The
ERISA
Industry
Committee

September 17, 2014

Subcommittee on Select Revenue Measures
Committee on Ways and Means
United States House of Representatives
1101 Longworth House Office Building
Washington, DC 20515

RE: Hearing on Private Employer Defined Benefit Pension Plans

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC"), as the representative of America's major employers on retirement issues, appreciates the Committee's focus on private-sector defined benefit plans. Thank you for the opportunity to submit this statement for the record for the Committee's hearing on Private Employer Defined Benefit Pension Plans.

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 single-employer defined benefit plans.[1]

- The current system designed by Congress benefits workers by providing them with protections, while encouraging greater retirement benefits.
- The current retirement plan system provides companies with the flexibility they need to attract and retain workers.
- Congress should protect and encourage the maintenance of retirement plans.

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[1] The comments in this letter focus exclusively on retirement plans sponsored by single employers.

OVERVIEW

In 2011, there were more than 45,000 employer-sponsored defined benefit plans with over 40 million participants.[2] Ninety-nine percent of these workers participate in large plans (that have 100 or more participants). These plans provide valuable benefits and allow many workers to retire comfortably.

In total, companies sponsor over 680,000 retirement plans, including both defined benefit and defined contribution plans, which provide significant retirement benefits for nearly 130 million American workers and their families.

Although many companies are committed to providing their employees with generous benefits through defined benefit plans, the total number of these plans has been steadily declining. The total number of defined benefit plans has declined from over 100,000 in 1975 to only 45,000 in 2011.[3] As discussed in greater detail below, ERIC strongly encourages the Committee to pass legislation that enables companies to continue to maintain their defined benefit plans.

Congress has repeatedly recognized the importance of the retirement plan system and the benefits it provides Americans. Over 100 members of Congress introduced a resolution in 2012, recognizing the value of retirement plans and stating that the current tax incentives for retirement plans should be maintained.[4]

ERIC urges the Committee on Ways and Means to acknowledge the value of private-employer-sponsored retirement plans, pass legislation that supports the sponsoring of defined benefit plans, and recognize the valuable benefits retirement plans provide to millions of workers and their families.

DETAILED COMMENTS

I. The current system designed by Congress benefits workers by providing them with protections, while encouraging greater retirement benefits.

A. Companies and employees jointly work towards preparing workers for retirement under the current system.

Under the current system, workers are encouraged to save for retirement, while companies are provided with the means to attract and retain employees. Companies sponsor hundreds of thousands of retirement plans which provide millions of participants with retirement income. The vast majority of these plans include employer contributions and also allow workers to contribute towards their retirement savings. Companies have the ability to 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

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[2] U.S. Dep't of Labor, *Private Pension Plan Bulletin: Abstract of 2011 Form 5500 Annual Reports* (Jun. 2013).
[3] *Id.*
[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).

rules, which ensure that employer contributions to plans are distributed among the vast majority of workers.

Under the current retirement plan system, workers are able to prepare for a comfortable retirement.

B. Flexibility in the current system has been a critical component to its success.

Workers are given the flexibility they need, when they need it, under the current retirement system. Employees can 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 educations or caring for their elderly parents.

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, companies can offer generous benefits to their workers based on their particular situations. They can also modify future benefits to be more generous as circumstances allow.

ERIC urges Congress to recognize the value of flexibility in the current system that benefits both workers and the companies that elect to sponsor retirement plans.

C. Congress has put measures in place that balance the interests of employees and their employers.

Congress has developed a carefully balanced system that addresses the needs of participants and the companies that sponsor their retirement plans. The government agencies that oversee retirement plans, including the U.S. Department of Labor, Treasury Department, and Pension Benefit Guaranty Corporation, have interpreted the legislation passed by Congress to protect participants and their retirement savings. These agencies 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 continues to evaluate, and revise, the rules for retirement plans.

Under the Employee Retirement Income Security Act of 1974 ("ERISA"), workers' interests are protected by fiduciaries who are required to ensure that retirement plans are operated properly. These fiduciaries are required to act solely in the interests of plan participants. They are also required to operate retirement plans in accordance with the highest standards known to the law and are held to the standard of a prudent person, acting in similar circumstances. Thus, the interests of participants are well protected.

Rules and regulations also 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.

D. The interests of workers should be protected by maintaining the current employer-based retirement plan system.

Congress should protect retirement plans and the workers who participate in them by maintaining the current rules. Congress has enacted laws that maximize the benefits of the retirement plan system while minimizing potential concerns. As a result, companies and workers are encouraged to jointly help employees save for retirement. It is critical that Congress protect the valuable retirement plan system that it has created.

II. The current retirement plan system provides companies with the flexibility they need to attract and retain workers.

The current employer-based retirement plan system enables 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 this system is critical to its success. The diverse nature of employers necessitates a flexible retirement system. For example, some companies employ only a handful of workers, while others have over a million employees. Some employers are regionally based, while other companies have workers all over the globe. 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, defined benefit plans may be more suited to some workers, while others may benefit more from a 401(k) plan.

Furthermore, flexibility fosters creativity in plan design. It allows companies to adopt innovative approaches that promote participation, increase deferrals, and help participants with the investment of contributions. These ideas often lead to overall improvement in the retirement plan system.

Flexibility is also critical in times of uncertainty and can even help to save jobs. 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 has been particularly crucial regarding the funding of defined benefit plans. Companies may have varying levels of profitability over several years. These plan sponsors 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. It is critical that the funding rules associated with defined benefit plans be reasonable, consistent and provide appropriate flexibility while maintaining high fiduciary standards and responsible financial commitments. Common-sense funding rules are imperative to address the pressures of changing economic conditions and the growing competition by international companies.

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 and encourage the maintenance of retirement plans.

A. Congress should minimize the rising costs of maintaining pension plans.

Congress has repeatedly increased the premiums that companies must pay to the Pension Benefit Guaranty Corporation ("PBGC") for their defined benefit plans over the past few years. In recent years, Congress increased premiums by almost $9 billion over 10 years in MAP-21 and by an additional $7.9 billion under the Bipartisan Budget Act of 2013.

The PBGC over the past few years has also repeatedly argued for higher premiums. The President's budget proposed to give the PBGC Board the authority to adjust variable premiums.[5] Allowing the PBGC to raise premiums, plus the two recent increases, would result in a cumulative $51.4 billion hit to the U.S. economy over 11 years.

ERIC, along with others, funded a study which showed the proposed increases would limit the ability of companies to invest, create jobs and grow the economy.[6] It found PBGC premiums would cost an average of 42,000 jobs per year, peaking at a loss of more than 67,000 jobs in 2017. Congress could save an average of 24,500 jobs per year by rejecting additional premium hikes.

The PBGC recently issued its FY 2013 Projections Report which states that there has been improvement in the funded status of the PBGC's single-employer program. It noted a significant decrease in underfunding in the single-employer system.

The recent increases in PBGC premiums has also forced employers to consider de-risking strategies that would mitigate the fixed costs of PBGC premiums, especially by plans that are well funded. If this trend continues, it will have a negative effect on the PBGC by leaving more underfunded plans in the system and less well funded plans. ERIC is particularly concerned that the discussion during the last two premium increases centered around revenue without full exploration of the policy implications.

ERIC strongly urges Congress to refrain from increasing PBGC premiums any further given the negative impact it would have on the economy and the defined benefit system as a whole and the lack of need as evidenced by the PBGC's own report.

B. Congress should help companies to maintain their frozen defined benefit plans.

Companies also need help to enable them to maintain their 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

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[5] The White House, *The President's Budget for Fiscal Year 2015*, available at http://www.whitehouse.gov/omb/budget.
[6] The Pension Coalition, *Increasing Pension Premiums: The Impact on Jobs and Economic Growth* (May 2014), available at http://bit.ly/X9gzvX.

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.

These arrangements can cause nondiscrimination testing problems over time 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.[7]

On July 31, 2014, Representative Tiberi (R-OH), introduced H.R. 5381, which would provide relief from ongoing nondiscrimination testing for frozen defined benefit plans, subject to certain conditions.[8] H.R. 5381 would protect older, longer-serving participants by providing an exception to nondiscrimination testing and allowing frozen defined benefit plans to apply the nondiscrimination rules to the closed class of participants as of the freeze date and beyond. Therefore, if the plan passed the nondiscrimination testing requirements as of the date of the freeze applicable to the closed class of participants, a plan would no longer be required to apply the nondiscrimination testing requirements to the closed class of participants (unless a plan amendment applied to and changed the benefits of the closed class of participants).

ERIC supports Congressman Tiberi's bill and encourages Congress to pass legislation that supports the maintenance of frozen defined benefit plans.

C. Congress should recognize the deferral nature of retirement plans as it contemplates tax reform.

The rules for retirement plans are unlike those for other types of tax benefits. Taxes are merely deferred for retirement plan contributions until the employee receives the funds, which is typically during retirement. As a result, 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).

It is critical that Congress 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. Their calculations do not consider that there is only a deferral of taxation when they measure the cost of the tax deferrals into retirement 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. As a result, 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

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[7] 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.
[8] Representative Neal (D-MA) introduced The Retirement Simplification and Enhancement Act of 2013 in May 2013, which contained a similar provision as H.R. 5381.

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

The approach of the JCT and Treasury 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. Congress should recognize that retirement plan contributions are deferrals, not deductions, when evaluating the tax provisions related to retirement plans.

D. Congress should also be wary of proposals to change the current retirement plan system as they would cause significant negative consequences.

It is critical that Congress recognize the negative results that could occur if it changes the employer-based retirement plan system. The U.S. retirement plan system is designed to carefully balance the interests of employers and employees and research indicates that changes to the system would likely have a negative impact on retirement savings. Several proposals have been suggested that claim to "improve" the current retirement system or reduce the federal budget deficit.[9] These proposals would generally 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.

Research reflects that these proposals would reduce retirement security for workers at all income levels, not just high-income workers.[10] 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.

Furthermore, the President has repeatedly proposed changes to the system that would limit the amount American workers could save for retirement.[11] This proposal 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.[12] Workers have shown that they will save less when there is increased complexity in retirement plans.

ERIC strongly encourages Congress to be wary of unintended consequences that could result from these proposals. 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

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[9] 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.
[10] *Id*.
[11] The White House, *The President's Budget for Fiscal Year 2015*, available at http://www.whitehouse.gov/omb/budget.
[12] 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.

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.

Additionally, workers significantly value the ability to contribute to their 401(k) plans on a pre-tax basis.[13] 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 long-term policies that could enhance retirement outcomes for Americans, rather than on short-term deficit reduction.

CONCLUSION

Congress should protect the retirement system to allow future generations to prepare for an adequate retirement. It is critical that Congress exercise substantial caution when considering any changes to the retirement system in order to avoid major unintended adverse consequences. The effects of significant changes for individuals, employers and the system as a whole are simply too harmful and must be avoided.

The current employer-based 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. Furthermore, both workers and plan sponsors are given the flexibility they need in order to maximize retirement plan benefits.

ERIC urges Congress to pass legislation that protects and encourages the maintenance of retirement plans, minimizes costs to maintain retirement plans, provides relief for frozen defined benefit plans, recognizes the deferral nature of retirement plans, and critically evaluates proposals to change the system.

ERIC appreciates the opportunity to provide comments with respect to the Committee's hearing on Private Employer Defined Benefit Plans. 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

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