ERIC

The ERISA Industry Committee

September 16, 2014

Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD-219
Dirksen Senate Office Bldg.
Washington, DC 20510-6200

RE: Retirement Savings 2.0: Updating Savings Policy for the Modern Economy hearing on September 16, 2014

Dear Senator Wyden:

As the representative of America's major employers on retirement issues, the ERISA Industry Committee ("ERIC") appreciates the Committee's focus on retirement security. Thank you for the opportunity to submit this statement for the record for the Committee's Retirement Savings 2.0: Updating Savings Policy for the Modern Economy hearing.

ERIC's Interest in Retirement Plans

The ERISA Industry Committee ("ERIC") is a nonprofit association committed to the advancement of the employee retirement benefit plans of America's largest employers. ERIC's members provide comprehensive retirement benefits to tens of millions of active and retired workers and their families. ERIC is committed to preserving and enhancing the voluntary employer-provided retirement system and the tax incentives that support it.

Summary of Comments

ERIC recommends that Congress consider the following with respect to retirement plans.

- The current employer-based retirement system benefits workers by providing workers with protections, while facilitating retirement savings.
- The voluntary employer-based retirement plan system allows companies to attract and retain quality workers, while giving companies the flexibility they need.
- Congress should protect the tax incentives that help workers to save for retirement.

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OVERVIEW

As we celebrate the 40th anniversary of the Employee Retirement Income Security Act of 1974 ("ERISA"), we should reflect on the successes of the voluntary employer-sponsored retirement system. The current employer-sponsored retirement plan system allows tens of millions of American workers to save for retirement. The U.S. Department of Labor reports that in 2011, private companies sponsored over 680,000 retirement plans and nearly 130 million Americans participated in retirement plans.[1]

Large companies voluntarily establish retirement plans and encourage their employees to participate in order to help them adequately prepare for retirement. According to the Bureau of Labor Statistics, 89% of employees at companies with 500 or more employees have the ability to participate in an employer-sponsored retirement plan.[2]

The Government Accountability Office ("GAO") included a summary of some of the benefits of employer-sponsored retirement plans in a recent report. The GAO explained that retirement plans "generally [have] lower fees, better comparative information, and ERISA plan fiduciaries are required to select and monitor reasonable investment options."[3]

Congress has also repeatedly recognized the value of the retirement plan system. For example, in 2012, over 100 members of Congress introduced a resolution seeking a "Sense of Congress" that the current tax incentives for retirement plans should be maintained.[4]

As the Committee on Finance considers tax reform, we urge the Committee to recognize the value of the tax treatment of retirement savings and the benefits it provides to millions of workers and their families. Employer-sponsored retirement plans help millions of American families achieve a secure retirement. We believe that it is important to distinguish a tax deferral from a tax exclusion or deduction. Unlike a tax exclusion or deduction, tax deferral in retirement plans increases taxes paid when the taxpayer takes a distribution from the plan. Not appreciating this distinction can lead to unintended policy decisions. We urge the Committee on Finance to preserve the current tax treatment for retirement plans that encourages employers to offer and workers to contribute to these plans.

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[1] U.S. Dep't of Labor, *Private Pension Plan Bulletin: Abstract of 2011 Form 5500 Annual Reports* (Jun. 2013).
[2] Bureau of Labor Statistics, *Table 1. Retirement benefits: Access, participation, and take-up rates* (March 2014).
[3] Gov't Accountability Office, *GAO-13-30: 401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants* (Mar. 7, 2013), available at http://www.gao.gov/products/GAO-13-30.
[4] H.Con.Res.101, Expressing the sense of the Congress that our current tax incentives for retirement savings provide important benefits to Americans to help plan for a financially secure retirement, 112th Congress, 2d Session (Feb. 16, 2012).

DETAILED COMMENTS

I. The current employer-based retirement system benefits workers by providing workers with protections, while facilitating retirement savings.

A. The current system encourages companies and employees to jointly work towards preparing workers for retirement.

The current employer-provided retirement system encourages workers to save for retirement, while providing companies with the means to attract and retain employees. Access to a mechanism to save is critical to facilitate individuals' saving for retirement. As indicated above, companies sponsor hundreds of thousands of retirement plans which provide millions of participants with retirement income. In addition to employer retirement contributions, the vast majority of these plans also allow workers to contribute towards their retirement savings. Companies can adopt defined benefit plans and/or hybrid plans, where the employer typically funds the benefit; as well as defined contribution plans, where both the plan sponsor and the employees can contribute. Congress has also established nondiscrimination rules, which ensure that employer contributions to plans are distributed among the vast majority of workers.

The retirement plan system has been successful at providing retirement benefits to all workers and in particular, moderate-income workers. According to the Employee Benefit Research Institute ("EBRI"), over 70 percent of workers making between $30,000 and $50,000 save when covered by a workplace savings program, whereas less than 5 percent of those same workers save on their own when not covered by a plan.

B. Participants benefit from the flexibility the current system affords them to save more when they are able to do so.

The current retirement system works well by providing workers with the flexibility they need, when they need it. Employees need the flexibility to be able to save more when they are able and contribute less when they are under financial constraints. For example, an individual may be able to save more when they are younger or once their children become adults, but have less money to contribute when paying for their children's college education or caring for their elderly parents.

The system that Congress developed allows employees to make elective deferrals up to $17,500 per year and up to $23,000 for workers age 50 and older. By adopting this approach, Congress recognized the need for older workers to be able to save more as they are nearing retirement.

As a result, it is critical that Congress recognize the value of the current system that reflects typical lifetime savings habits and maintain the elective deferral limits.

C. Congress also enacted laws that ensure that companies properly administer retirement plans.

Employees benefit from the important services provided by the fiduciaries of retirement plans. These fiduciaries ensure that the plan is well-run by selecting quality investment alternatives, monitoring plan fees, and choosing high quality service providers.

Furthermore, ERISA requires fiduciaries to act solely in the interests of plan participants. These fiduciaries are required to operate retirement plans in accordance with the highest standards known to the law. They are also held to the standard of a prudent person, acting in similar circumstances. As a result, the interests of participants are well protected.

D. Retirement plans are portable and transparent, which allows workers to understand their benefits and take those benefits with them when they change jobs.

Data shows that American workers frequently change employers. The median tenure for wage and salary workers was around 5.5 years in 2012.[5] As a result, flexibility is a key component for workers to obtain adequate retirement savings. Flexibility also allows companies to design plans that work effectively and efficiently based on the needs of their workforces and the industries in which they operate. As a result of this flexibility, employers can offer generous benefits based on their particular situations.

Defined contribution plans are also highly portable so workers can take their defined contribution plan assets with them when they change jobs. Congress has enacted laws that allow workers to roll their retirement plan benefits into IRAs or, in many circumstances, into other qualified retirement plans.

Rules and regulations also require a high level of transparency so that employees receive regular disclosures about their retirement savings plans that indicates that their employers are administering their retirement plans prudently and in the best interests of the participants.

E. Congress and the government agencies have instituted measures to ensure that the interests of participants and plan sponsors are balanced.

The current retirement system involves a delicate balance between the needs of participants and the companies that sponsor their retirement plans. Several government agencies, including the U.S. Department of Labor, Treasury Department, and Pension Benefit Guaranty Corporation, have the responsibility of protecting participants and their retirement savings. They issue detailed regulations and guidance to ensure that participants' interests are well-protected. For example, there are rules regarding vesting, coverage, and the allocation of benefits in retirement plans. Congress also oversees, and frequently revises, the rules for retirement plans.

F. Congress should protect the interests of workers by maintaining the current employer-based retirement plan system.

ERIC urges policymakers to protect retirement plans and the workers who participate in them by maintaining the current rules. Over time, Congress has enacted laws that maximize the benefits of the retirement plan system while minimizing potential concerns. This system encourages companies and workers to jointly help employees save for retirement and ensures that plans are properly administered. These laws, and their corresponding regulations, have also resulted in portable and transparent retirement plans which balance the needs of employers and employees. As a result, it is critical that Congress protect the valuable system that it has created.

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[5] Employee Benefit Research Institute (EBRI), *Employee Tenure Trends*, 1983–2012 (Dec. 2012).

II. The voluntary employer-based retirement plan system allows companies to attract and retain workers, while giving them the flexibility they need.

The voluntary employer-based system also allows companies to use retirement plans as a means to compete for quality workers, to keep those workers, and to ensure that they can retire from their workplace with adequate retirement savings.

The voluntary nature of the private sector retirement system is critical to its success. The diverse nature of employers necessitates a flexible retirement system. Some companies employ only a handful of workers, while others have over a million employees. Some employers have workers all over the globe, while others are regionally based. As a result, a "one-size-fits-all" approach to retirement plans often will not address the challenges of companies who want to offer retirement benefits to their workers. For example, some workforces may prefer defined benefit plans based on the needs of the employees, while other workers may prefer to participate in 401(k) plans.

Flexibility fosters creativity in plan design and enables companies to implement innovative approaches to promote participation, increased deferrals, and appropriate investment of contributions. These ideas often lead to overall improvement in the retirement plan system.

Flexibility is also critical in times of uncertainty. For example, some companies faced financial difficulties during the recent recession and had to stop making matching contributions to their 401(k) plans. Many plans made these decisions based on limited cash flow realities and decided to temporarily reduce retirement benefits while saving company jobs. When profitability returned, these plans were able to resume their contributions and the number of plans making matching contributions is back to pre-recession levels. If rules are too stringent and inflexible and do not allow for employers to respond to rapid economic changes in the best interest of their workforce, it will undoubtedly lead to decisions that undermine the U.S. economy and workforce. Anecdotal evidence reflects that many workers strongly supported their companies' decisions to provide a temporarily lower company 401(k) match in order to save jobs.

Flexibility is particularly crucial with respect to the funding of defined benefit plans. Companies may be highly profitable in some years and less so in other years. They need to be able to contribute more to their retirement plans when they are financially able and obtain relief during the years when it is needed. As a result, the funding rules associated with defined benefit plans should be reasonable, consistent and allow appropriate flexibility while maintaining high fiduciary standards and responsible financial commitments. Defined benefit plans involve long-term liabilities – over 20, 25 to 30 years. Common-sense funding rules are imperative to address the pressures of changing economic conditions and the growing competition by international companies.

Flexibility is also important for the maintenance of frozen defined benefit plans. Plan sponsors often grandfather some or all of the existing employees in a plan when it freezes its defined benefit plan for some existing or new employees. These grandfathered employees continue to accrue benefits under the plan and are very helpful to the older longer service employees who often have made retirement plans based on the benefit formula previously in effect.

Over time, however, these arrangements can cause nondiscrimination testing problems when workers in the plan often typically become higher earners and no new lower paid workers are included in the plan for testing purposes. The most workable solution to this problem in many cases is to (1) remove some or all of the longer service (and perhaps more highly compensated) employees from the defined benefit plan, or (2) more likely, completely freeze the defined benefit plan. This can result in participants losing the most beneficial years of pension plan participation. Although the Treasury Department has issued temporary relief for defined benefit plans that provide ongoing accruals, the relief will apply only to a limited number of plans.[6]

ERIC strongly encourages Congress to continue to encourage companies to voluntarily sponsor retirement plans, by including reasonable flexibility in any changes to the rules for retirement plans.

III. Congress should protect the tax incentives that help workers to save for retirement.

A. The deferral nature of retirement plans allows Congress to promote retirement savings at a reduced cost.

Historically, Congress has supported, on a bipartisan basis, tax incentives that help support the employer-based retirement savings program. It is important to note that in retirement plans, taxes are merely deferred for retirement plan contributions until the employee receives the funds (which is typically during retirement). Thus, tax revenue is not lost when workers contribute to their retirement accounts, it is merely *delayed* until the worker retires and begins taking distributions. This differs from tax expenditures where the tax is completely avoided (i.e., deductions).

Congress should recognize that the deferral nature of retirement savings is not properly reflected in the calculations performed by the Joint Committee on Taxation ("JCT") and the Treasury Department. These calculations do not consider that there is only a deferral of taxation when they measure the cost of the tax deferrals into retirement plans, such as 401(k) plans. The majority of the taxes paid show up outside the 10-year time frame used by the JCT and Treasury Department because workers generally withdraw money from these plans only in retirement. The majority of the costs for deferrals are "scored" as lost revenue, instead of being reflected as deferred revenue. This approach significantly exaggerates the actual cost to the government for the tax incentives for retirement plans and ignores the real long term value of the plans to the country and working Americans.

This approach could also damage the long-term solvency of the government. If Congress acts upon these measurements, the amount of funds the government will receive when the money was scheduled to be received (i.e., when participants retire) could be significantly reduced. It is critical that Congress recognize that retirement plan contributions are deferrals, not deductions, when evaluating the tax provisions related to retirement plans.

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[6] See, ERIC Comment Letter to IRS, *Notice 2014-5 - Nondiscrimination Relief for Closed Defined Benefit Plans* (Feb. 28, 2014), available at http://www.eric.org/uploads/doc/retirement/ERIC%20Comment%20Letter%20on%20Notice%202014-5.pdf.

B. Proposals to change the current retirement plan system would have significant negative consequences.

Congress has indicated that it is considering making changes to the tax system. We urge the Committee to recognize that the current U.S. employer-sponsored retirement plan system is designed and structured to carefully balance the interests of employers and employees.

Various proposals have been offered in the context of claiming to "improve" the current retirement system or reduce the federal budget deficit.[7] Generally, these proposals would limit the amount that could be contributed to a retirement plan, replace the current deferral of contributions with a credit, or limit the value of the retirement benefit. However, research reflects that these proposals would reduce retirement security for workers at all income levels, not just high-income workers.[8] For example, the study revealed that some employers would decide to no longer offer a plan to their workers and some participants would decrease their contributions under the proposals. The combined effect of these changes could result in reduced retirement savings of between 6 and 22 percent for workers currently age 26-35, with the greatest reductions for those in the lowest income quartile. Lowest-income participants in retirement plans with less than $10 million in assets could see reductions as high as 40 percent.

Additionally, the President has repeatedly proposed changes to the system that would limit the amount American workers could save for retirement.[9] This would negatively impact the amount Americans save for retirement. For example, there were significant negative consequences in the 1980s when Congress limited retirement contributions. When the eligibility requirements for individual retirement accounts ("IRAs") were complicated, deductible contributions declined from $37.8 billion in 1986 to only $14.1 billion in 1987 and continued to steadily decline thereafter.[10] Workers have shown that they will save less when there is increased complexity in retirement plans.

We urge Congress to be wary of unintended consequences. Changes to the rules for retirement plans often result in a "chilling effect" on savings even by individuals who are *unaffected* by the rules change. Congress should take into account all the factors that contribute to a healthy and successful private sector retirement system. In the above IRA example, policymakers underestimated the role financial services companies played in encouraging IRA contributions. When everyone could make a deductible IRA contribution, banks and other institutions would take out full page ads in newspapers to remind and encourage individuals to make their annual IRA contribution. When the rules changed and became too complicated to explain, the advertisements disappeared and so did the IRA contributions.

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[7] EBRI, *Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances* (Mar. 2012), available at http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5019.
[8] *Id*.
[9] The White House, *The President's Budget for Fiscal Year 2015*, available at http://www.whitehouse.gov/omb/budget.
[10] Sarah Holden, Kathy Ireland, Vicky Leonard- Chambers, and Michael Bogdan, *The Individual Retirement Account at Age 30: A Retrospective*, The Investment Company Institute, available at http://www.ici.org/pdf/per11-01.pdf.

Additionally, workers significantly value the ability to contribute to their 401(k) plans on a pre-tax basis.[11] Over 89 percent of people surveyed by EBRI indicated that the ability to contribute to a retirement plan on a tax-deferred basis was somewhat or very important to them.

ERIC urges Congress to recognize that any changes to retirement savings incentives must focus on policy that will result in better long-term retirement outcomes for Americans, rather than on short-term deficit reduction.

CONCLUSION

The current structure for employer-provided retirement plans is a key component of the successful U.S. retirement system. Our current system helps working Americans at all income levels build resources for a financially secure retirement. Changing the current tax treatment of employer-sponsored plans could have a significant negative impact on Americans' retirement readiness. It could jeopardize the retirement security of tens of millions of workers, impact the role of retirement assets in the capital markets, and create challenges for future generations of retirees in maintaining their quality of life.

The current retirement system works well for both companies and workers by carefully balancing their needs. Retirement plan rules ensure that plans treat participants fairly and without discrimination (e.g., the vesting, coverage, and nondiscrimination rules) while encouraging employers to voluntarily sponsor the retirement plans that benefit their workers.

Congress should protect the retirement system to allow future generations to prepare for an adequate retirement. ERIC urges Congress to exercise significant caution when considering any changes to the tax incentives relating to the retirement system and avoid major unintended adverse consequences.

ERIC appreciates the opportunity to provide comments on tax reform. If you have any questions concerning our comments, or if we can be of further assistance, please contact us at (202) 789-1400.

Sincerely,

Kathryn Ricard

Kathryn Ricard
Senior Vice President, Retirement Policy

[11] EBRI, *Tax Reform Options: Promoting Retirement Security* (Nov. 2011), available at http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4934.