Principal℠

# United States Senate Committee on Finance

## *Challenges in the Retirement System*

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**215 Dirksen Senate Office Building**

## Statement for the Record

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## United States Senate Committee on Finance:

Challenges in the Retirement System

**As the Senate Finance Committee considers current challenges in the retirement system today,** Principal Financial Group® (Principal®) is pleased to offer expertise based on our work with tens of thousands of retirement plan clients of all sizes and millions of their employees. Principal is based in Des Moines, Iowa, and operates nationally and worldwide in 80 countries.

Principal assists businesses and individuals by offering comprehensive solutions that help grow and protect their assets. We specialize in providing solutions to protect against risk and loss, assist with succession planning and wealth transfer, and build and protect wealth for retirement. As a leading provider of retirement plans and a global investment manager, our expertise is based on more than 75 years in the retirement industry and our experience mostly with small- to medium-sized employers and their employees. We currently provide retirement services to more than 45,500 retirement plans and 5.9 million employee participants, including more than 38,000 retirement plans of small businesses[1] and their 1.6 million participants. We are a top-5 recordkeeper of retirement plans,[2] # 1 provider of Employee Stock Ownership Plans (ESOP),[3] # 1 provider of Defined Benefit plans,[4] # 1 provider of Non-Qualified deferred compensation plans,[5] and are on the leading edge of providing innovative products that allow savers to convert accumulated savings into a stream of guaranteed income. We also provide group dental, vision, life, and disability insurance.

Our retirement business expertise extends internationally. Principal is an industry leader in providing pension management and retirement savings in emerging markets. We are the largest pension provider in Latin America (by AUM) and operate long-term savings businesses in seven Asian markets. We work closely with international organizations such as the OECD and World Bank to ensure our approach to retirement policy continually incorporates the best global practices with respect to pension system design, behavioral economics, and financial education.

In addition to being proud of the communities that we serve, Principal is also incredibly proud of its engaged and educated workforce. We have a diverse range of employee resource groups, including the very active and passionate LGBTQQIA Employee Resource Group. In 2018, in its first ever ranking of the kind, *Forbes* named Principal the # 1 employer for women, and the National Association for Female Executives named Principal as one of the top companies for female executives for the 17th year in a row. Our employee population boasts a 59 percent majority of women, with 55 percent of our executives also being women. Additionally, our board consists of 45 percent women.

We serve all size ranges of employers and have a significant presence in the small- and medium-size business retirement plan market. Our experience gives us a unique perspective into the motivations,

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[1] Retirement plans of small business defined as those with less than 500 participants.
[2] Based on number of plans and assets, *Pension & Investments* Annual Recordkeeper Survey, 2018
[3] Based on number of plans, PLANSPONSOR Recordkeeping Survey, June 2017.
[4] Based on number of plans, PLANSPONSOR Defined Benefit Administration survey, May 2018
[5] Based on total number of Section 409A plans, PLANSPONSOR 2018 NQDC Recordkeeping Survey, June 2018.

frustrations, and challenges of small- and medium-sized employers and their employees. Our perspective is informed by a representative client council that holds annual client conferences to solicit feedback and gather information about what plan sponsors and their employees want and need for their retirement security. Additionally, we perform focus group testing of individuals, including those participating in plans and those who don't, to help us better understand how to effectively inform, engage, and encourage individuals to take action regarding retirement security. We also gather real-time feedback from plan sponsors through a new online portal, and plan to expand this capability to online and digital participant portals in the near future. Finally, we collect data to ensure that the technology we create and make available for our plan participants continues to drive outcomes in a positive way for their financial security in retirement.

What we learn from our clients and their employees through our client council, focus groups, real-time feedback, and data collection informs our innovation efforts that seek to better connect and engage with plan sponsors, eligible employees, and participants. Our ultimate goal is to consistently and positively improve participant outcomes, while maintaining flexibility to innovate as the needs of consumers change. Some examples of recent enhancements we've made to the participant experience include:

1. **"Retirement Wellness Score" – Providing retirement income illustrations**
   As an example of how we are helping to change how individuals think about saving for their futures, Principal frames all account summaries online, digitally and on paper statements, not only in a traditional account balance perspective, but as an illustration of how much monthly income could be generated from an employee's accumulated savings at retirement. This income illustration is personalized to each participant, using their current account balance, contribution level, annual pay and estimates of income from other sources like Social Security, a pension or a Health Savings Account, including certain assumptions.

   The retirement income estimate is compared to an estimate of the participant's pre-retirement income, giving the individual a basic understanding of whether they are saving enough. The measure of an individual's position relative to their income goal is known as their "Retirement Wellness Score" (Score). The Score uses a basic range of 1 to 100, with the number reflecting the percentage of pre-retirement income estimated to be replaced at retirement, and is accompanied by a green, yellow or red depiction of the status, each with clear-cut action prompts. The online and digital tools and resources are interactive, and allow an individual to, as an example, "dial up" contribution percentages to determine how changes may impact their Score, as well as add savings from another source or for a spouse or partner.

2. **Engaging with individuals through newly redesigned online and digital experiences**
   When enrolling through our new, online enrollment experience:
   - The average deferral rate for newly eligible employees is nearly 8 percent (that's more than 34 percent higher than other enrollment methods) and 29 percent of newly eligible employees defer 10 percent or more.

- For existing participants of plans that transition to Principal, nearly 1 in 4 participants opt to save 10 percent or more.
- When looking at all participants who have visited the website, average deferrals are 50 percent higher than those who do not engage online.

Specialized and personalized financial wellness education and planning is available to all clients' employees through our interactive financial wellness planner experience called My Virtual Coach.

- Those who enroll by taking the full planner experience have an average deferral rate of 8.26 percent.
- Those existing participants who elect and subsequently take part in future My Virtual Coach Checkups have an average deferral rate of 9.15 percent.
- 30 percent more participants increased deferrals after having access to their Wellness Scores and the Planner compared to participants who did not access the Planner.
- The Retirement Wellness Score among participants who use the Planner is more than 10 points higher than the average score (a score of 100 points signaling an expectation that you are on track to meet 100 percent of your retirement income goal).
- Access to a growing suite of financial wellness education and assistance addresses common challenges like dealing with student loan debt, building emergency savings, budgeting and establishing a will.

## The State of our Retirement System

In many respects, our nation's Defined Contribution (DC) Retirement Plan System has been a great achievement. Assets invested in DC plans and IRAs, a majority of which originated in DC plans, total $16.3 trillion, making up 60 percent of total assets in the U.S. retirement system. The traditional, full-time worker has excellent opportunities to save in a worksite retirement plan (80 percent have employers that offer a plan and 80 percent of those workers participate).[6] The majority (96 percent) of employers who sponsor a 401(k) plan provide some form of additional employer contribution in excess of the worker's own contribution.[7]

The unique combination of the U.S. progressive Social Security system and employer-sponsored retirement plans has helped position millions of Americans for a secure retirement. A recent study coauthored by the Investment Company Institute and the Internal Revenue Service Statistics of Income Division staff found that most American workers maintain or increase their spendable income after claiming Social Security. The study also finds that, after claiming retirement, most get substantial amounts of both Social Security benefits and income from retirement savings sources (from employer-sponsored retirement plans, annuities, or IRAs). In fact, the median worker in the study had spendable income that was greater (103 percent) than spendable income in the year before claiming. Notably,

[6] Bureau of Labor Statistics
[7] Vanguard *How America Saves* 2018

median replacement rates were found to be highest for individuals in the lowest quintile of income (123 percent) and lowest for individuals in the highest quintile (93 percent).

It's been nearly 15 years since the Pension Protection Act of 2006. We need a retirement system that keeps up with changes in innovation, technology, workforce, and consumer needs and desires that offers a range of solutions within a competitive marketplace and is sensitive to the challenges of small employer plan sponsorship. The Retirement Enhancement and Savings Act (RESA) is a tremendous first step, and we offer our enthusiastic and full support for the work that both the House and Senate have done on RESA.

Of course, more can always be done. As the Committee has appropriately highlighted, we must find ways to enhance our current voluntary retirement system to provide even greater financial security to American workers. More Americans need access to worksite retirement plans. Those who do have access to plans need to save more. More near-retirees and retirees should consider securing guaranteed income from their account balances. To accomplish these goals, necessary enhancements must focus on expanding workplace retirement plan coverage to more Americans, increasing both participation and savings levels in workplace plans and encouraging plan sponsors to offer and participants to secure guaranteed income for their retirement.

Having worked with businesses of all sizes and their employees on their 401(k) and other DC plans for over 40 years, Principal has gained valuable insight about both employer motivations and worker behaviors. The insights make us bullish advocates for our robust retirement system and we offer our comments to both applaud the Committee on their bipartisan efforts to advance the Retirement Savings and Enhancement Act (RESA) but to also offer new ideas to enhance retirement security for Americans.

## RESA's Time is Now

Our economy is evolving at a rapid pace. Workers' needs, driven in part by advances in technology and generational differences, are also changing rapidly. The retirement industry, leveraging behavioral finance and intense study of 40 years of development in the defined contribution system, is creating innovative engagement techniques and products to meet the changing needs. Yet the legislative underpinnings of our retirement system have not kept pace.

We applaud the Committee for working in a bipartisan manner to advance RESA, which consists of a collection of beneficial provisions, some of which have been considered in legislation as far back as 10 years ago. As the Committee has rightfully concluded, it's past time to enact RESA's set of common-sense reforms, and to consider the next phase of reforms to keep pace with rapidly changing needs and solutions.

To reinforce the importance of RESA's enactment, we would like to highlight several key provisions of the bill that we believe will be extremely impactful in expanding coverage of worksite retirement plans to more workers, driving adequate levels of savings, and addressing the challenge of income in retirement.

**Expand coverage of worksite retirement plans to more workers.** While access to worksite retirement plans is common for many in the workforce, there is still a significant portion of the working population that lacks access. The gap in workplace retirement plan coverage is most pronounced among employees of small employers. For workers without access to a workplace retirement plan, nearly 58 percent work for companies with fewer than 100 employees. Employers that do not offer plans pointed to the financial cost (37 percent) and organizational resources needed to start a plan (22 percent) as the chief barriers.[8] The same respondents most frequently said that increased profits and tax credits to offset the expenses of starting a plan would make offering retirement benefits more likely. Of course, there is no one-size-fits-all solution for helping small businesses start and maintain a workplace plan. Policy makers must take a holistic view of employees and employers.

RESA employs a multi-faceted approach which, collectively, will be a good step toward closing the retirement plan coverage gap for employees of small employers:

- Providing tax credit levels that are meaningful to small employers will help to offset retirement plan set-up costs and encourage more employers to sponsor a retirement plan.
- Eliminating outdated barriers to allow expansion of open multiple employer plans (MEPS) will provide opportunities for small employers to offer retirement benefits to their employees while effectively reducing the burdens of establishing a plan and outsourcing a significant amount of the administrative duties and fiduciary obligations incumbent on a plan sponsor. Open MEPs also afford small employers the ability to band together in a collective plan that can generate greater efficiencies and economies of scale than might otherwise be possible in a single employer plan.

**Driving adequate savings levels.** Research published in the American Society of Pension Professionals and Actuaries (ASPPA) Journal determined that savings rate is the primary driver of retirement success and, compared to other factors, is approximately five times more important than asset allocation, and approximately 45 times more important than investment quality.[9] An individual's savings rate is attributable to 74 percent of their retirement outcome, with asset allocation attributing to 20 percent, and the specific investment options utilized attributing to only 2 percent. We must encourage higher levels of savings within retirement plans.

Studies abound that prove the effectiveness of automatic plan design in driving and increasing both worker participation and savings levels. One published report found that 92 percent of employees participated in automatic enrollment plans while only 57 percent participated in voluntary enrollment plans.[10] Unfortunately, automatic plan design continues to be underutilized among small employers. Only 19 percent of plans between $1 and $10 million in assets use automatic enrollment. Even for plans between $10 and $50 million in assets, adoption rates are only around 35 percent. RESA offers an initial step by encouraging more small employers to adopt automatic enrollment through a tax incentive to do

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[8] Pew Charitable Trust 2017 Employer Barriers to and Motivations for Offering Retirement Benefits survey
[9] ASPPA Journal *Retirement Success: A Surprising Look into the Factors that Drive Positive Outcomes*, David M. Blanchett, QPA, QKA and Jason E. Grantz, QPA, 2011
[10] Vanguard *How America Saves* 2018

so. The bill also encourages more progressively-minded plan sponsors who employ both automatic enrollment and automatic escalation of contributions through a safe harbor plan design to allow escalation to continue beyond 10 percent of pay by removing the existing 10 percent of pay cap.

**Addressing the challenge of income in retirement.** Many individuals simply do not have a realistic understanding of how much money they need in retirement or how much they can spend before they run out of income from their savings. And while many savers are attracted to the idea of a guaranteed income stream in retirement, few actually use their accumulated DC balances to purchase products like income annuities before or at retirement. Yet, increasing levels of annual guaranteed income is demonstrated to improve retirees' satisfaction levels in retirement, regardless of their level of wealth.[11] To solve the challenge, we must leverage more effective education techniques and expand access to lifetime income product solutions for plan participants.

We also must make it easier for individuals to access product solutions that provide guaranteed lifetime income. RESA includes two key provisions that will encourage broader adoption by plan sponsors of guaranteed lifetime income products within defined contribution plans:

- The most common reason plan sponsors don't offer an in-plan annuity option today is concern with fiduciary liability.[12] The annuity provider selection safe harbor establishes a realistic and workable set of obligations for plan sponsors to follow when selecting and monitoring an annuity provider for their plan.
- Permitting defined contribution plan sponsors to make a direct trustee-to-trustee transfer or distributions of lifetime income investments in the form of a qualified plan distribution annuity allows plan fiduciaries to fulfill their fiduciary obligations without fear of negatively impacting participants who have purchased lifetime income in their retirement plan.

## Looking beyond RESA

We are encouraged by the number of new proposals from Members of Congress related to retirement system enhancements. Given the time that has expired since the last comprehensive retirement reform was passed into law, there is opportunity for retirement law to catch up to developments in innovation that have occurred in the retirement marketplace.

As the Committee looks beyond enactment of RESA, we would recommend the following areas of focus for additional Congressional action:

**Remove barriers to the adoption of best practice, automatic plan design safe harbors, particularly for small employers.** Best practice, automatic enrollment and escalation plan features (commonly considered as those that use an automatic enrollment default percentage of at least 6 percent and

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[11] The Health and Retirement Study, conducted through the University of Michigan, surveys approximately 20,000 older Americans. The 2014 wave of the survey includes a question that asks retirees to estimate the amount of satisfaction they are experiencing with their life in retirement. At all levels of wealth, more guaranteed income had a strong positive impact on retiree satisfaction. http://hrsonline.isr.umich.edu.

[12] Alight 2019 Top Topics in Retirement and Financial Wellbeing: Building on Past, Working Toward the Future

automatically escalate participants to at least 10 percent) can have a dramatic effect on improving both employee participation in plans and contribution levels. Unfortunately, even basic automatic enrollment plan design is underutilized among small employers as noted earlier in our testimony.

We know from our work with small employers that a safe harbor from nondiscrimination testing can be an effective incentive. However, the safe harbor design must also be sensitive to employer costs. The existing Qualified Automatic Contribution Arrangement (QACA) safe harbor requires a specific, two-tier matching formula (100 percent of the first 1 percent of pay, 50 percent of the next 5 percent of pay) that equates to an employer contribution of 3.5 percent of pay.

However, the most common matching formula in use today is a single-tier match formula consisting of 50 percent match on 6 percent of pay, equating to a total employer contribution of 3 percent of pay. To conform with the safe harbor, a plan sponsor must consider not only a plan amendment but also an increase in their employer contribution. We believe the latter consideration is a major factor in the lack of adoption of QACA.

We propose establishing a new safe harbor that would require automatic enrollment at 6 percent of pay, automatic escalation each subsequent year to at least 10 percent of pay, and a flexible matching contribution requirement. At a minimum, the matching formula would require a 50 percent match on 6 percent of pay, conforming with the most widely used matching formula in practice today. The minimum requirement would result in participants saving 9 percent in the initial year capping at 13 percent total savings, assuming a participant doesn't opt out. Additional matching formulas could meet the safe harbor, but only if they a) equate to at least a 3 percent employer contribution when the employee contributes 6 percent, and b) the matching formula does not increase as employee contributions increase.

To further support our proposal, a recent study of more than 2,000 retirement plans found no discernable difference in opt out rates between plans with a 3 percent default and plans with a 6 percent default (11.3 percent and 11.4 percent respectively).[13] The study also found no difference in opt out rates among lower income workers and higher income workers.

**Expand RESA's Open MEPto 403(b) plans.** Small non-profit organizations should similarly benefit as for-profits. We urge Congress to expand MEPs to 403(b) plans.

**Recognizing workers burdened by student loan debt.** Student loan debt nearly tripled between 2005 and 2017[14] and through our conversations with our plan sponsor community, we know that employers are increasingly concerned about the impact that student loan debt has on their employees' ability to participate in their retirement savings plan. The Internal Revenue Service's recent Private Letter Ruling, PLR-131066-17, allows the submitting employer to make non-elective contributions of 5 percent of pay

[13] Wells Fargo Institutional Retirement and Trust 2018 Driving Plan Health. Data was gathered from more than 2,000 plans representing more than 4 million eligible employees in a range of industries.
[14] Center for Retirement Research at Boston College *Do young adults with student debt save less for retirement?* 2018 research brief.

to the retirement plan account of employees who can demonstrate paying at least 2 percent of compensation to their student loan debt.

While a positive development for employers concerned about employees similarly limited by student loan debt, there are many questions regarding the subsequent impact on coverage, nondiscrimination, and contribution limits. There is the real potential for coverage and nondiscrimination failures. We urge Congress to explore options, like Ranking Member Wyden's *Retirement Parity for Student Loans Act*, to avoid harmful consequences of a policy aimed at helping struggling employees establish a foothold in retirement savings.

**Reevaluate administrative requirements in the era of Open MEPs and automatic plan features.** We're all invested in the success of Open MEPs and believe in their potential to provide efficient, professionally-managed defined contribution plans to small businesses. As plans expand in the marketplace, we should take a fresh look at the regime of administrative requirements, many of which were designed for a single employer plan structure at a time when automatic plan features were not even a consideration.

In support of a fresh look, our own survey results from the *Principal Financial Group Retirement Readiness Survey*[15] found nearly half of plan sponsors felt easing reporting requirements (47 percent) and compliance burdens (42 percent) would help with plan operations. More than half of plan sponsors (52 percent) said allowing all employees to defer up to Internal Revenue Service limits would make it easier for employers to operate their plans.

Reevaluating requirements in the emerging context of the Open MEP structure and auto-feature safe harbors may identify areas for simplification and reduction of administrative burdens, all of which will be beneficial to encouraging more small businesses to sponsor a defined contribution plan and improving the operating efficiencies of Open MEPs.

**Conclusion**

Thank you for the opportunity to testify about the importance of and successes in our private retirement system. Principal Financial Group appreciates the effort and sincerity with which Chairman Grassley, Ranking Member Wyden, and all Members of the Senate Finance Committee have undertaken the important considerations of Americans' retirement security. We commend the Chairman, Ranking Member, and their dedicated staff for their thoughtful and deliberate leadership on RESA and look forward to continuing to work with the Committee on future legislative efforts to help all Americans save for and realize a financially secure retirement.

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[15] The *2011 Principal Financial Group Retirement Readiness Survey* commissioned by Principal Financial Group conducted by Harris Interactive online. Data was gathered May 17-June 17, 2011 from 1,305 employers.

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**About the Principal Financial Group**

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[17] As of December 2018.