AARP
Real Possibilities

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April 15, 2015

The Honorable Michael D. Crapo
Committee on Finance
United States Senate
239 Dirksen Building
Washington, DC 20510

The Honorable Sherrod Brown
Committee on Finance
United States Senate
713 Hart Building
Washington, DC 20510

Attn: Savings@Finance.Senate.gov

Dear Senators Crapo and Brown:

On behalf of our nearly 38 million members and all Americans age 50 and older, AARP would like to take this opportunity to express our thoughts on the important role that tax incentives play in promoting and improving the financial security of millions of Americans and their families. AARP believes that proposals to restructure all or part of the federal tax system should recognize the importance of – and therefore maintain -- incentives for retirement savings. Such incentives are not only important to assist individuals in attaining the security they deserve, but are vital to our nation's future economic well-being. We also urge that as tax reform advances, changes to the tax code should not result in a disproportionate, adverse impact on older Americans.

Enhancing Retirement Security

A major priority for AARP has long been to assist all Americans in accumulating and effectively managing the resources they need to supplement Social Security and maintain an adequate standard of living throughout their retirement years. Unfortunately, both economic and social trends over recent decades, as well as developments affecting employer-provided benefits, have made the goal of achieving and maintaining an adequate income in retirement more challenging.

The state of America's future retirement landscape is cause for great concern. According to a calculation by the Center for Retirement Research at Boston College, the

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"retirement income deficit" for American households ages 32 to 64 is estimated to be roughly $7.7 trillion. In fact, 57 percent of workers in 2013 reported that the total value of their entire household's savings and investments (not just for retirement), was less than $25,000, and 28 percent had less than $1,000. Long term stagnation and recent decline in retirement savings underscore the critical importance Social Security plays, and will play, in the retirement security of both current and future generations of Americans. In fact, for older Americans, including middle-class families, it is the primary source of retirement income. Moreover, for nearly all Americans, Social Security is the only source of retirement income guaranteed to last a lifetime and keep pace with inflation.

AARP believes that given the growing need and heavy reliance on Social Security, particularly for middle income families, there should be no further increase in the taxation of Social Security benefits. Beginning in 1984, Congress made up to 50 percent of Social Security benefits subject to federal income tax for those whose adjusted gross income (plus nontaxable interest income and one-half of Social Security benefits) exceeds thresholds of $25,000 for single people and $32,000 for married couples. In 1994, Congress increased the amount of Social Security benefits subject to federal income tax by making up to 85 percent of benefits taxable when beneficiaries' annual modified adjusted gross income exceeds $34,000 for single filers and $44,000 for married couples. These thresholds are not indexed for inflation and today more than one in three Social Security beneficiaries age 65 and older are affected by some taxation of Social Security benefits. Currently, revenue from the first tier of taxation is dedicated to Social Security, while revenue from the second tier of taxation is dedicated to Medicare. The current exclusion helps older Americans with more modest incomes preserve the funds they will need throughout their retirement.

In addition, AARP also supports retention of the extra standard deduction for those age 65 or older. While roughly half of older Americans do not have incomes large enough to pay tax, the standard deduction helps modest income tax filers who do not have itemized deductions. The additional standard deduction allows more seniors to remain below the tax filing thresholds, and helps those at modest income levels maintain more of the modest pension or retirement income they currently receive – funds that will be needed to last through their retirement years. Without the additional standard deduction, a revised tax code is likely to result in a disproportionate adverse tax impact on modest income older Americans.

It is widely accepted today that workplace retirement plans and 401(k)-type plans, including those sponsored by state and local governments, have become the primary supplemental retirement savings vehicles for the vast majority of Americans. Yet, only about half of workers in the private sector have access to such plans, and the numbers have only marginally changed over four decades. In order to encourage employers to provide retirement plans and individuals to participate in these plans, Congress has provided tax incentives in the form of tax deferral of contributions and earnings on those contributions, until such time as they are distributed; at that time, the withdrawals are generally taxed. AARP notes that the time period between the tax-deferred contribution and the taxed distribution can be more than 40 years. Separately, individuals may also

set aside retirement savings in either a tax-deferred traditional or a Roth individual retirement account (IRA).

Any tax reform proposals should retain or increase incentives for employers to establish or maintain work-place retirement savings, including plans sponsored by state and local governments, for example, through payroll deduction IRA plans. The goals of these incentives are (1) to encourage private savings in a dedicated fund for retirement; (2) to help overcome obstacles to retirement savings, such as current consumption and debt repayment; (3) to increase the amount of savings in the retirement system at any given time; (4) to increase national savings and economic growth and (5) to avoid reliance of future retirees on government financed programs. Combining these goals with the valuable lessons learned from behavioral economics, numerous employers have improved the success of these plans through features such as automatic enrollment, automatic escalation, and defaults to diversified low cost plans. By safeguarding these dedicated funds and accounts and minimizing lump sum cash-outs, significant long-term savings will be available at the time they are needed, that is, at retirement.

Access to a workplace retirement plan is very important for building retirement security. The Center for Retirement Research found that access to a workplace retirement savings plan or pension is second only to having a job as the most important factor in helping moderate-to-low income individuals build retirement security. AARP has long advocated that all workers should have access to a dedicated retirement plan tied to their workplace. We support Automatic IRA legislation, which would provide an easy and low-cost method for employees to save in an Individual Retirement Account through payroll deduction. AARP also supports ongoing state efforts to extend “work and save” plans to private-sector employees that currently lack access to a workplace retirement savings plan.

Expanding access to a workplace retirement savings plan, while necessary for improving retirement security, is only a first step. The growing importance of individual account savings plans has raised questions about the capability of individuals to make savings and asset allocation decisions that will lead to a financially secure retirement. Evidence shows that many individuals when faced with these complicated decisions will not take any action. While automatic features are recent DC plan innovations to help workers overcome obstacles to saving, there are still shortcomings.

One concern with automatic enrollment is that plan participants often stay at the low default contribution rate -- commonly 3 percent of pay. As a result, many automatically enrolled participants will not save enough for a secure retirement. Automatic escalation can help overcome this obstacle by increasing contributions over time unless the participant elects otherwise. AARP believes that, given their success, all plans should be encouraged to adopt automatic saving features. In addition, plans should be encouraged to use low-fee default investments made up of index funds and similar investments so that less money goes to fees and more to building plan balances. Taking both steps will improve savings and the overall economic security of future retirees.

There are a variety of other proposals that also could be combined to expand and improve retirement savings. In addition to the President's MyRA initiative, the Administration's FY 2016 budget proposals to expand small employer tax credits for plan start-up costs, and to provide access to automatic savings for part-time workers, are worthy of further consideration. Numerous groups, including the ERISA Advisory Council, have recommended that Congress consider model small employer pools to expand access. The Government Accountability Office has issued several reports recommending strengthened rules for workers' retirement monies when workers change jobs, including automatic roll-overs to other retirement plans and improved default investments for small accounts. Further, as Americans live longer, retirement savings policy should encourage lifetime income streams and revisit the required minimum distribution rules so individuals can better pace their savings to their growing life expectancy.

Retirement tax incentives could be better targeted to encourage savings from those less likely to save. Existing incentives are generally more generous to higher-income taxpayers who are less in need of assistance to save, while smaller incentives go to low-income and middle-income taxpayers who are most likely to respond to the incentives and thus benefit most from them.

Accordingly, AARP believes that retirement savings incentives should ensure that (1) the tax benefits are progressively and broadly distributed to result in greater net savings than in the current tax code; (2) tax benefits are better targeted to low- and middle-income people who are less likely to increase their savings without the incentive (e.g., improving and expanding the current Saver's Credit to provide a more robust benefit to those who are less likely to save, such as by expanding the income limitations, eliminating the "cliffs" in the credit, providing a government match for saving, and directly depositing the credit into the retirement account); and (3) incentives for employers to make retirement savings mechanisms available in the workplace are not undermined.

We also are mindful of and urge Congress to protect the promises made to millions of workers and retirees who depend on defined benefit plans for their retirement security. Some employers have started to wind down these plans through risk-shifting – often called "derisking" -- but neither Congress nor the oversight agencies have put forth guidance to protect workers and retirees during the transition. Retirees who already have elected lifetime annuity payments should not be enticed into inappropriate lump sums. Also, without adequate legislative review, Congress just recently permitted multiemployer pension plans to seek to cut retiree pensions without first seeking additional efforts by employers and unions to maintain the plan's earned benefits. We strongly believe Congress can best ensure retirement security by protecting promises made, especially for vulnerable retirees and their families.

Two consequences of the shift away from defined benefit to defined contribution plans are (1) the loss of automatic life annuities through employer-based plans and (2) the loss of spousal consent for the type of distribution being made from these plans. Defined benefit plans must offer a life annuity as the default payout option. Very few 401(k) plans or other types of DC plans offer a life annuity option. Defined benefit plans

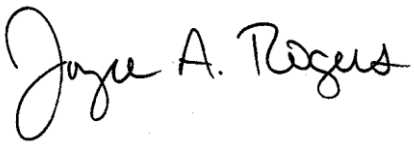
also protect spouses through automatic survivor annuities and spousal consent requirements to accept other forms of retirement receipt. By comparison, DC plans do not have a default distribution option, and workers generally may take distributions as a lump sum or in installments without the spouse's consent. AARP believes more DC plan sponsors should offer fixed life annuities as a distribution option. Adding spousal consent requirements could also increase the proportion of workers taking distributions in the form of annuities, also enhancing women's retirement security.

AARP is pleased to support the bipartisan Lifetime Income Disclosure Act – bipartisan legislation sponsored by Senators Isakson and Murphy -- that would provide individuals with a better understanding of the lifetime value of their 401(k) plan assets by including in a yearly benefit statement a conversion of their total accrued benefits into a monthly dollar amount as if they had opted to receive a lifetime annuity. This conversion would help provide a more meaningful long term perspective to 401(k) plan participants than is generally presented under current practices by giving them a more accurate picture of the lifetime value of their plan and helping them make better decisions about how much they may need to save and how best to manage their retirement assets.

Overall, AARP believes that a well-constructed fabric of tax and pension rules is essential to help Americans save for their retirement and build on the solid foundation of Social Security. The evidence emerging after enactment of the Pension Protection Act has made it clear that taxpayers will benefit from positive incentives such as automatic default features. Indeed, these enhancements have resulted in millions of new retirement accounts, millions of new savers and billions more dollars being saved. This success demonstrates both the effectiveness and the importance of well-constructed tax and pension policies to encourage Americans to save, but more can and should be done to expand access to retirement plans.

Once again, AARP would like to thank the members of the Committee for the opportunity to provide comments on the important role tax incentives play in promoting and securing the financial security of millions of Americans and their families. If you have any questions or need additional information, please feel free to contact me, or have your staff contact Michele Varnhagen on our Government Affairs staff at 434-3829.

Sincerely,



Joyce Rogers
Senior Vice President
Government Affairs

cc: Chairman Hatch
Ranking Member Wyden