ERIC

**The ERISA Industry Committee**

April 14, 2015

**Submitted electronically to Savings@finance.senate.gov**

The Honorable Mike Crapo and The Honorable Sherrod Brown
United States Senate
Chairmen, Savings & Investment Working Group
Washington, DC 20510

**RE: Importance of Retirement Tax Benefits**

The ERISA Industry Committee is pleased to respond to the request of the Senate Finance Committee for feedback on retirement tax incentives in the context of comprehensive tax reform.[1] We take this opportunity to provide some background regarding the current system and to urge the Senate Finance Committee and Congress to proceed with caution when considering any possible major changes to the nation's very successful employer-sponsored retirement system. In addition, we encourage policymakers to expand, support and promote the incentives relating to the employer-sponsored retirement plan system in order to ensure its continued success in helping working Americans save for retirement.

## ERIC's Interest in Retirement Plans

The ERISA Industry Committee ("ERIC") is the only national trade association advocating solely for the employee benefit and compensation interests of the country's largest employers. ERIC supports the ability of its large employer members to tailor health, retirement and compensation benefits for millions of employees, retirees and their families. ERIC's members provide comprehensive retirement benefits to tens of millions of active and retired workers and their families. Preserving and enhancing the voluntary employer-provided retirement system and the tax incentives that support it are key policy goals of ERIC and its member companies.

## Summary of Comments

ERIC recommends that Congress consider the following with respect to retirement plans. We have focused our comments on provisions in the Internal Revenue Code that are likely to be considered as part of Congress' tax reform efforts. These include:

- Employer-provided plans are a key and successful component of our nation's retirement system. Employers are critical to the success of the private retirement system. The voluntary employer-provided retirement plan system works well as a result of the flexibility provided to companies and their workers. Retirement plans also play a significant role in the capital markets.

[1] U.S. Senate Finance, *Hatch, Wyden Launch New Effort to Seek Input on Bipartisan Tax Reform*, available at http://www.finance.senate.gov/

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- The taxation of retirement plans assets is unique in that the taxes are merely deferred until the funds are distributed to the employee.
- As a result, the key aspects of the retirement plan system should be retained and expanded. For example, the elective deferral limit works well and should be maintained. Some proposals to change the current retirement plan system would have detrimental consequences. Additionally, we believe Congress should encourage the sponsorship of defined benefit plans.

## OVERVIEW

The employer-sponsored retirement plan system has enabled tens of millions of American workers to save for retirement. Large companies voluntarily establish retirement plans and encourage their employees to participate in order to help them adequately prepare for retirement.

Placing limits on or constricting the current tax treatment of employer-sponsored plans would 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. The current retirement system works well for both companies and workers. It is highly regulated by multiple government agencies, including the Treasury Department, the Internal Revenue Service, the Department of Labor and the Pension Benefit Guaranty Corporation. Employers offering plans have a fiduciary duty – one of the highest fiduciaries standards enacted by Congress – to act in the best interest of plan participants and beneficiaries. Retirement plan rules balance the need for plans to treat their participants fairly and without discrimination (e.g., the vesting, coverage, and nondiscrimination rules) with the goal of encouraging companies to continue to voluntarily sponsor retirement plans to benefit their workers. Since the passage of The Employee Retirement Income Security Act of 1974 (“ERISA”)[2], Congress has made multiple changes to the laws applicable to retirement plans.

While we continue to work to improve the retirement system as well as to reduce the deficit, we must not negatively impact one of the central foundations – the tax treatment of retirement savings – upon which the system has been successfully built. The effects of such a change for individuals, employers and the system as a whole are simply too harmful and must be avoided. These plans are helping millions of American families achieve a secure retirement. We urge the Senate Finance Committee to preserve the current tax treatment for retirement plans that encourages employers to offer and workers to contribute to these plans.

## DETAILED COMMENTS

### I. Employer-provided plans are a key and successful component of our nation’s retirement system.

#### *A. Working Americans have access to employer-sponsored retirement plans.*

[2] Pub. L. 93-406, 88 Stat. 829, enacted September 2, 1974.

Employer-provided retirement plans, combined with Social Security and individual savings, produce significant retirement benefits for America's working families. According to the U.S. Department of Labor, there were over 675,000 private employer retirement plans in 2012, which covered nearly 130 million workers.[3]

The Bureau of Labor Statistics ("BLS") reported that in March 2014, 74 percent of all full-time workers had access to an employer-sponsored retirement plan.[4] The BLS found that 89 percent of full-time workers at large employers had access to a retirement plan.

Workers' retirement assets have significantly increased over the years. In 1974, U.S. retirement market assets totaled $369 billion. By the end of 2014, workers had $24.7 trillion available for retirement.[5]

As a result, employer-sponsored retirement plans are available to an overwhelming majority of working Americans and are helping workers prepare for retirement.

### *B. The voluntary employer-provided retirement plan system works well.*

Employers voluntarily establish retirement plans for a variety of reasons: to compete for quality workers, to keep quality workers and to ensure workers can retire from their workplace with adequate retirement savings. The voluntary nature of the private sector retirement system is critical to its success. Employers come in all shapes and sizes. They employ workers in different industries and regions of the country. Some are global in position and some are limited to one physical location. Therefore, a "one-size-fits-all" approach to rules and regulations often will not address the challenges of companies who want to offer retirement benefits to their workers. Defined benefit plans, once the dominant form of retirement plans in the U.S., are useful to companies and workers under certain circumstances, but most notably for workers who stay with one company for a majority of their working lives.

Work-life trends and business and economic changes have resulted in more mobile workers who change professions and jobs multiple times over a single career. As a result of this reality, companies have turned to defined contribution plans, most notably, the 401(k) plan, to respond and better meet the needs of a mobile and changing worker population. Both defined benefit plans and defined contribution plans provide workers with a method to achieve financial and personal security for retirement.

Employers take on fiduciary responsibility by establishing and maintaining these plans. They monitor plan fees, select quality investment alternatives, and make significant contributions. In 401(k) plans, they also provide financial education and facilitate savings through payroll deductions and systematic contributions to plans. Employees do a better job saving for retirement when an employer plan is available. Payroll deduction facilitates the "savings habit" and employer matching

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[3] U.S. Dep't of Labor, *Private Pension Plan Bulletin: Abstract of 2012 Form 5500 Annual Reports* (Jan. 2015), available at http://www.dol.gov/ebsa/pdf/2012pensionplanbulletin.pdf.
[4] Bureau of Labor Statistics, *Employee benefits data tables: United States, March 2014*, available at http://www.bls.gov/ncs/ebs/.
[5] ICI, *The U.S. Retirement Market, Fourth Quarter 2014*, available at http://www.ici.org/research/stats/retirement

contributions as well as the Saver's Credit provide further contributions to a worker's account as well as increases incentives for retirement savings. The Saver's Credit particularly benefits lower-income workers who save through these employer-sponsored retirement plans. These plans must be operated for the exclusive benefit of and "solely in the interest" of participants. They must meet broad coverage and nondiscrimination tests that ensure that the eligibility and operation of the plan are fair. Employer contributions become "vested" for participants at points in time established by Congress.

Retirement plans offer significant benefits to workers. The retirement plan system has been incredibly successful at providing retirement benefits to middle-income workers and getting them to save. 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.[6]

Defined contribution plans are also designed to be portable and transparent. 401(k) plans are highly portable so workers can take their defined contribution plan assets with them when they change jobs. Rules and regulations established by Congress and implemented by the government agencies charged with overseeing retirement plans require a high level of transparency so that employees receive information that indicates that their employers are administering their retirement plans prudently and in the best interests of the participants.

The Government Accountability Office has highlighted the benefits of employer-sponsored retirement plans in its report on rollovers. It stated that retirement plans "generally [have] lower fees, better comparative information, and ERISA plan fiduciaries are required to select and monitor reasonable investment options."[7]

The employer retirement system provides the bulwark of retirement security for working Americans. As a result, it is important that Congress protect the value provided by the current retirement plan system and avoid unnecessary changes that could result in likely unintended adverse consequences to the country and its workers and retirees.

### *C. Congress and the government agencies make sure that interests of participants and plan sponsors are balanced.*

The current retirement system involves a delicate balance between the needs of companies and their workers. Government agencies, including the U.S. Department of Labor, Treasury Department, and Pension Benefit Guaranty Corporation, issue detailed regulations and guidance to ensure that workers' interests are well-protected. For example, there are requirements that ensure fairness and nondiscrimination, including rules governing vesting, coverage, and the allocation of benefits in retirement plans. Congress also oversees – and frequently revises – the rules for plans.

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[6] EBRI (2010) estimate using 2008 Panel of Survey of Income and Program Participation (SPP) (covered by an employer plan) and EBRI estimate (not covered by an employer plan).

[7] 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.

Additionally, ERISA and the courts have held that the persons who oversee retirement plans are held to incredibly high standards. The duties of fiduciaries to their plans "are the highest known to law."[8]

Congress and the agencies also recognize the important role that companies play with respect to retirement plans. Employers voluntarily set up, administer, and typically contribute their own assets to plans. They also make sure the plan assets are properly invested and educate their employees about how the plan works.

As a result of the efforts of companies, among others, the "401(k) plan" has become a common part of the nomenclature. Employees now have a general understanding that these plans provide them with a means to help them prepare for an adequate retirement. Although the rules for employers who sponsor retirement plans are complex, workers understand the fundamentals – How much is in my plan? How much do I contribute? How much does my employer contribute? What fees are charged to my account? Am I vested in my account? What are my account investments? These fundamentals help workers save for retirement through 401(k) plans.

As discussed above, retirement plans provide significant benefits to workers, including the ability to save for retirement and often receive employer contributions on their behalf. Employees are familiar and comfortable with these plans and rely on them to prepare for retirement. As a result, it is critical that Congress recognize and protect the opportunities and value that plans provide to American workers.

We recommend that policymakers protect the retirement system and encourage the employers who sponsor plans by issuing clear, simple common-sense rules and regulations in an efficient and effective manner. Uncertainty with respect to retirement plan rules and regulations undermines an employer's ability to offer and maintain a plan for its workers and risks undercutting the success of the system. We need to ensure that rules are targeted to the majority of law abiding employers and rely on targeted government enforcement activities to weed out the bad players.

### *D. Flexibility is an important component of the retirement plan system.*

Flexibility is critical in retirement plans. It allows companies to design plans that work effectively and efficiently based on the needs of their workforces and the industries in which they operate. Rules that are too onerous or overly restrictive can chill an employer's commitment to offer and a participant's interest to participate in an employer-sponsored plan. The ability (and flexibility) to respond to quickly changing economic conditions is critical when an employer makes the decision to offer a retirement plan to its workers. Furthermore, a "one-size-fits all" approach to plan design often does not apply to employers of various sizes and in different industry sectors. Flexibility allows employers to offer generous benefits based on their particular situations.

The value of this flexibility was clearly demonstrated during the 2008 economic downturn. When companies faced financial difficulties, some of them were forced 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. However,

[8] *Donovan v. Bierworth*, 680 F.2d 263, 271 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982).

the number of plans making matching contributions is back to pre-recession levels. This recent experience underscores the importance of flexibility – rules that are too stringent and inflexible and do not allow for employers to respond to rapid economic changes in the best interest of their workforce will undoubtedly lead to decisions that undermine the U.S. economy and workforce. Anecdotal stories during this time period showed strong support by workers of company decisions to provide a temporarily lower company 401(k) match in order to save jobs.

Flexibility also fosters creativity in plan design. As a result, companies are often incubators of new ideas of innovative approaches to encourage participation, salary deferral and appropriate investment of contributions. These ideas often lead to overall improvement for employer-sponsored retirement plans.

One area where flexibility is crucial is in the funding of defined benefit plans. Companies need to be able to contribute more to their retirement plans when they are financially able. They also need to be able to get relief during the years when it is needed. When excessive contributions are required in counter-cyclical economic times, many companies are under tremendous pressure to divert large amounts of cash from other corporate sources, including capital improvements, job retention, and benefit reductions. 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. We respectfully remind policymakers that defined benefit plans involve long-term liabilities – over 20, 25 to 30 years. Viewing pension liabilities and associated funding requirements through a snapshot window is short-sighted. We believe this approach by Congress and by the accounting rules has contributed to the declining number of active defined benefit plans. Without common-sense funding rules, the pressures of changing economic conditions and the growing competition by international companies whose countries provide pension benefits alleviating the need for the company to offer such benefits will lead to even fewer companies choosing to maintain defined benefit plans.

Another example of the importance of flexibility and the defined benefit system is with respect to maintaining frozen defined benefit plans. When a plan sponsor decides to freeze its defined benefit plan for some existing or new employees, it often grandfathers some or all of the existing employees in the plan. They continue to accrue benefits under the plan. These grandfathering arrangements are very helpful to the older longer service employees who often have made retirement plans based on the benefit formula previously in effect. However, these arrangements can, over time, cause nondiscrimination testing problems. Workers in the plan would typically become higher earners and can result in failing the nondiscrimination test as no new lower paid workers are included in the plan for testing purposes.

Unfortunately, as a practical matter, in the vast majority of cases, the most workable solution to the discrimination problem described above 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 is a very unfortunate result for defined benefit plan participants who can lose the most beneficial years of pension plan participation. In fact, by losing such beneficial years, older, longer service participants could experience the “worst of both worlds” by also not benefiting from higher allocations earlier in their career.

We applaud the legislation introduced by Senators Portman (R-OH) and Cardin (D-MD) and Representatives Tiberi (R-OH) and Neal (D-MA) in the last session of Congress that would address this problem. We understand that the Treasury Department is working on guidance in this area and we are hopeful that it will respond to the needs of employers and participants in these plans.

By updating rules put in place prior to the trend toward usage of section 401(k) plans and partnering with employers to determine other areas where rule updates are needed, policymakers will help encourage employers to establish and maintain workplace retirement plans. ERIC believes that Congress and regulators should strive to create rules that ensure transparent, fair, and reasonable parameters for employers to administer retirement plans. However, the regulatory process should not be considered a substitute for an enforcement policy. Enforcement, we strongly believe, is a separate and important arm of any regulatory system. Therefore, we urge Congress to continue to include reasonable flexibility for employers when it makes changes to the rules regulating retirement plans.

### *E. Retirement plans play a significant role in the capital markets.*

Retirement plans are very important to the capital markets. As of December 31, 2014, retirement assets totaled $24.7 trillion, of which over $10 trillion is attributable to employer-provided plans.[9] This pool of capital helps to finance productivity, which enhances investments and business expansion. Contributions by employees and employers to defined contribution plans continued even through the recent years of financial stress.

Changes to the tax treatment of retirement plans that would reduce contributions or discourage the establishment and maintenance of plans could negatively impact the role of these pivotal players in the capital markets as well as the capital markets themselves.

## II. The taxation of retirement plan assets is unique in that the taxes are merely deferred until the funds are distributed to the employee.

Unlike tax expenditures where the tax is completely avoided (i.e., deductions), taxes are merely deferred for retirement plan contributions until the employee receives the funds (which is typically during retirement). To put it bluntly – tax revenue is not lost when workers contribute to their retirement accounts – it is merely *delayed* until he/she retires and begins taking distributions.

When measuring the cost of the tax deferrals into retirement plans, such as 401(k) plans, the calculations performed by the Joint Committee on Taxation (JCT) and the Treasury Department do not consider that there is only a deferral of taxation. Because workers generally withdraw money from these plans only in retirement, the majority of the taxes paid show up outside the 10-year time frame used by the JCT and Treasury Department. As a result, the majority of the costs for deferrals is "scored" as lost revenue, rather than deferred revenue. The approach used by the JCT and Treasury Department significantly exaggerates the actual cost to the government with respect to the

[9] Investment Company Institute, *Retirement Assets Total $24.7 Trillion in Fourth Quarter 2014* (Mar. 25, 2015), available at http://www.ici.org/research/stats/retirement/ret_14_q4.

tax incentives for retirement plans and ignores the real long term value of the plans to the country and working Americans.

In addition, it damages the long-term solvency of the government. If Congress acts upon these flawed measurements, it will negatively impact the amount of funds the government will get when the money was scheduled to be received – that is, when participants retire.

***Because taxes on retirement savings are deferred, not excluded, they are not comparable to the exclusion associated with other tax expenditures***. It is critical that Congress recognize this distinction when evaluating the tax provisions related to retirement plans.

## III. The current retirement plan system should be maintained and/or enhanced.

### *A. The elective deferral limit works well and should be maintained.*

Workers need flexibility to be able to save more when they are able and less when 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.

Under the current system, employees are able to make elective deferrals up to $18,000 per year. Congress recognized the need for older workers to save more as they are nearing retirement. As a result, workers age 50 and older can currently contribute up to $24,000 per year. Policymakers have acknowledged that the "savings cycle" can be different depending on an individual's circumstances. We urge Congress to continue to support and expand the ability of individuals to save through their workplace retirement plans, by continuing COLA increases to deferral limits and reviewing the adequacy of the section 402(g) limits in the Internal Revenue Code.

Research by the EBRI showed that workers significantly value the ability to contribute to their 401(k) plans on a pre-tax basis.[10] Over 89 percent of people surveyed by EBRI said that the ability to contribute to a retirement plan on a tax-deferred basis was somewhat or very important to them.

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 limit.

### *B. Proposals to change the current retirement plan system would have detrimental consequences.*

The U.S. retirement plan system is structured to carefully balance the interests of employers and employees. Various proposals have been offered in the context of claiming to "improve" the

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

current retirement system or reduce the federal budget deficit.[11] 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.

EBRI studied a number of these proposals and found that they would reduce retirement security for workers at all income levels, not just high-income workers.[12] Specifically, the study revealed that some employers would decide to no longer offer a plan to their workers and some participants would decrease their contributions. The combined effect of these changes would result in reduced savings balances at retirement 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 would see reductions as high as 40 percent.[13]

Additionally, the President is again proposing changes to the system that would limit the amount American workers could save for retirement.[14] The President's proposal would impose caps on the total accumulated savings amounts in individual retirement savings accounts including 401(k) plans and IRA's. As in past years, the President is also proposal imposing limits on itemized deductions, including income exclusions for pre-tax contributions to tax-favored retirement accounts, to individuals earning $200,000 or less and households earning $250,000 or less.

Last year, after months of bi-partisan effort, Representative Camp (R-MI), then Chair of the House of Representatives Ways and Means Committee, released a draft tax reform plan (the Tax Reform Act of 2014). Included in this proposal were provisions that would limit the value of certain tax benefits, including tax deferred retirement savings, to individuals and families earning under a determined amount of income per year. In addition, the Camp proposal would limit (by 50%) the amount of pre-tax or tax-deferred savings an individual could contribute to his/her 401(k) account. The proposal would require that the remaining contributions (over $8,750) to a 401(k) account be made as a "Roth" contribution (after-tax). Finally, the Camp proposal would freeze the contribution limits to retirement plans to 2014 levels until 2024. So for instance, under the Camp proposal, there would NOT have been the increase in maximum contributions to $18,000 for 2015 from $17,500 in 2014 (as permitted under current law). ERIC believes such proposals, if enacted into law, would adversely impact the amount Americans save for retirement.

In the 1980s, we saw the significant negative consequences when a well-intentioned Congress set out to limit retirement contributions. When Congress complicated the eligibility requirements for individual retirement accounts ("IRAs"), deductible contributions declined from $37.8 billion in 1986 to only $14.1 billion in 1987 and continued to steadily decline thereafter.[15] Workers have shown that they will respond to increased complexity in retirement plans by saving less. Changes to the rules and regulations associated with saving for retirement often have unintended consequences including a "chilling effect" on savings even by individuals who are *unaffected* by the rules change. It is critical to take into account all the factors that contribute to a

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[11] 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.
[12] *Id*.
[13] *Id.*
[14] The White House, *The President's Budget for Fiscal Year 2016*, available at http://www.whitehouse.gov/omb/budget.
[15] 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.

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.

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 employer-sponsored retirement plan system is helping over 130 million American workers get ready for retirement. Congress should protect, support and expand the retirement system to allow future generations to prepare for retirement. We urge Congress to proceed with caution when considering any cutbacks to the tax incentives relating to the current retirement system in order to avoid the risk and strong possibility of major unintended adverse consequences to the country and the financial and personal security of working Americans. The effects of significant changes for individuals, employers and the system as a whole are simply too harmful and must be avoided. In addition, we encourage Congress and policymakers to take this opportunity to further strengthen and support the U.S. employer-sponsored retirement system.

We look forward to working together to ensure that tax reform is enacted in a way that does not jeopardize the retirement readiness of American workers.

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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

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