April 15, 2013

The Honorable Pat Tiberi
United House of Representatives
106 Cannon House Office Building
Washington, D.C. 20515

The Honorable Ron Kind
United House of Representatives
1502 Longworth House Office Building
Washington, D.C. 20515

Dear Representatives Tiberi and Kind:

On behalf of our members and all Americans age 50 and over, AARP is pleased to provide comments to the Committee on Ways and Means' Tax Reform Working Group on Pensions and Retirement. As a nonprofit, nonpartisan organization, with a membership of over 37 million Americans, AARP appreciates the opportunity to submit written comments on the impact of tax reform on the current and future state of retirement security of American workers and their families.

Introduction

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 pensions, have made the necessity of achieving and maintaining an adequate income in retirement more challenging than ever before.

While the focus of both this letter and the task force's deliberations is building savings for retirement, AARP's support for saving goes well beyond achieving retirement security. Saving is the gateway to both self-reliance and economic mobility, and has allowed millions of Americans to own their own home, enable children to receive better educations than their parents, and allowed families to both start businesses and protect themselves against sudden economic reverses. Studies show that when an individual starts to save, their attitudes change and they become both more focused on the future and more connected to their neighborhoods. In addition to tax incentives, we believe there needs to be a national effort to build a savings culture that includes a greater emphasis on financial literacy at all ages and ensuring that all Americans have the opportunity to save. We look forward to working with the task force on these issues which will help to improve retirement security.

The state of America's future retirement landscape is cause for great concern.[1] Moreover, current trends underscore the critical importance Social Security plays, and will play, in the retirement security of both current and future generations of Americans.

AARP believes that a well-constructed fabric of tax and pension rules can help address this concern. The Pension Protection Act enhancements such as automatic enrollment and automatic escalation of contribution amounts for 401(k)'s and similar retirement plans made it clear that taxpayers will respond to positive incentives. Indeed, these enhancements have resulted in millions of new retirement accounts, millions of new savers and millions 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.

For these reasons, AARP submits that any tax reform efforts should focus on the following:

- Ensuring that as many workers as possible have access to tax-deferred plans at their place of work, while recognizing and minimizing any additional burden these plans place on their employers. Keeping and creating incentives to offer workplace plans are crucial to this effort because savings through the workplace has proven to be the most efficient and effective method to increase savings. Thus, financing retirement savings through payroll deductions is an optimal system that helps to maximize the number of workers with access to retirement savings accounts;

- Keeping and creating incentives to save for all income levels while targeting in particular those low- and moderate-income earners who have fewer opportunities to save. Increasing private savings overall is critical to economic

[1] According to a recent calculation by the Center for Retirement Research at Boston College, the "retirement income deficit" for American households ages 32 to 64 is estimated to be roughly $6.6 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. R. Helman, M Greenwald, et al., The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many 17 (EBRI, Mar. 2013), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-13.No384.RCS1.pdf.

growth and our policies should recognize that low- and moderate-income Americans have a more difficult time setting money aside for their retirement; and

- Increasing education efforts regarding the savings gap and the need for Americans to improve their rate of retirement saving so that the incentives provided are utilized and effective. Many Americans in a position to set money aside simply do not, and improved and more persistent education can help address that challenge.

Social Security: The Foundation

Social Security is the foundation for retirement security, but it was never intended to be the sole source of income for people who have retired. Social Security has become the only defined benefit plan for most Americans and, generally, the only one with a built-in cost of living adjustment. However, due to shortcomings in other traditional components of the retirement security framework that help individuals achieve and maintain an adequate level of income for their golden years – employer-based pension plans, personal savings, and affordable health care – many Americans rely, and will continue to rely, on Social Security as their primary, if not sole, source of family income for their retirement. Indeed, Social Security is currently the principal source of income for nearly two-thirds of older American households receiving benefits, and roughly one third of those households depend on Social Security benefits for nearly all (90 percent or more) of their income.

Despite its critical importance, Social Security's earned benefits are modest, averaging only about $1,200 per month for all retired workers in December 2012. Nonetheless, Social Security keeps countless millions of older Americans out of poverty and allows tens of millions of Americans to live their retirement years independently, without fear of outliving their retirement income. Moreover, Social Security's current cost of living adjustment keeps many seniors from falling further behind, including falling into poverty, after they have retired. AARP strongly believes that Social Security's lifetime, inflation protected, guaranteed benefit will continue to be the crucially important foundation of retirement income for all Americans.

According to its trustees, the Social Security program has sufficient income from payroll contributions and assets in Treasury notes to pay 100 percent of promised benefits for the next 20 years, and even with no changes, can continue to pay approximately 75 percent of promised benefits thereafter. Social Security is therefore not in crisis. Nonetheless, AARP believes that the current shortfall should be addressed sooner rather than later so that the fundamental structure of the program can be retained and the protections it offers to almost all workers and their families can be protected. However, any such changes to the Social Security system must be made within the proper framework of protecting and increasing the retirement security of real people who have paid into the program, protect current beneficiaries and be phased in gradually.

In the face of declining pensions, shrinking savings, stagnating wages, and rising health costs, Social Security deserves its own national conversation that focuses on preserving and strengthening the retirement security of Americans and their families for generations to come. AARP welcomes that conversation and stands at the ready to engage our members and other Americans on ways to strengthen Social Security now and in the future.

Employer-Based Pension and Retirement Savings Coverage and Risks

AARP has long advocated that all workers should have access to a dedicated retirement plan tied to their workplace that supplements Social Security's critical foundation. The enactment of the Employee Retirement Income Security Act of 1974 (ERISA) advanced that paradigm through its emphasis of three central issues: coverage and participation; security; and adequacy. AARP believes that the Committee's current work should embrace these key objectives. In order to do so, AARP submits that as a general rule, retirement reforms should primarily be judged by their long-term impact on the preservation and equitable expansion of retirement coverage and the efficient and equitable delivery of benefits, not simply by their impact on the federal budget.

Employer-provided retirement plan coverage in the U.S. private-sector labor force has generally hovered around a modest 50 percent for decades, with larger employers more likely than smaller ones to offer retirement plans.[2] The actual participation rate of workers in private-sector pension plans varies with age, income, education, ethnicity, size of employer and type of employment. Older, better-educated, full-time, better-paid, male workers are more likely to have coverage than younger, less educated, part-time, lower-paid, female workers.

For those workers who are fortunate to work for employers who offer a workplace retirement vehicle, the type of plan provided has changed dramatically over time. Today, only about 18 percent of workers have defined benefit pension coverage on their current

[2] C. Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends*, 2011, at 9 (EBRI Issue Brief No. 378, Nov. 2012).

job, 41 percent have defined contribution plan coverage with 10 percent of workers having both. A significant contrast exists between these two types of plans, particularly around the question of who bears the different types of risk – longevity, investment, and interest rate risks.

Defined benefit plans are especially good at addressing both investment and longevity risks. Indeed, the recent market drop has made it clear that defined benefit plan participants are much better protected from market volatility compared to individual investors, many of whom fled the market at its bottom only to return after it had recovered – also known as the "sell low, buy high" syndrome. AARP strongly believes that Congress should protect the defined benefit system and consider ways to improve and expand it. Ideas for protecting the existing system that have been suggested include reducing short term volatility costs for employers (*e.g.*, modifications to the funding rules) and strengthening PBGC's premium base. AARP submits that it would also be beneficial to explore other innovative ways to offer defined benefit features through pooled arrangements, so as to better balance the respective risks and rewards of longevity and investment concepts.

Many employers have moved away from providing defined benefit plans and increasingly offer only defined contribution plans, such as 401(k) plans, either to reduce costs or because they are unable or unwilling to shoulder the longevity and/or investment risks. In these situations, it is the individual who must choose to participate and who bears the risk. Unfortunately, most individuals are not as able to handle risks as an employer paid and managed group plan. While such features as automatic enrollment and escalation play an important role in assisting plan participants to make better decisions, they do not substitute for the risk protections found in defined benefit plans.

Moreover, unlike defined benefit plans, individuals may have easier access to their defined contribution accounts prior to retirement and can withdraw money for other uses. Such withdrawals may erode retirement savings and underscore the necessity for maintaining a dedicated account only for retirement; otherwise current consumption needs can undercut an individual's retirement security. On the other hand, defined contribution plans offer portability between jobs that defined benefit plans do not which is crucial for today's mobile workforce. And, for those individuals that contribute early and regularly, make reasonable investment choices and do not withdraw their assets before retirement, they can amass a significant account balance.

AARP notes that older employees generally fare the worst when employers change from a defined benefit plan to a defined contribution plan later in one's career. In essence, older workers get the worst of both plans – the reduction in defined benefits that come with the loss of the most valuable years of service, and the loss of the compounding over time that does not occur with a new defined contribution plan.

Benefits at Retirement

The importance of a guaranteed lifetime monthly annuity benefit historically offered by defined benefit plans cannot be underestimated – not only for the income that such plans provide, but also for the peace of mind that the individual will not outlive his or her money. However, even traditional defined benefit plans are now offering lump-sum distribution options in increased numbers. They do so, in part, because plan sponsors are thereby able to shed longevity risk and pension costs by increasing the take-up of lump-sum distributions by plan members, and because workers have expressed a preference for them. Thus, many retirees are opting for lump sum distributions – even if it is not in their best financial interest – including some retirees who are in pay status where the plan sponsors have decided to transfer risk to the retirees (a/k/a de-risking).

As for defined contribution plans, although more participants may be interested in the annuity option than had been previously thought, the lump sum option is still the overwhelming choice. A contributing factor may be regulatory hurdles that discourage employers from offering annuity-like products as part of their plans. Effectively managing the spend-down phase of accumulated contributions or lump sum distributions can be especially complicated, but it is essential for the long term well-being of millions of American workers. AARP is concerned that – unlike the case with Social Security benefits – many Americans will outlive the retirement assets they have accumulated due to the combined effects of longer life expectancies and the overly optimistic assumptions many individuals make when spending down these assets.

AARP believes that the risk shifting resulting from this trend imposes an unreasonable burden on individuals who are ill-suited to the task of knowing how long they will live. In addition, and not less significant, is that this approach undercuts the retirement system's rewards of pooled retirement savings.

Workers with No Employer Coverage

While the current system has its shortcomings, an even greater risk is being borne by those who do not have an employment based opportunity to save for retirement because their employers fail to offer any type of pension or payroll deduction retirement savings plan. As noted, about half of the workforce falls into this category. AARP believes that expanding coverage is a crucial component to increasing retirement security. One way of expanding employment based coverage savings opportunities would be through such proposals as the Automatic IRA.

The Automatic IRA proposal is a simple, low-cost and common-sense solution to the problem that too few Americans are saving for their retirement. If enacted, this legislation would give tens of millions of employees a new saving option at work through regular, automatic payroll deductions. Studies show that contributions to 401(k) accounts rise dramatically when individuals can contribute to them automatically. The proposal gives employees the choice to opt out of the savings plan, but the goal is to make saving as simple and streamlined as possible for those who wish to do so.

Individual Retirement Accounts

Overall, roughly 78 million American workers (both public and private) do not have access to a workplace retirement plan, such as a pension or 401(k)-type plan. Unfortunately, few of these individuals save for retirement on their own. To the extent they do save for retirement, much of this savings is in tax-deferred plans like individual retirement accounts (IRAs). Currently, IRA owners lack many of the protections of the employer-based systems, including required disclosures concerning fees and fiduciary protections for bad investment advice.

Approximately 49 million (or 40 percent) of total households hold IRAs; about half include rollovers from employer sponsored retirement plans.[3] Ownership of IRAs increases with age and household income, as individuals move closer to retirement age. The median amount of assets in an IRA is $45,000, with account balances increasing the longer the IRA is held. For example, after 20 years the amount of median assets in an IRA is $100,000 (or a monthly annuity for a 65 year old male of about $650) while the mean is $188,200. One particularly good piece of news regarding IRAs is that the individuals who own them generally withdraw assets only for retirement-related expenses.

Despite the growth of balances in IRA, the income they will generate will not fully compensate for the lack of coverage under employer provided retirement plans. AARP believes that these modest account balances underscore the importance of preserving and

[3] ICI, *The Role of IRAs in U.S. Households' Saving for Retirement, 2012*, at 3, 12 (Dec 17, 2012), http://www.ici.org/pdf/ per18-08.pdf.

strengthening the employer-based system as the most effective and efficient method of promoting retirement savings.

Incentives and Retirement Plans

It is widely accepted that workplace retirement plans and 401(k)-type plans, including those sponsored by state and local governments, are an efficient and effective means for individuals to save and earn benefits for their own retirement. 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.[4] This tax-deferred status is based on the assumption that the pension system will work fairly and that workers will receive the pensions promised to them.

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; and (4) to increase national savings and economic growth. By using dedicated funds and accounts, these savings will be available at the time they are needed, that is, at retirement.

Any tax reform proposals should retain incentives for retirement savings, including those sponsored by state and local governments.[5] Such incentives are not only important to assist individuals in attaining a secure retirement, but are vital to our nation's future economic well-being. However, existing incentives are not as targeted, and, therefore not as effective, as they could be. 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 benefit from such savings incentives and to change their behavior in response to such incentives.

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[4] AARP notes that the time period between the tax-deferred contribution and the taxed distribution can be more than 40 years.

[5] Congress has worked over the years to make refinements to the Code to address the unique policy issues affecting public sector plans. AARP believes it would be counterproductive to state and local retirement employees' security to undercut successful State and local retirement policies and impose immense burdens on state and local workers and their employers in attempts to reform the federal tax code.

Accordingly, AARP believes that any changes to 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; and (3) incentives for employers to make retirement savings mechanisms available in the workplace are not undermined.

Improving the Saver's Credit

Many moderate-income and low-income people cannot benefit from the current tax incentives that Congress has provided to individuals because they are not earning enough income. For those moderate-income people that do, the benefits provided through tax incentives are often minimal.

Accordingly, AARP supports adoption of progressive savings incentives. This could include improving and expanding the current Saver's Credit to provide a more robust benefit to those who are less likely to save (particularly those with low to moderate incomes). Improvements could include expanding the income limitations, eliminating the "cliffs" in the credit, making it refundable, and directly depositing the credit into the retirement account.

Conclusion

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 a secure retirement, but are vital to our nation's future economic well-being.

Sincerely,

Joyce A. Rogers

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SVP Government Affairs