VanDerhei, Jack. "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," March 2012, EBRI Notes

[20] See Plan Sponsor Council of America, 54th Annual Survey, Reflecting 2010 Experience, Table 45.

to save – will be reluctant to set aside money today in order to get a small government match.

Finally, moving to this complex new regime would create great confusion among individuals, thereby deterring savings. This would be extremely counterproductive at a time when all have agreed that the way to foster savings is to keep things simple. Reducing and impeding the incentives to save in plans and IRAs in this way would be particularly detrimental as such savings typically represent a significant share of families' total financial assets.

CHANGES IN RETIREMENT POLICY SHOULD BUILD ON EXISTING SYSTEM, NOT ERODE IT

Promoting retirement savings must remain one of our Nation's top policy priorities. We urge this Committee to continue its leadership in pursuing policies to improve our Nation's retirement system. But any changes that are made should build upon our existing and successful tax incentive structure so that it works even more effectively to facilitate retirement plan coverage and savings by American families.

As this Committee considers these issues in the future, the Council urges you to focus on four objectives when crafting specific retirement policies. These objectives are all designed to advance the goal of retirement income adequacy for American workers.

Accumulating Retirement Savings: The first and most important policy objective in helping Americans generate adequate retirement income is to assist them in accumulating retirement savings during their working lives (which can then be used to generate income in retirement). Current retirement policies and vehicles, particularly employer-sponsored plans, successfully assist American families in doing so. Employer-sponsored retirement plans make effective use of payroll deductions, provide fiduciary oversight and group pricing, typically involve substantial financial contributions by employers to employees' benefits, and facilitate access to investment education and advice. But in order to ensure that as many Americans as possible accumulate the retirement savings they need, policy improvements should be made in the following areas:

- *Coverage* – expanding access to individual and workplace retirement savings plans;
- *Adequacy* – helping individuals (supported by their employers) to save at higher levels;
- *Investing* – encouraging the wise investment of retirement assets; and
- *Preservation* – promoting portability of retirement savings and avoiding spending of savings prior to retirement (leakage).

Unfortunately, given the fiscal condition of the federal government, it will be difficult to remove revenue considerations from policy debates, even in the retirement area. Some good proposals will likely have to be delayed at this time because they are too costly and the required federal resources are simply not available.

Still, incremental improvements in each of these areas can and should be made and even small changes that help create a culture of saving will make a big difference. One area that deserves special attention is promoting the use of default enrollment and increase strategies. Automatic enrollment and automatic escalation strategies hold great promise for increasing DC plan coverage, and also increasing contributions to those plans. Such plan designs, under which workers must opt out of plan participation rather than opt in, have been demonstrated to increase participation rates significantly, helping to move toward the universal employee coverage typically associated with defined benefit plans.[21] More employers are adopting these designs every year, but accelerating those trends is important. Employers are also beginning to increase the default savings rate at which workers are automatically enrolled and designs that automatically increase an employee's rate of savings into the plan over time, typically on a yearly basis. Those changes all will help ensure that workers will have saved enough to generate meaningful income in retirement. In particular, studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income, younger, and minority workers because these groups are typically less likely to participate in a 401(k) plan where affirmative elections are required.[22]

Recent experience shows the power of automatic enrollment and automatic escalation designs to increase participants' annual savings percentages to the higher levels that they will need to achieve a secure retirement. Plan sponsors that establish an initial automatic enrollment default rate of 6% see very little reduction in the participant opt out rate, but experience substantial increases in total employee contributions when compared with employers who establish a more modest 3% default rate. Significantly, even those employees who affirmatively make their own choice on how much to defer, appear to save more when the default level is set higher. Similarly, plan sponsors that

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[21] *See, e.g.*, Vanguard Center for Retirement Research, *Measuring the Effectiveness of Automatic Enrollment*, (Dec. 2007) (stating that "[a]n analysis of about 50 plans adopting automatic enrollment confirms that the feature does improve participation rates, particularly among low-income and younger employees"); *401(k) Benchmarking Survey – 2008 Edition*, Deloitte Consulting LLP (2008) (stating that "[a] full 82% of survey respondents reported that auto-enrollment had increased participation rates").

[22] *See, e.g.*, Copeland (Oct. 2008), *supra* note 27 (noting that Hispanic workers were significantly less likely than both black and white workers to participate in a retirement plan); Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, EMPLOYEE BENEFIT RESEARCH INSTITUTE ISSUE BRIEF No. 318 (June 2008) (noting that industry studies have shown relatively low participation rates among young and low-income workers); Fidelity Investments, *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans* (2007) (stating that, in 2006, among employees earning less than $20,000, the participation boost from automatic enrollment was approximately 50%).

allow participants the choice to opt in to an annual automatic contribution escalation feature find that only 5.8% of participants do so. But if participants default into automatic escalation (with the opportunity to opt out), then 79.6% take advantage of automatic escalation.[23]

We encourage this Committee to find ways to create incentives that will accelerate the trend toward employer adoption of automatic enrollment designs that include higher initial default contribution rates and automatic annual increases. Those changes could include the creation of new and simpler nondiscrimination testing safe harbors, removal of the existing limit on auto escalation levels in existing safe harbors, and tax credits to employers that adopt automatic enrollment and escalation features.

These enhanced automatic enrollment strategies should be accompanied by an extensive effort (1) to educate all Americans on the importance of the level of savings needed to meet anticipated retirement expenses and (2) to inform low- and moderate-income taxpayers on the availability and operation of a simpler and improved Saver's Credit.

Translating Retirement Savings into Retirement Income: A second important policy objective is helping individuals understand how their accumulated retirement savings from all sources (including the savings and benefits of one's spouse, where applicable) may be converted into streams of income in retirement. Recent guidance from the Internal Revenue Service and the Department of the Treasury provides an example of how even modest clarifications can simplify decisions for retirees and provide new ways for them to gain comfort that they will not outlive their retirement savings.

Supporting an Evolving Approach to Retirement: A third important policy objective is to facilitate a flexible and evolving approach to retirement that accommodates those individuals who need or choose to continue paid work into the traditional retirement years. Those individuals should be able to reduce their level of work over time as they transition into full retirement.

Simplification: Tax reform efforts in the retirement area should focus on simplification and reducing the administrative burden on plan sponsors. For example, the number of required notices should be reduced and streamlined and rules should be updated to better accommodate electronic delivery. Those changes could substantially reduce the costs of plan administration. But simplification should not necessarily need to involve consolidation of existing retirement plan options. Different types of employment-based retirement plans provide employers with the flexibility to design plans that meet the unique needs of their particular workforce in the business's specific competitive environment. DC plans, traditional DB plans, hybrid plans, and SIMPLE IRAs all are

[23] Data from the Principal Financial Group® December 2010 and May 2011; Profit Sharing/401k Council of America 2011.

the right fit in different situations. Plan participants are not asked to choose between a 401(k) plan and 403(b) plan, they simply have one or the other (and most are quite happy with the one they have). IRAs have their own unique roles, and are critical for individuals rolling over funds from employment-based plans and provide an opportunity to save when they may not have access to another retirement plan. We also do not believe that existing retirement savings plans should be consolidated or eliminated in favor of other types of non-retirement savings vehicles (e.g., Coverdell Education Savings Accounts, Medical Savings Accounts, or Health Savings Accounts), which have their own purpose and relative merits.

We stand ready to assist the Members of this Committee in continuing its long history of promoting retirement savings. Thank you.