Testimony Submitted by Judy A. Miller
on behalf of the
American Society of Pension Professionals and Actuaries

Subcommittee on Social Security, Pensions, and Family Policy of the Senate Finance Committee Hearing

Retirement Savings for Low-Income Workers

February 26, 2014

Thank you Chairman Brown, Ranking Member Toomey and members of the Subcommittee for the opportunity to speak with you about retirement savings for low income workers. I am Judy Miller, Director of Retirement Policy for the American Society of Pension Professionals and Actuaries ("ASPPA"). Before working for ASPPA, I had the honor of serving as Senior Benefits Advisor on the Committee staff from mid-2003 through November of 2007.

ASPPA is a national organization of more than 16,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, attorneys and investment advisors. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

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. Over 60 million working Americans already participate in a workplace retirement plan. Workplace savings opportunities should be expanded to tens of millions more, many of whom are low income, while preserving and enhancing the current structure of tax incentives that have motivated employers to voluntarily sponsor retirement plans, and both employers and employees to contribute to these plans.

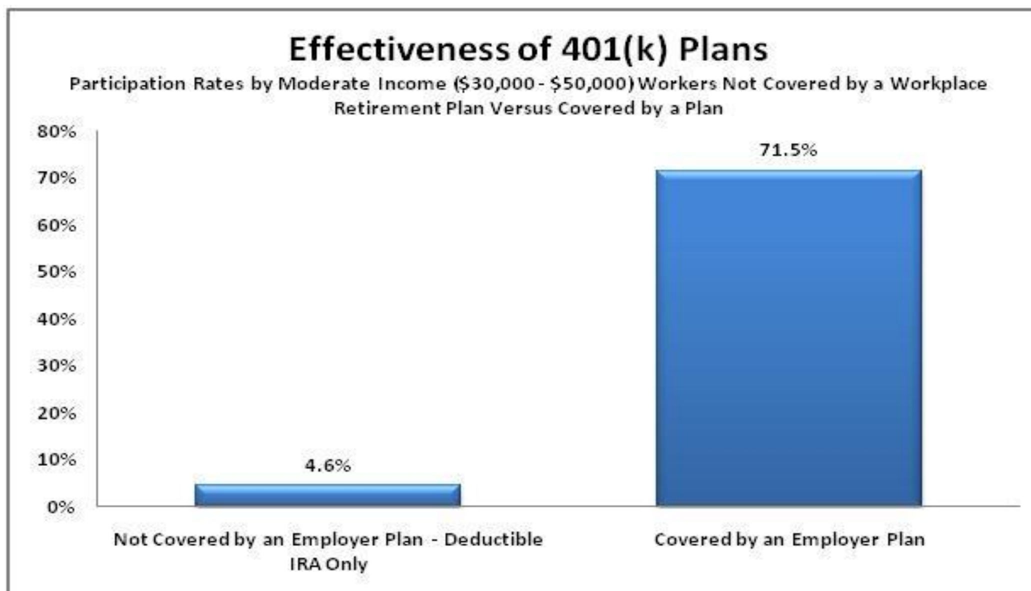
Background

The past 20 years has seen a gradual shift in employer-sponsored arrangements from defined benefit plans to defined contribution plans. The number of participants (active, retired and deferred vested) reported as covered by defined benefit plans has been fairly stable - about 40 million in 1986, and 42 million in 2007, but an increasing proportion of those are retired participants. Over the same period, the reported number of participants in defined contribution plans increased from 37 million to 80 million.[1] In 2012, over 61 million *active* workers participated in employer-sponsored retirement plans.[2]

Data shows that 401(k) and similar plans (such as 403(b) and 457(b) arrangements) have been very successful in getting workers to save for retirement. Contrary to the common assertion that only half of working Americans are covered by a retirement plan, a recent study from the Social Security Administration ("SSA") shows that about 70 percent of private sector workers have access to a retirement plan at work, and 80 percent of eligible workers with access to a plan participate in that plan.[3]

The success of saving through an employer-sponsored plan extends to low to moderate income workers. The chart below, based on data prepared by the Employee Benefit Research Institute (EBRI) updated to 2010, shows that over 70% of workers earning from $30,000 to $50,000 participated in employer-sponsored plans when a plan was available, whereas less than 5% of those without an employer plan contributed to an IRA.

Figure 1



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[1] *EBRI Databook on Employee Benefits: Chapter 10: Aggregate Trends in Defined Benefit and Defined Contribution Retirement Plan Sponsorship, Participation, and Vesting*, Employee Benefit Research Institute, available at http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2010.pdf

2 *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2012*, Employee Benefit Research Institute, available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_011-13.No392.Particip.pdf

[3] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011), available at http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf

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

Sixty-eight percent of U.S. households now have an IRA or an employer-sponsored retirement plan. At the end of 2012, private employer-sponsored defined contribution plans held about $5.1 trillion in assets, private employer-sponsored defined benefit plans held $2.6 trillion and state and local retirement plans held $3.2 trillion. There was another $5.4 trillion held in IRA accounts. Although IRAs include contributions made by individuals to the IRA on their own behalf, a substantial portion of IRA assets are attributable to rollovers from employer-sponsored plans and direct employer contributions. Of the 49 million households that own IRAs, 51% report that their IRA accounts include a rollover from another retirement plan, and over 9 million of the IRAs are employer-sponsored retirement savings arrangements such as SEPs and SIMPLE IRA plans.[4]

Current Tax Incentives

In ERISA, Congress decided to direct tax incentives for employer-sponsored plans toward coverage of substantially full-time employees. Nearly 80% of full time civilian workers now have access to workplace savings, so the incentives have been effective in providing coverage for the targeted group. The incentives are also very efficient at providing coverage to all income groups. This efficiency is derived in large part from two features that set the retirement savings incentives apart from other individual tax incentives:

- The retirement savings incentive is income *deferral*, not a permanent exclusion. 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 methodology overstates the true cost by over 50%.[5]
- Nondiscrimination rules for employer-sponsored plans assure the plans do not discriminated 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.

What are the incentives?

Employer contributions made to qualified retirement plans are deductible to the employer when made. Income tax on investment earnings on those contributions is deferred until amounts are distributed from the plan. When a distribution is made to a plan participant, all amounts are subject to ordinary income tax. Employer contributions made on a participant's behalf are not subject to FICA. In addition, individuals with adjusted gross income ("AGI") of less than $27,750, and married couples with AGI of less than $55,500, may qualify for a Saver's Credit

[4] *2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry*, Investment Company Institute, available at http://www.ici.org/pdf/2013_factbook.pdf.

[5] Judy Xanthopoulos and Mary Schmidt, *Retirement Savings and Tax Expenditure Estimates* (April 2012), available at http://www.asppa.org/Main-Menu/govtaffairs/RET2012.aspx

ranging from 10% to 50% of the first $2,000 the individual contributes to an IRA or employer-sponsored defined contribution plan.

Limits are placed on contributions to defined contribution plans, and on benefits payable from defined benefit plans:

- Certain defined contribution plans permit employees to contribute on their own behalf by electing to have a certain dollar amount or percentage of compensation withheld from pay and deposited to the plan. These "elective deferrals" are excludable from income for income tax purposes, but FICA is paid on the amounts by both the employer and the employee. For 2014, the maximum elective deferral to a 401(k) or similar plan is $17,500. Employees age 50 or over can also make a "catch-up contribution" of up to $5,500. Elective deferrals to a SIMPLE plan are limited to $11,500, plus a $2,500 catch-up contribution for those age 50 or over.
- If the employer also contributes to a defined contribution plan (such as a 401(k) plan), the maximum contribution for any employee is $52,000. This limit includes any elective deferrals other than catch-up contributions. This means a participant that is age 50 or over, and who makes the full $5,500 catch-up contribution, would have a total limit of $57,500.
- The maximum annual benefit payable from a defined benefit plan cannot exceed the lesser of the average of three year's pay or $210,000. If retirement is before age 62, the dollar limit is reduced. Employers can deduct the amount required to fund promised benefits.
- Annual IRA contributions are limited to $5,500, plus "catch-up" contributions of $1,000 for those age 50 or over.

Compensation in excess of $260,000 cannot be considered in calculating contributions or in applying nondiscrimination rules under either defined benefit or defined contribution plans. For example, if a business owner makes $400,000, and the plan provides a dollar for dollar match on the first 3% of pay the participant elects to contribute to the plan, the match for the owner is 3% of $260,000, not 3% of $400,000.

The higher contribution limits for qualified retirement plans – both defined contribution and defined benefit plans – come with coverage and non-discrimination requirements. For example, a small business owner with several employees cannot simply put in a defined contribution plan and only contribute $50,000 to his or her account. Other employees who have attained age 21 and completed 1 year of service with at least 1000 hours of work must be taken into consideration, and the employer must be able to demonstrate that benefits provided under the plan do not discriminate in favor of "Highly Compensated Employees" ("HCEs"), which would include the owner.

Safe harbors are available. For example, if all employees covered by a 401(k) plan are provided with a contribution of 3% of pay that is fully vested, the HCE can make the maximum elective deferral, regardless of how much other employees choose to contribute on their own behalf.

Age can also be considered when determining the amount of contributions that can be made on a participant's behalf. A larger contribution (as a percentage of pay) can be made for

older employees because the contribution will have less time to earn investment income before the worker reaches retirement age (usually age 65).

<u>How do retirement savings tax incentives differ from other incentives?</u>

Unlike many tax incentives, the income tax incentives for retirement savings are not permanent deductions or exclusions from income. Taxes are *deferred* as long as the savings remains in the plan, but tax must be paid in later years when distributions are made from the plan. Furthermore, the distributions are subject to tax at *ordinary income* tax rates, even though lower capital gains and dividends rates may have applied if the investments had been made outside of the plan.

The tax incentives for qualified employer-sponsored retirement plans also come with stringent non-discrimination rules. These rules, coupled with the limit on compensation that can be considered under these arrangements, are designed to insure that qualified employer-sponsored retirement plans do not discriminate in favor of HCEs. Non-discrimination rules do not apply to other forms of tax-favored retirement savings. For example:

- IRAs share the incentive of tax deferral. However, if a small business owner makes a personal contribution to an IRA, there is no corresponding obligation to contribute to other employees' IRAs. However, under the current rules, the contribution limit for IRAs is set low enough (and the limit for employer-sponsored plans high enough) to make a qualified retirement plan attractive to a business owner who can afford it.
- Annuities purchased outside of a qualified plan share the benefit of "inside buildup" - the deferral of income tax on investment earnings until distributed from the arrangement – but have *no limit on contributions or benefits, and no non-discrimination requirements*.
- Distributions from qualified retirement plans are subject to ordinary income tax, so investment income earned during the accumulation phase is taxed at a higher rate that if it had been invested outside the qualified plan and taxed at the lower rate for capital gains and dividends.

Because of the available alternatives, the attraction of a qualified retirement plan for a small business owner is heavily dependent on the interaction of non-discrimination rules and the contribution limits for a qualified retirement plan.

<u>How does tax deferral work to incent coverage?</u>

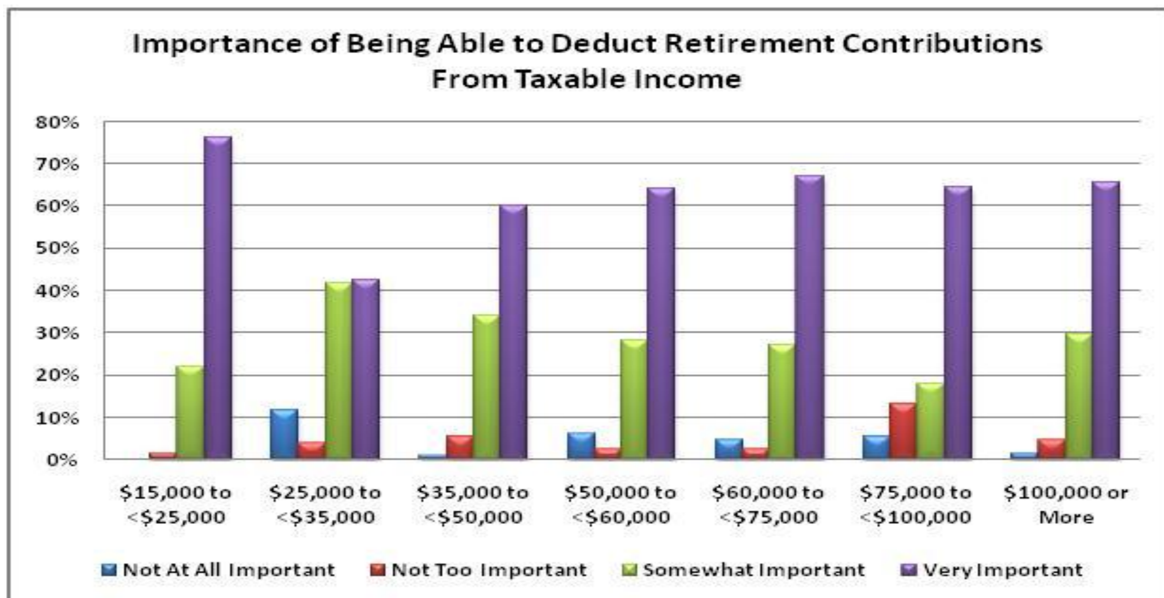
The tax incentive for a small employer to sponsor a qualified retirement plan is a critical component to the establishment of a 401(k), defined benefit or other qualified retirement plan. The tax savings for the company's owner (or owners) can generate all or part of the cash flow needed to pay required contributions for other employees, which substantially reduces the cost of the plan to the owner (and transfers much of the apparent tax benefit to covered employees). Consider the following situation:

> ABC Company has been in operation for 5 years. The owner has some retirement savings in an IRA, but has never taken time to think about retirement. The business has other employees earning from $35,000 to $70,000. The owner takes compensation of $10,000 per month during the year, then takes a year-end bonus of the amount of company profits. The owner pays individual income taxes on the full amount of the profits at a marginal rate of 28%.
>
> The owner meets with a retirement plan consultant. The owner is older than most of the other workers, so the consultant recommends a safe harbor 401(k) plan with an additional "cross-tested" contribution. Thanks to the nondiscrimination rules that apply to qualified retirement plans, putting $50,000 of the profits into the 401(k) plan for the owner means the owner must contribute at least 5% of pay for the employees. However, tax savings on the $50,000 will substantially cover that 5% contribution, and the tax credit for the cost of setting up and operating a new plan helps defray any startup and initial operating costs. Setting up the plan becomes a simple question of "Do you want to give that money to your employees? Or add it to the check you are sending to IRS?"

The current tax incentives transform what would have been a bonus to the business owner, subject to income taxes, into a retirement savings contribution for the owner *and the employees*. Not only will the employees receive an employer contribution of 5% of pay, most will also make additional contributions on their own behalf. This incentive for the business owner to contribute for other employees results in a distribution of tax benefit that is *more progressive* than the current income tax structure. Just how progressive is illustrated in Figure 3 (on page 8), showing the share of this tax benefit going to households earning under $50,000 is more than *three times* the share of income taxes paid by these households. (And that is just the tax benefit, not the full amount of employer contributions received that would otherwise have never been made on the employees' behalf.)

The tax incentives are also used to encourage employees to join 401(k) plans and similar plans. Educational materials encouraging participants to enroll in, and contribute to, plans typically show the worker how tax savings will help them save more than they could through another savings arrangement. For example, materials will show how contributing $100 to your 401(k) account will only cost $85 (or $72 for higher income workers). As shown in the chart below, over 80% of workers in all income categories find this incentive somewhat or very important.

Figure 2



Source: Jack VanDerhei, *The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results From the 2011 Retirement Confidence Survey*, ebri.org Notes (Mar. 2011), available at http://ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=4785.

The importance of the tax deferral on retirement contributions was also born out in a recent Investment Company Institute (ICI) survey in which more than 80% of households owning DC plan accounts said the immediate tax savings from their retirement plans were a big incentive to contribute.[6]

How is the tax benefit distributed?

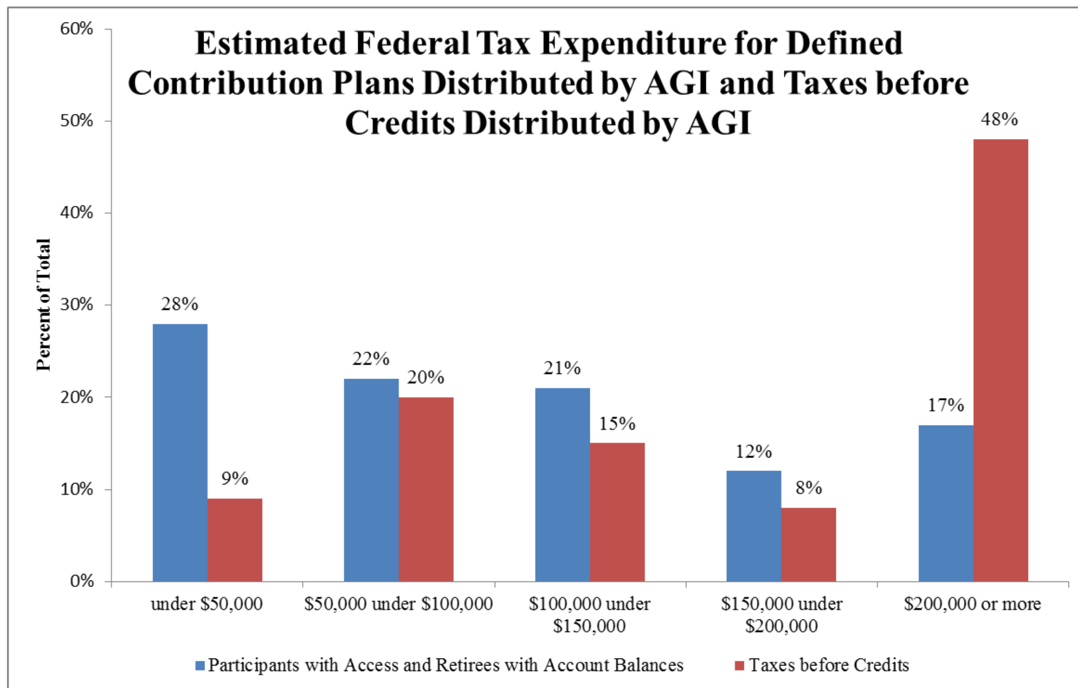
Distribution of the tax benefit is typically analyzed by applying the marginal tax rate to contributions allocated to an individual's account multiplied by the marginal tax rate.[7] Because the U.S. income tax system is progressive, the value of the tax incentive on a dollar of retirement savings *in the year of deferral* increases as the marginal tax rate increases. This progressive income tax structure, coupled with the assumption that the more income a worker has, the more he or she can afford to save, would lead one to expect the tax benefit for retirement savings would be more skewed than the incidence of income tax. However, the non-discrimination rules that apply to employer-sponsored retirement plans, coupled with the limit on compensation that may be considered for purposes of determining contribution allocations, leads to a very different result. The distribution of the tax incentive for retirement savings is *more progressive* than the current progressive income tax system. As the following chart shows, households with incomes of less than $50,000 pay only about 9% of all income taxes, but receive 28% of the defined contribution plan tax incentives. Households with less than $100,000 in AGI pay about 29% of income taxes, but receive about 50% of the defined contribution plan tax incentives. Contrast this

[6] Investment Company Institute, *America's Commitment to Retirement Security: Investor Attitudes and Actions January 2012* available at http://www.ici.org/pdf/ppr_12_retir_sec_update.pdf

[7] For example, see Table 1 of the Hamilton Project paper "Improving Opportunities for Savings and Incentives for Middle- and Low-Income Households" by William Gale, Jonathan Gruber and Peter Orszag.

distribution to the distribution of tax benefit for capital gains, where about 90% of the benefit goes to households earning over $200,000. (In fact, one estimate of the distribution of the capital gains tax benefit for 2015 shows over 68% of the tax benefit going to households with more than $1 million in income.)[8]

Figure 3



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI) and ASPPA, "Distributional Analysis and Pension Tax Provisions", April 2013 (http://www.asppa.org/Main-Menu/govtaffairs/Distributional-Analysis-and-Pension-Tax-Provisions.aspx)

What this clearly shows is that, contrary to one common myth, the tax incentives for retirement are *not* upside down at all. Thanks to the balance imposed by the current law contribution limits and stringent nondiscrimination rules, these tax incentives are *right side up* – even before properly considering other components of this incentive.

The standard methodology for measuring the benefit of the tax incentive (multiplying marginal rate times income deferred) shows that the tax incentives for employer-sponsored retirement savings are more progressive than the current income tax code. However, because of the unique nature of this tax incentive, this methodology actually *understates* how progressive the current tax incentives are:

- First, as illustrated in the "ABC Company" example beginning on page 5, this measurement fails to consider that much, if not all, of this apparent tax savings to a

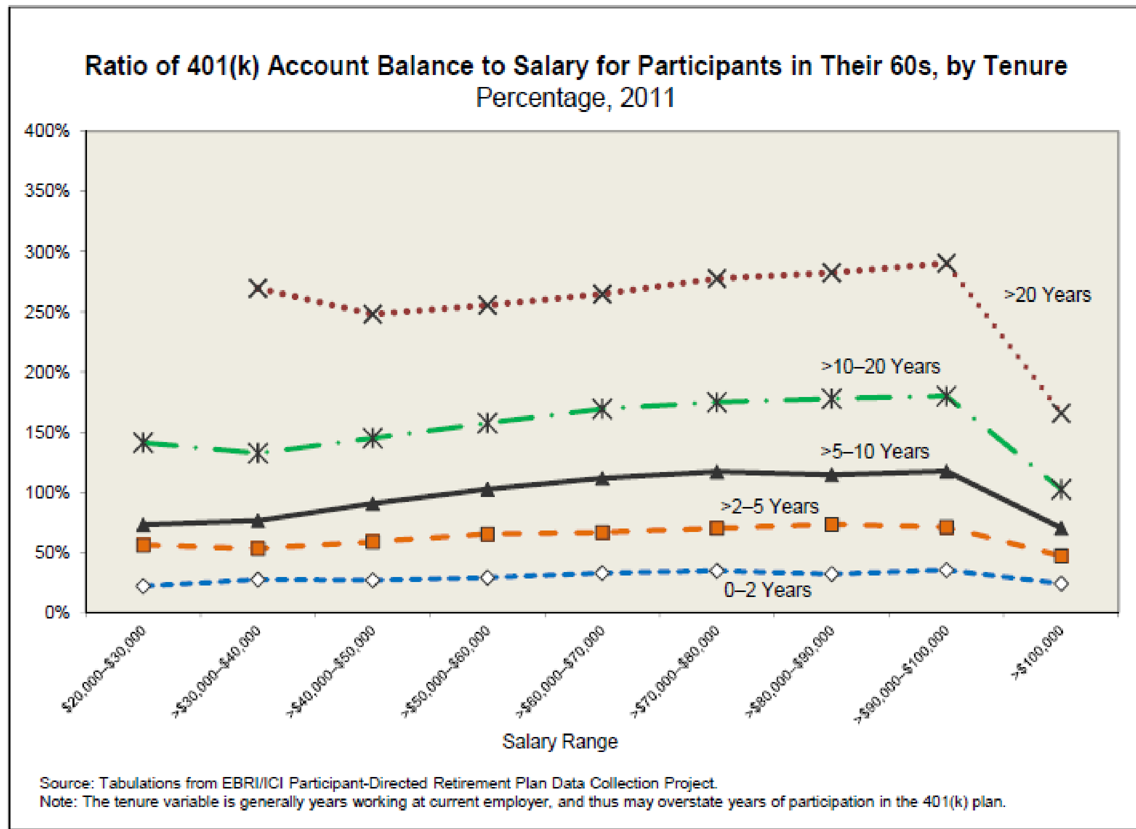
[8] Tax Policy Center, *T13-0258 - Tax Benefit of the Preferential Rates on Long-Term Capital Gains and Qualified Dividends; Baseline: Current Law; Distribution of Federal Tax Change by Expanded Cash Income Level, 2015* (Dec 18, 2013), available at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=4035&topic2ID=40&topic3ID=41&DocTypeID=1

small business owner is transferred to employees in the form of employer contributions. The standard methodology credits the small business owner contributing $50,000 on her own behalf with $14,000 "tax savings" (28% marginal rate times $50,000). If payroll for other covered employees is $200,000, the nondiscrimination rules require the employer to contribute at least 5% of pay, or $10,000, to the accounts of these other employees. Assuming for the sake of simplicity that the business tax rate is the same as the owner's rate of 28%, the net cost of the $10,000 contribution is $7,200. The small business owner's net benefit for the current tax year is therefore only $6,800 ($14,000 - $7,200). Assume the average marginal rate for the other employees is 15%. The rate times contribution method results in an apparent tax benefit of $1,500 (15% of $10,000). In fact the benefit is the full $10,000. So, although standard methodology would measure the tax incentive in the current year as $14,000 for the owner and $1,500 for the other employees, the true allocation is $6,800 for the owner and $10,000 for employees.

- Part of the cost of the retirement savings tax incentive is the deferral of income taxes on investment income. However, if a small business owner elected not to set up a qualified plan, and had simply paid income taxes instead of making retirement contributions for herself and the other employees, she could have gained identical deferral of income tax on investment earnings by investing the $50,000 in an individual annuity, or benefitted from lower capital gains and dividend tax rates on investment income by purchasing investments outside of a retirement savings vehicle. Therefore, the cost of the qualified retirement plan tax incentive should only reflect the cost of excluding the deferral in the year the contribution is made, plus deferral of tax on investment income on contributions in excess of an after-tax contribution amount, *less* the difference between ordinary income tax and capital gains and dividend taxes on investment income. (Note that for this small business owner, the after-tax value of the *employee* contributions would be available for investment outside of the qualified retirement plan, not just the after-tax value of the $50,000 contribution for the owner.)
- Analyzing the benefit for any given year during an accumulation period also fails to recognize the deferral nature of the savings tax incentive. When an individual saving $50,000 per year reaches retirement and distributions begin, the marginal income tax rate of those distributions will be substantially higher than for those with a history of lower contributions. (The fact that the amount of Social Security benefits includible in income, if any, depends on the amount of other retirement income received during a year increases the rate differential for retirees). As a result, this failure to consider taxes to be paid at a later date tends to overstate the relative benefits offered by the current system to those who make higher levels of contributions to these plans.

The impact of the nondiscrimination rules in distributing the benefit of the tax incentives is shown in Figure 4 below, which shows the ratio of account balance to salary for participants in their 60's with differing years of service with their current employer. The ratio is fairly level across the salary range for workers with similar tenure until the ratio drops dramatically at the top income level, presumably due to the impact of the dollar limits on contributions and the limits on the amount of compensation that is allowed to be considered in determining benefits. This shows the current rules clearly produce a very fair result among all income classes.

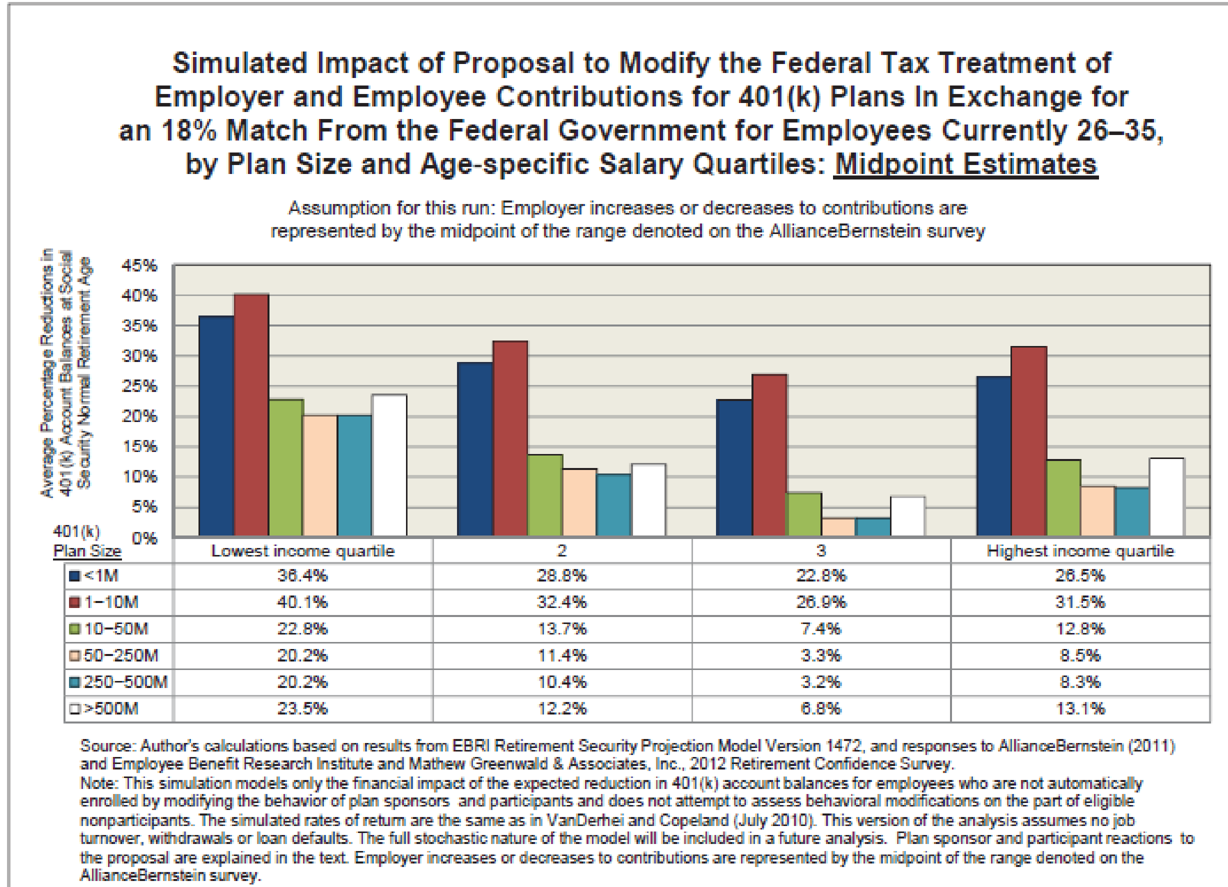
Figure 4



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
Note: The tenure variable is generally years working at current employer, and thus may overstate years of participation in the 401(k) plan.

The fact that the current incentive structure works well for lower income workers is further borne out by the projected impact of converting the current incentives to a refundable credit. The following chart shows the *decline* in projected account balances for participants considering both changes in employee behavior and employer behavior, including the termination of plans, if the current year's exclusion from income were modified to an 18% refundable credit. As expected, participants in smaller plans would suffer most, but note that the lowest income quartile shows the largest reduction for all plan sizes.

Figure 5



401(k) Plan Size	Lowest income quartile	2	3	Highest income quartile
<1M	36.4%	28.8%	22.8%	26.5%
1–10M	40.1%	32.4%	26.9%	31.5%
10–50M	22.8%	13.7%	7.4%	12.8%
50–250M	20.2%	11.4%	3.3%	8.5%
250–500M	20.2%	10.4%	3.2%	8.3%
>500M	23.5%	12.2%	6.8%	13.1%

From EBRI Notes March 2012 available at http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5019

Adequacy of Benefits

The availability of a defined contribution plan at work is a key determinant in the likelihood for having a secure retirement. This is true regardless of the level of income. EBRI projections based on voluntary enrollment in 401(k) plans show a 76% success rate of achieving income replacement of 70% for the lowest income quartile with more than 30 years of eligibility ion a 401(k) plan. If automatic enrollment and auto-escalation are added to the projection, that success rate increases to 90%. The success rates for the top quartile are 73% and 81% respectively.[9] In other words, the 401(k) structure with auto-enrollment and auto-escalation produces a higher success rate for the lowest quartile.

The success of lower income workers with access to workplace savings relative to higher income workers is due in part to the higher income replacement Social Security provides for lower income workers, and in part to the non-discrimination rules and the limits on contributions that affect primarily higher income workers. Because Social Security is very progressive, lower income workers need to replace less income through retirement savings than do workers at

[9] VanderHei, Jack; *Statement for the Record, Testimony before the Subcommittee on Social Security, Pensions, and Family Policy Hearing on The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis*, December 18, 2013

higher income levels. For example, for an individual retiring in 2014 with "Average Indexed Monthly Earnings" of $1,500 ($18,000 per year), the Primary Insurance Amount (PIA) would provide about 63% of the AIME. For someone with an AIME of $4,000 ($48,000 per year), the PIA would replace about 44% of AIME. For an individual with the maximum AIME of $8,890 ($106,680 per year), the PIA would replace about 30% of AIME.

The current employer-based system, combined with Social Security, provides the structure for successful outcomes for workers of low and moderate levels. The key is to expand access to workplace savings for those who do not currently have access.

Who Benefits

Who is participating?

The Bureau of Labor Statistics ("BLS") found that 78 percent of all full time civilian workers had access to retirement benefits at work, with 84 percent of those workers participating in these arrangements. For private sector workers, BLS found the access and participation rates are 73 percent and 80 percent respectively. Availability and take up rates are substantially lower for part-time workers, so if part time workers are included, BLS found that 68 percent of civilian workers had access to retirement plans, and 80 percent of those actually participate in the offering. For the private sector only, the access and participation rates for all workers are 64 percent and 76 percent respectively.[10]However, alternative research suggests these estimates are less than what is actually happening in the workplace.

A report from SSA shows 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.[11] The SSA used data from a Census survey merged with W-2 tax records to correct for respondents' reporting errors. SSA found "among private-sector wage and salary workers, both employer offer rates and employee participation rates in *any* type of pension plan considerably increase when W-2 records are used, an indication of substantial reporting error." [12] The SSA results indicate the BLS statistics on availability are likely understated.

Part-time workers are far less likely to have a retirement plan available at work, and less likely to participate in a plan when it is available. BLS data shows only 37% of part-time private sector workers have a retirement plan available at work, and 54% of those participate in the plan. Similarly, employees that work for smaller employers are less likely to have a plan available. BLS data shows 49 percent of private sector employees who work for employers with less than 100 employees have a plan available at work. Sixty-nine percent of those workers do participate

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[10] Bureau of Labor Statistics, *Employee Benefits Survey: Retirement Benefits, March 2011: Retirement benefits: access, participation, and take-up rates: National Compensation Survey March 2011* available at http://www.bls.gov/ncs/ebs/sp/ebnr0017.pdf (hereinafter "BLS Survey").

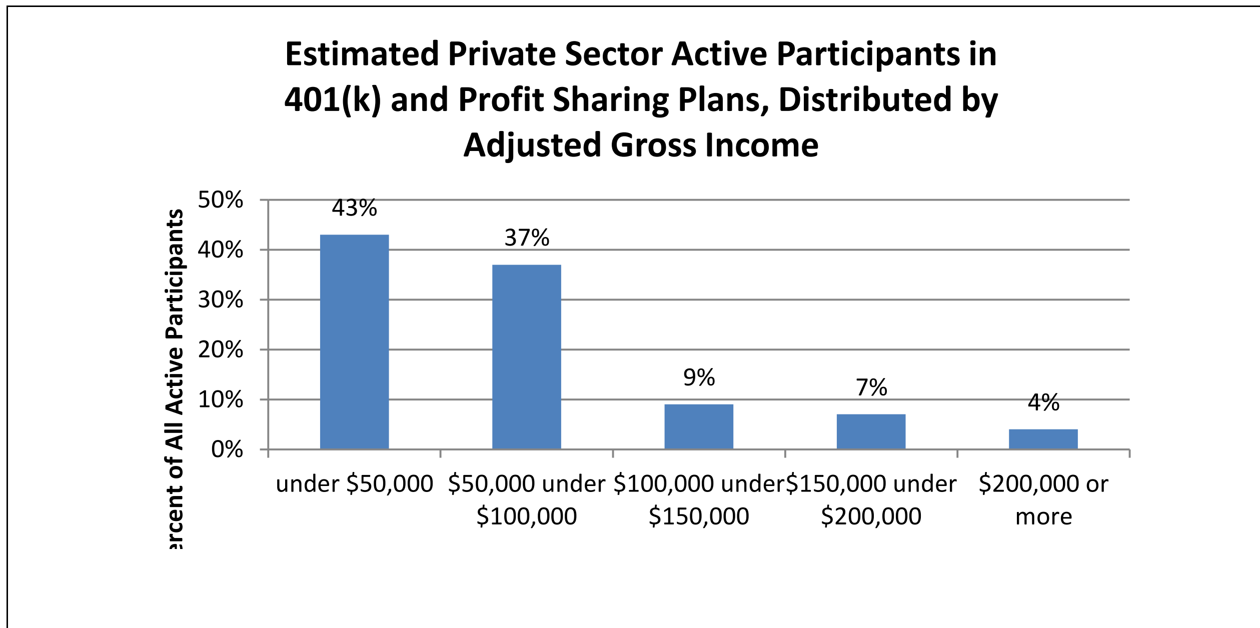
[11] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011), available at http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf

[12] *Id*. at 1 (noting "We find substantial reporting error with respect to both offer and participation rates in a retirement plan. About 14 percent of workers who self-reported nonparticipation in a defined contribution (DC) plan had contributed as indicated by W-2 records, whereas 9 percent of workers self-reported participation in a DC plan when W-2 records indicated no contributions.").

when a plan is offered, though. Employer surveys indicate business concerns are the primary driver of this low rate of sponsorship among smaller employers.

Participation in employer-sponsored defined contribution plans is heavily weighted toward middle class Americans. As the chart below shows, over 40% of participants in defined contribution plans make less than $50,000 per year. About 80% make less than $100,000.

Figure 6



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

What Should Be Done?

The current system is working very well for millions of working Americans. Expanding *availability* of workplace savings is the key to improving the system. There is no need for dramatic changes, but measures should definitely be considered to make it easier for employers, particularly small businesses, to offer a workplace savings plan to their employees.

There are a number of other proposals that we believe would expand coverage, including the Starter 401(k) Plan proposed in S.1270. This proposal would allow employers who cannot afford to make contributions for employees put their toes in the water with a 401(k) plan that could easily be amended to a full blown plan when the business becomes more stable. ASPPA is also supportive of the auto-IRA proposal developed by the Retirement Security Project, and proposed by Rep. Neal (D-MA) in H.R. 2035. This proposal does not require employers to contribute to a retirement plan, or impose fiduciary responsibilities on business owners. It does give employees an opportunity to contribute to an IRA on their own behalf through payroll deduction. Both Starter K and auto-IRA recognize that not only are many lower income workers employed by small business, but many small business owners have very modest incomes themselves and cannot be burdened with contribution requirements in order to offer a retirement savings arrangement.

I have heard calls for "simplification" as a means of expanding coverage. Any proposal that would reduce options available to employers under the guise of simplification definitely are *not* the road to expanded coverage. I spent over 20 years working with small businesses that were considering whether or not to set up a retirement plan. I can assure the Subcommittee that "complicated" testing does *not* discourage employers from establishing plans, and employers would be *less* likely to establish plans that include employer contributions if the employer had less flexibility in plan design. The truth is, it is that flexibility that creates sufficient tax savings for the small business owner to fund the contributions for employees, and the availability of general nondiscrimination testing is key to this flexibility.

Complexities that 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, are not plan design, but 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. For example, multiple employer plans (MEPs) are one approach that has gained favor in the marketplace. However, DOL has concluded that the employers must have a relationship other than joint sponsorship of the plan to participate in a "multiple employer plan". There have been a number of legislative proposals to permit these so-called "open" MEPs. We think the provision in Senator Hatch's SAFE Act (S. 1270) would be a good approach that permits open MEPs, while providing safeguards for adopting employers through a designated service provider.

There are numerous other examples of how the framework for operating a small qualified plan could be simplified, but here are a few suggestions:

- Eliminate mandatory "interim amendments"[13] 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 leads to mistakes being made by well-meaning plan sponsors (who are voluntarily providing this benefit). Small plan sponsors in particular are shocked and surprised when asked to pay thousands of dollars in sanctions when an inadvertent amendment mistake is uncovered during an IRS audit. Amendment deadlines co-ordinated with the plan's 5 or 6 year review cycle would be user friendly and cost-effective. (Included in S.1270.)
- Don't penalize small employers for allowing employees to start contributing to a 401(k) plan immediately upon employment. This could easily be accomplished by excluding employees the statute would have allowed to be excluded from

[13] Qualified retirement plans are governed by written documents that must meet certain requirements under the Internal Revenue Code 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 cycles, and pre-approved documents are on six-year cycles. During these five or six-year 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.

participation in the plan[14] from the 3% minimum "top heavy"[15] contribution requirement. (S.1270 goes further and eliminates the top heavy rules.)

- Make it less "dangerous" for small employers to use automatic enrollment by making it less expensive when the plan inadvertently fails to automatically enroll an employee. Small employers shy away from automatic enrollment, often because a mistake can cost the employer 3% of the employee's pay for the year, in addition to any matching contribution the employer would have made if the employee had been enrolled and contributed the default amount. It is reasonable to require the employer to make any matching contributions that would have been due if the employee had contributed the default amount, but to impose an additional cost because the employer voluntarily adopts automatic enrollment simply discourages adoption of automatic enrollment.
- Eliminate unnecessary notices, such as the notice requirements for the 3% safe harbor. The safe harbor information is already provided to participants in the Summary Plan Description, and since employees receive the contribution whether or not they contribute to the plan, it does not cause participants to change their behavior. (Included in S.1270.)
- Simplification should not be limited to defined contribution plans. Enactment of the proposal to eliminate reduction of assets by credit balances in applying the benefit restrictions of Internal Revenue Code section 436 would not only make sense from a policy standpoint, but would dramatically simplify the operation of that provision. (This proposal is included in S.1979 sponsored by Senators Harkin and Brown.)

In addition to these plan simplifications, the Saver's Credit for individuals should be streamlined. For example, replacing the current tiered formula with a simple formula such as 50% of a fixed amount of contributions would make it much easier to explain and communicate.

ASPPA looks forward to working with the Committee to enhance the current employer-based retirement savings system, and to help more American workers, especially small business owners and their employees, take advantage of workplace savings.

I would be pleased to discuss these issues further with the Committee or answer any questions that you may have.

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[14] Employees who have not attained age 21 or who have not completed a year of employment with at least 1000 hours of service may be excluded from plan participation.

[15] A plan is considered top heavy if over 60% of the accrued benefits are for "key employees". Many small business plans are top heavy and, as a result, must provide all participants in a defined contribution plan with a contribution of at least 3% compensation. For a defined benefit, the requirement is a minimum accrued benefit of 2% of pay per year of service, with a 20% maximum. Special rules apply to participants covered under both types of plans.