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**Senate Finance Committee Hearing**

# Retirement Savings 2.0: Updating Savings Policy for the Modern Economy

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Thank you Chairman Wyden, Ranking Member Hatch and members of the Finance Committee for the opportunity to talk with you about our private employer-sponsored retirement system. My name is Scott Betts and I am Senior Vice President of National Benefits Services, LLC (NBS). NBS is a fee-for-service Third Party Administrator specializing in the design and administration of all types of employer-sponsored retirement and benefit plans. NBS has more than 225 employees located in West Jordan, Utah, and supports more than 7,500 retirement and benefit plans in 46 states. I am also a member of the American Society of Pension Professionals and Actuaries (ASPPA). ASPPA is a non-profit professional organization with two major goals: to educate all retirement and benefits professionals like myself, and to advocate for policies that give every working American the ability to save for a comfortable retirement.

I am pleased to report that our private employer-sponsored retirement system in general, and 401(k) plans in particular, have been successful at providing substantial retirement benefits for tens of millions of American workers at all income levels. These plans benefit middle class families who represent the overwhelming majority of participants in 401(k) plans: 80 percent of participants in 401(k) plans make less than $100,000 per year, and 43 percent of participants in these plans make less than $50,000 per year (see chart #1).[1] The primary factor in determining whether or not a middle-income worker is saving for retirement is whether or not they have a retirement plan at work. Data prepared by the nonpartisan Employee Benefit Research Institute (EBRI) shows that over 70 percent of workers earning from $30,000 to $50,000 participated in employer-sponsored retirement plans when a plan was available, whereas less than 5 percent of those middle income earners without access to an employer-sponsored plan contributed to an IRA (see chart #2).[2] In other words, middle class workers are ***15 times*** more likely to save for their families' retirement at work than on their own.

Because of the effectiveness of these workplace savings opportunities, it is imperative that no harm is done to the current structure of the tax incentives that have motivated employers to voluntarily sponsor and contribute, along with the employees themselves, to these retirement plans. The tax incentive for retirement savings is unique in that it is a deferral, not a permanent exclusion. No income tax is paid on contributions and investment earnings as long as the money stays in the retirement account, but income tax will be paid in the future when benefits are distributed. Also, the tax incentive for employer-sponsored plans, like 401(k) plans, comes with nondiscrimination rules that ensure contributions 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. The result is a tax incentive that is more progressive than our progressive income tax system (see chart #3).

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[1]Estimate of private sector active participants in 401(k) and profit sharing plans, distributed by adjusted gross income – Source: Internal Revenue Service, Statistics of Income Division.
[2]Estimate using 2008 Panel of Survey of Income and Program Participation (SIPP) data and 2010 Employee Benefit Research Institute (EBRI) data of workers not covered by an employer plan but saving through an IRA – Source: Employee Benefit Research Institute.

Though the current system is working well for millions of American workers, there are ways to adapt the current rules to enhance retirement plan coverage and simplify the current operation of these employer-sponsored plans. With input from its diverse professional national membership, ASPPA has developed a document entitled ***Proposals to Enhance the Private Retirement System***[3] which contains more than 30 legislative proposals to improve the current system. These proposals would expand employer-sponsored retirement plan coverage and simplify employer-sponsored retirement plan administration through modest changes to the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act (ERISA). Fortunately, many of these proposals have already been included into bipartisan and bicameral legislation introduced in the current Congress.

Specifically, the private retirement provisions in Title II of Ranking Member Hatch's Secure Annuities for Employee (SAFE) Retirement Act (S.1270) make numerous sensible reforms. These changes will simplify the operation of employer-sponsored retirement plans by eliminating unnecessary paperwork and traps for the unwary, as well as providing new approaches to expand the availability of workplace savings, especially for small business retirement plans. These common sense proposals will go a long way toward improving the retirement security of millions of working Americans. I commend Ranking Member Hatch for offering these long overdue solutions and applaud your committee's commitment to enhancing the private retirement system and the retirement security of our nation's workers.

I will explain first why the current system should be viewed as a success. Then, I will explain the details of these proposals and why they would make such a positive difference for the American people.

## The Current System Works

First I would like to review the aggregate amounts of retirement assets accumulated by the American people to date. The numbers are staggering. At the end of 2013, Americans had accumulated more than $23 trillion in retirement assets. Of that amount, $5.9 trillion is held in employer-sponsored defined contribution plans of all types. Another $6.5 trillion is held in IRAs, most of which originated in the form of rollovers from employer-sponsored retirement plans.[4] Make no mistake, however, the single most important factor in determining whether or not workers across the income spectrum save for retirement is whether or not there is a workplace retirement plan. If increasing retirement and financial security is the goal, increasing the availability of workplace savings is the way to get there.

[3] Proposals to Enhance the Private Retirement Plan System (December 2013) – Prepared by the American Society of Pension Professionals & Actuaries Government Affairs Committee.
[4] Investment Company Institute, 2014 Investment Company Fact Book (May, 2014).

While each person's retirement situation is unique, Fidelity recently conducted a study that aggregated the retirement account balances for clients who had both an investment account through an employer-sponsored retirement plan and an IRA at Fidelity to get a sense of how an average individual participating was performing in the current system. In contrast to reports of "average" 401(k) balances which generally include a wide and disparate variety of age, tenure, and income levels, this study found that for near retirees (ages 55-59), the average combined balance was $328,257.[5] That is a substantial amount of money that these individuals can use, in addition to any social security benefit that these individuals may enjoy, to achieve a secure retirement. This data shows that the retirement system works for those that participate in it over the course of their working careers.

The good news is that over 60 million working Americans currently participate in employer-sponsored retirement plans.[6] Contrary to some reports that suggest only about half of American workers have access to these programs, the Bureau of Labor Statistics (BLS) reports that 78 percent of all full time civilian workers had access to retirement benefits at work, and that 83 percent of those workers participated in these arrangements. While availability and take-up rates are substantially lower for part-time workers, even when they are included in these statistics, BLS found that 68 percent of civilian workers had access to retirement plans, and 80 percent of those participate in the offering. For full time private sector workers, BLS found the access and participation rates are 74 percent and 80 percent respectively, and the access and participation rates for all private-sector workers (including part time) are 64 percent and 76 percent, respectively.[7]

Robust as those results are, alternative research even suggests that these estimates may understate what is actually happening in the workplace. A report from the Social Security Administration, based on an integrated assessment of Census data and W-2 records, found that 72 percent of *all* employees who worked at private companies in 2006 had the ability to participate in a retirement plan, and 80 percent of those participated.[8] This analysis, which provided the ability to look at actual data, rather than rely on respondent self-reporting, indicates that the BLS statistics on availability are probably understated.

[5] Fidelity® Retirement Savings Analysis Highlights Higher Balances and Contribution Rates of Investors Saving Beyond Workplace Savings Plans, (February 28, 2013).
[6]Employee Benefit Research Institute estimates from the March 2013 Current Population Survey.
[7] Bureau of Labor Statistics, Employee Benefits Survey: Retirement Benefits, March 2013: Retirement benefits: access, participation, and take-up rates: National Compensation Survey March 2013.
[8] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011).

It is important to bear in mind the current set of incentives that efficiently encourage such a high level of voluntary sponsorship of these programs. This efficiency is derived in large part from two features that set the retirement savings incentives apart from other individual tax incentives. First, by choosing to defer the receipt of their 401(k) contributions in their current pay, individuals defer – but do not escape – their tax obligations. Every dollar that is excluded from income this year will be included in income in a future year. Unfortunately, that is not reflected in the cash basis measurement of the retirement savings "tax expenditure." In fact, the current accounting methodology may overstate the true cost by over 50 percent.[9] Secondly, nondiscrimination rules for employer-sponsored plans assure the 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. As a result, this tax incentive is more progressive than the current progressive tax code.

This progressivity can be seen in the accompanying chart (see chart #3), which shows that households with incomes of less than $50,000 pay only about 9 percent of all income taxes, but receive 27 percent of the defined contribution plan tax incentives. Households with less than $100,000 in AGI pay about 28 percent of income taxes, but receive about 49 percent of the defined contribution plan tax incentives. Contrast this distribution to the distribution of tax benefit for capital gains, where about 90 percent of the benefit goes to households earning over $200,000.

This mix of incentives and limits has produced a highly effective voluntary retirement savings structure where these workplace programs exist. And, based on the data cited earlier, we know that middle class workers are ***15 times*** more likely to save for their families' retirement at work than on their own. The key is to find ways to expand the opportunity to save in the workplace. We know that there are still millions of workers across the country that do not yet have access to an employer-sponsored retirement plan, particularly those employed with small employers. A key policy focus for those looking to expand and enhance the nation's retirement security lies in finding ways to make it easier for employers to sponsor these arrangements that we know to be a success.

That is why provisions like those in Title II of Ranking Member Hatch's SAFE Retirement Act are so important. This legislation directly addresses obstacles that frequently keep employers from sponsoring these arrangements, enhancing the likelihood that more workers will have access to these programs in the workplace. Let me explain how they could make a difference.

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[9] Judy Xanthopoulos and Mary Schmidt, *Retirement Savings and Tax Expenditure Estimates* (April, 2012).

## What Proposals Would Make the Current System Even Better

Even with the success of our current retirement system, there are significant hurdles facing employers from taking on the work and responsibility of sponsoring retirement plans for their employees. These complexities discourage small business owners from taking advantage of the tax incentives for maintaining a plan, or incorporating features that would make the plan more effective as a savings vehicle for all employees, because of the *significant* red tape, fines and penalties that can accompany even the most basic of these arrangements. Some complications are statutory and some are regulatory. The proposals contained in the ASPPA document and in Title II of Ranking Member Hatch's SAFE Retirement Act (S. 1270) address these complexities and complications.

**The Starter 401(k) Plan**

The Starter 401(k) Plan proposed in S.1270 would give employers that do not already sponsor a 401(k) plan a less expensive option to provide a substantial retirement benefit for their employees. The plan allows employees to save up to $8,000 per year through the arrangement, which is more than individuals can currently save through an IRA, though less than individuals can save through a traditional 401(k) arrangement at present. While the plan does not require employers to make contributions for their employees, it does provide ERISA protections for participants in the plan.

This proposal would also provide start-up companies, who may be reluctant to commit to make employer contributions a way to offer workers a chance to save in a 401(k) plan that could later be easily amended to a traditional 401(k) plan when the business becomes more stable. The Starter 401(k) Plan recognizes that not only are many workers employed by start-ups, but many owners of these entities have very modest incomes themselves and cannot be burdened with retirement contribution requirements when the business is still in the early stages.

**Permit Additional Flexibility in Time to Adopt a Retirement Plan**

IRS Revenue Ruling 81-114 provides that a deduction for qualified retirement plan contributions is not allowed for a prior taxable year if the plan is not established by the end of that taxable year. Consequently, in order to make deductible contributions for a taxable year, an employer must formally adopt a new qualified retirement plan by the end of such year (unlike a Simplified Employee Pension (SEP) plan, which can be established as late as the due date of the employer's tax filings with extensions).

Frequently, the employer's profitability for a year will be a major factor in his or her decision to establish a retirement plan. This is especially true for small employers. Reliable information on how the business did in the prior year is often not available until

after the close of the employer's taxable year. The provision provided in S. 1270 will allow employers to consider the adoption of a qualified retirement plan, or the addition of non-elective contributions to an existing plan, when the final results of the business for the prior year are available. This flexibility would be instrumental in expanding retirement plan coverage and employer-funded retirement benefits, especially for small businesses. This provision will also place ERISA-covered retirement plans on par with a non-ERISA SEP program.

**Interim Amendments**

Qualified retirement plans are governed by written documents that must meet certain requirements under the Internal Revenue Code (IRC) to maintain tax-favored status. Revenue Procedure 2007-44, as modified by Rev. Proc. 2008-56 and Rev. Proc. 2012-50, provides staggered dates for plan documents to be submitted to IRS for review as to a plan's qualified status. Individually designed plans are on five-year review cycles, and pre-approved documents are on six-year cycles.

During these cycles, plans must adopt amendments to reflect legislative and regulatory changes to the qualification requirements. Except as provided by law or other guidance, these "interim amendments" must generally be adopted by the due date (including extensions) for filing the income tax return for the taxable year the change is effective. There is no coordination of the due dates of these required "interim amendments" with the cycle for submission of documents to IRS.

S.1270 would eliminate mandatory "interim amendments" which increase the cost and burden of maintaining a plan without any corresponding benefit. The current process is incredibly complicated, with different amendment deadlines that vary based upon the type of amendment and the plan's fiscal year. This can lead to mistakes being made by even the most well-meaning plan sponsors (who are voluntarily providing this benefit). Small plan sponsors in particular are justifiably shocked and surprised when asked to pay thousands of dollars in sanctions when an inadvertent mistake in this amendment cycle is uncovered during an IRS audit. Amendment deadlines coordinated with the plan's 5- or 6-year review cycle would be user friendly and cost-effective. This proposal is a perfect example of a simple and sensible change that would streamline the operation of the plan and remove an unnecessary trap for the unwary, but well-meaning employers who are providing retirement benefits for their employees.

**Streamline Plan Testing Requirements**

A plan is considered "top heavy" if over 60 percent of the accrued retirement benefits are credited to "key employees." Many small business plans are deemed "top heavy" and, as a result, must provide *all* employees, not just those required to be covered under

ERISA, in those defined contribution plans with a contribution of at least 3 percent of compensation. For a defined benefit plan, the requirement is a minimum accrued benefit of 2 percent of pay per year of service, with a 20 percent maximum. Special rules apply to participants covered under both types of plans. It is important to note that plan sponsors are still required to engage in non-discrimination testing in addition to the "top heavy" testing if a plan is considered "top heavy."

Unfortunately, these rules serve as a disincentive for employers to add more participants to the retirement plan, especially employees that ERISA allows to be excluded from participation (employees who have not attained age 21 or who have not completed a year of employment with at least 1000 hours of service). Removing this disincentive could easily be accomplished by excluding employees the statute would have allowed to be excluded from participation in the plan from the 3 percent minimum "top heavy" contribution requirement. S. 1270 does this one better, eliminating this extra testing requirement altogether so the employer would not have to worry about allowing more participants to be added to the plan, while still being subject to normal non-discrimination testing requirements.

**Electronic Delivery of Retirement Plan Information to Participants**

Under current Department of Labor (DOL) regulations, retirement plan disclosures to participants and beneficiaries required under ERISA must be provided on paper unless the participant or beneficiary chooses to receive disclosures electronically. (There is an exception for employees that have access to a computer as an integral part of their duties at work, but the exception is proving too limited to be useful.) The result is a lot of wasted paper and business time and expense to provide participants and beneficiaries with notices that are not read. Compounding the challenges, new DOL fee disclosure rules for individual retirement plan participants impose substantial additional paper disclosure documents. Real-world experience suggests that participants and beneficiaries might be more inclined to read these notices if they were provided on a more useful, interactive, and environmentally friendly basis through electronic means.

Plan sponsors and service providers should be permitted to default plan participants and beneficiaries into receiving documents electronically, instead of requiring an affirmative election. This change would still permit participants and beneficiaries the ability to elect to receive paper disclosures. S. 1270 addresses the DOL's outdated regulations by allowing all disclosures to participants and beneficiaries required under the IRC and ERISA to be made available to them electronically. Service providers would be required to provide participants and beneficiaries with an advanced notice describing the electronic delivery process and notifying them of their right to opt out of the electronic delivery of documents and receive paper documents instead.

**Consolidation and Simplification of Retirement Plan Notice Requirements**

S. 1270 makes multiple improvements to plan administration that provide opportunities to consolidate and simplify the multitudes of retirement plan notices to participants and beneficiaries required under the IRC and ERISA. These reforms serve two main purposes that directly benefit the retirement plan participants. First, consolidating and simplifying all the disparate notices into one main, easy to read document increases the likelihood that the information will be read and understood by the participant. Second, consolidating and simplifying these notices reduces the cost to administer the retirement plans, costs that are largely borne by the participants in the plan.

Specifically, S. 1270 allows certain defined benefit plans and certain defined contribution plans that must provide a notice to participants explaining their right to a Qualified Pre-retirement Survivor Annuity (QPSA) to include this notice as part of the Summary Plan Description (SPD). S. 1270 also directs the Secretaries of Labor and the Treasury to adopt final regulations providing that a retirement plan sponsor or service provider may consolidate two or more of the defined contribution employee notices required under the IRC and/or ERISA either into a single notice or consolidate these employees notices into either the SPD or the Summary of Material Modifications (SMM). The retirement plan sponsor or service provider can have this flexibility provided that the combined notice, SPD, or SMM includes the required content and is provided within the time required by law.

Another unnecessary notice that I feel should be eliminated is the notice requirement for the 3 percent safe harbor. The safe harbor information is already provided to participants and beneficiaries in the SPD, and since employees receive the contribution whether or not they contribute to the plan, it does not cause participants to change their behavior.

**"Open" Multiple Employer Plans (MEPs)**

The DOL has in recent years concluded that the employers must have a relationship other than joint sponsorship of an employer-sponsored plan to participate in a "multiple employer plan." This determination has effectively decreased the use of these so-called "open" multiple employer plan arrangements, which had gained favor in the marketplace as an option for small employers to provide retirement benefits to their employees.

In response to the DOL's regulatory action, there have been a number of legislative proposals to explicitly permit the operation of open MEPs in the marketplace. The provision in S. 1270 is, in my view, a good approach that permits open MEPs, while providing safeguards for adopting employers through a designated service provider.

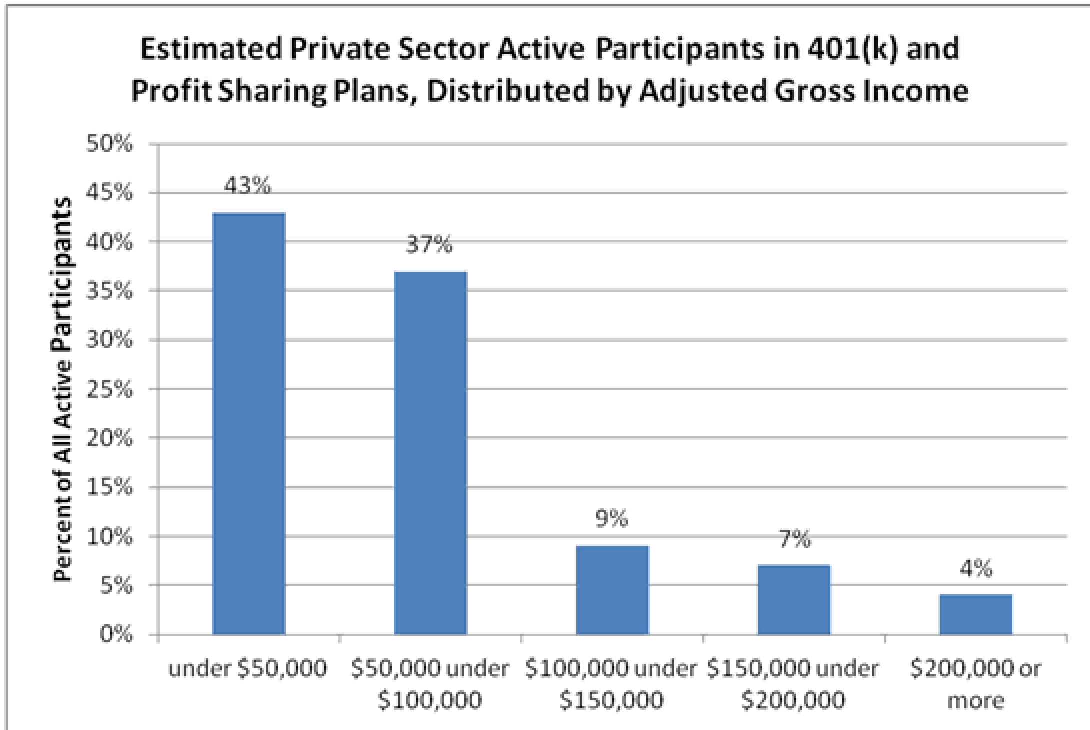
## Conclusion

The current retirement system works well for the tens of millions of Americans that have access to it and has proven a successful vehicle for individuals to save for their future. The key to continued and expanding success is enacting reforms that will further incent employers to provide a retirement savings vehicle for their employees. The private retirement provisions contained in Ranking Member Hatch's SAFE Retirement Act (S. 1270) are a huge step in the right direction to expanding the availability of retirement savings and removing certain complexities from the current system so business owners and service providers are able to provide a better retirement plan product to participants.

Thank you, and I would be happy to answer any further questions that the Committee may have.

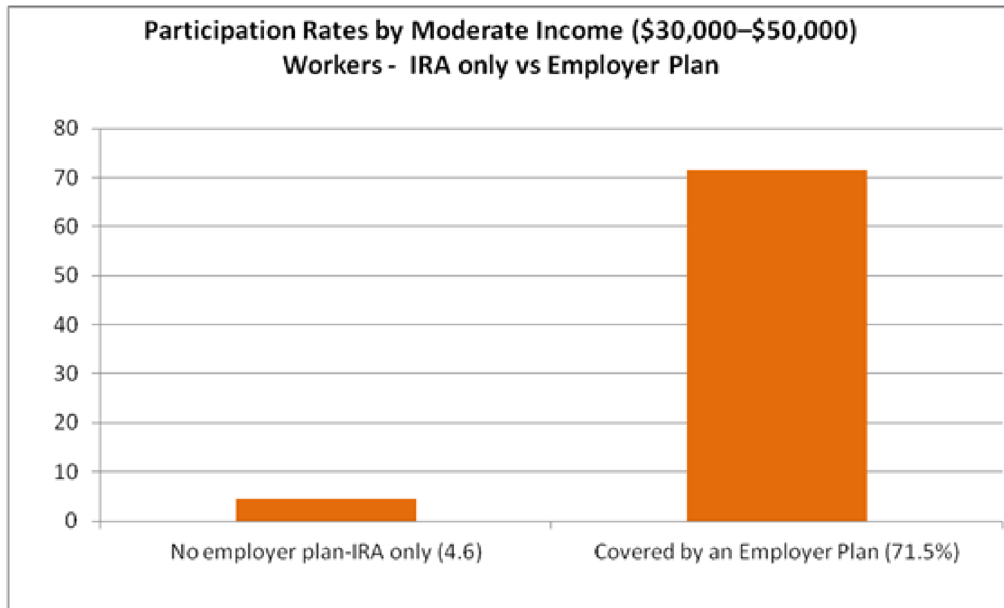
# Appendix

## Chart #1



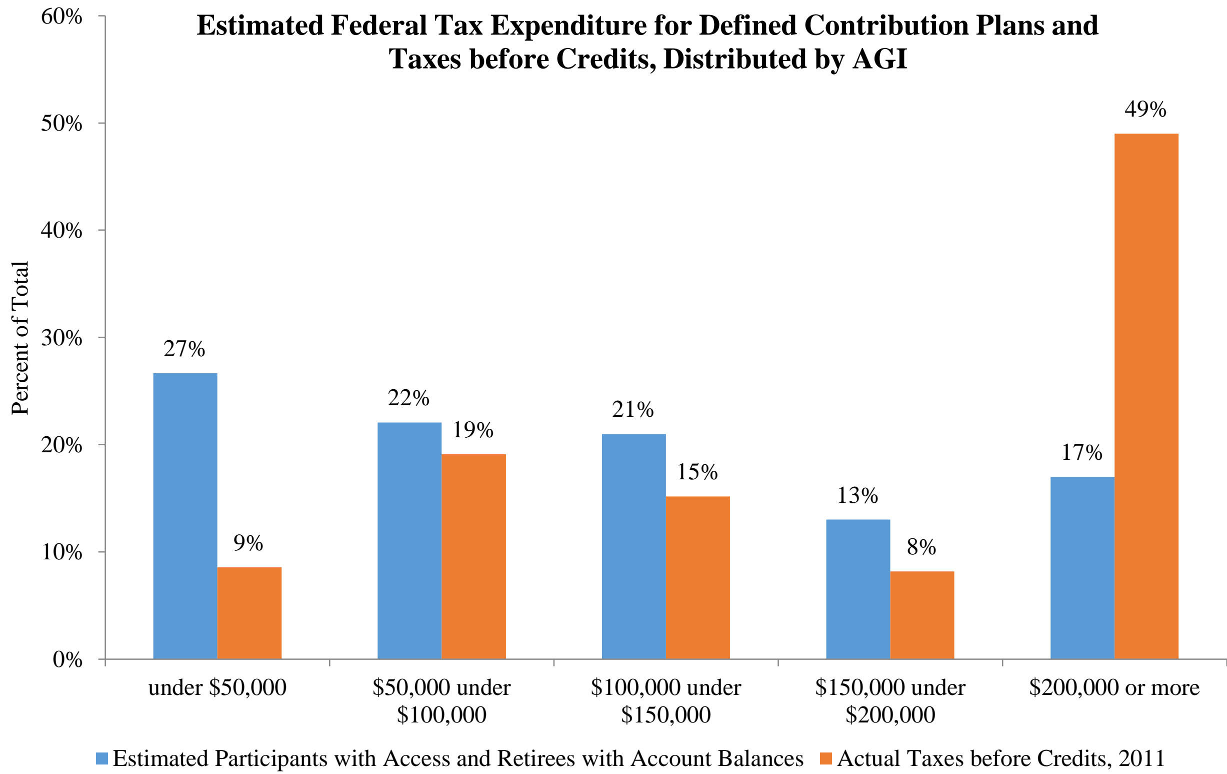

**Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI)**

## Chart #2




**Source: Employee Benefit Research Institute (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan-IRA only).**

## Chart #3




Source: “Distributional Analysis and Pension Tax Provisions”, American Society of Pension Professionals and Actuaries (April 2014)