TAX REFORM AND TAX-FAVORED RETIREMENT ACCOUNTS

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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TAX REFORM AND TAX-FAVORED RETIREMENT ACCOUNTS

TUESDAY, APRIL 17, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 10:02 a.m., in Room 1100, Longworth House Office Building, Hon. Dave Camp [Chairman of the Committee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
Tuesday, April 17, 2012
FC–24

Chairman Camp Announces a Hearing on Tax Reform and Tax-Favored Retirement Accounts

Congressman Dave Camp (R–MI), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on possible reforms to certain tax-favored retirement savings plans that might be considered as part of comprehensive tax reform. This tax reform hearing—scheduled to occur on tax filing day—will examine one source of complexity for individuals and employers by reviewing employer-sponsored defined contribution plans as well as Individual Retirement Accounts ("IRAs"). **The hearing will take place on Tuesday, April 17, 2012, in Room 1100 of the Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witness only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

Financial planners and advisors have long identified the major components of retirement security as Social Security, employer-sponsored plans, and personal savings. Financed by payroll taxes paid by covered workers and their employers, Social Security provides monthly cash benefits to retired or disabled workers and their family members and to the family members of deceased workers. Social Security is outside the scope of this hearing.

Outside of Social Security, many employers offer employees the option of participating in employer-sponsored retirement and pension plans, which generally receive favorable Federal income tax treatment. Employer-sponsored plans provide for either a defined benefit (which generally provides retired employees with an annuity) or a defined contribution ("DC"). Defined benefit pension plans represent an important source of retirement security, but raise policy questions that are outside the scope of this hearing. DC plans receive contributions from either employees or employers or both. Employees usually own their own accounts, and control the investment of account assets, thus bearing the risks and rewards of asset performance. In general, contributions to DC plans are deductible to the employer, excluded from the employee's income, grow tax-free, and are taxed upon distribution. DC plans also generally may offer Roth-style accounts; contributions to such accounts are made on an after-tax basis but earnings and distributions are tax-free.

Individuals also may be eligible to save through IRAs, which are similarly tax-advantaged, although with much lower contribution limits. Traditional IRAs are taxed similarly to 401(k) accounts. Contributions are deductible from income, earnings are not taxed currently, and distributions are taxed. Individuals participating in employer-sponsored plans cannot contribute to a traditional IRA if they exceed certain income levels. Contributions to Roth IRAs, on the other hand, are made on an aftertax basis, but earnings and distributions are excluded from income. Contributions to non-deductible IRAs are included in income, grow tax-free and are taxed at distribution less the amount of previously taxed contributions.

There are several types of DC plans, the most common of which are: 401(k) plans for private employers, 403(b) plans for non-profits and public schools, and 457(b) plans for State and local governments. In addition to the types of IRAs discussed above, some employers may offer IRAs through the workplace, including payroll deduction IRAs, SIMPLE IRAs and SEP IRAs. The proliferation of tax-favored retirement accounts has occurred as specific needs have led Congress to create new types of plans with specific rules. Some commentators, however, have questioned whether the large number of plans with different rules and eligibility criteria leads to confusion, reducing the effectiveness of the incentives in increasing retirement savings. In addition, many commentators have offered ideas for increasing participation in retirement plans and better targeting the incentives. These ideas range from simplification and consolidation of existing plans and accounts to changing the default rules governing whether an employee participates to additional incentives such as the Savers Credit.

In announcing this hearing, Chairman Camp said, **"Retirement security is one of the most important long-term policy priorities we face as a Nation. While many argue that the existing menu of tax-favored retirement plans provides choice and flexibility for families and employers alike, others have questioned whether the ad hoc development of retirement savings incentives has led to undue complexity and inefficiency that reduce the effectiveness of these incentives. The general principles of tax reform apply to retirement security as well: American families trying to save should have options that are simple, fair, and economically efficient."**

FOCUS OF THE HEARING:

The hearing will consider the current menu of options for retirement savings—both with respect to employer-based defined contribution plans and with respect to IRAs. The hearing will explore whether, as part of comprehensive tax reform, various reform options could achieve the three goals of simplification, efficiency, and increasing retirement and financial security for American families.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*Hearings*." Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, submit all requested information. ***ATTACH*** your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Tuesday, May 1, 2012**. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–2610.

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The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov*.

Chairman CAMP. Good morning. We meet today to continue our dialogue about what I hope will result in a bipartisan path forward to reform our Federal income tax system. In recent weeks much of the discussion about tax reform has centered on the corporate side, especially after Japan lowered its corporate rate on April 1st, leaving America with the dubious distinction of having the highest corporate tax rate in the industrialized world. It is simply unacceptable that American employers face such an undue burden at a time when we desperately need them to get the economy growing and get almost 13 million unemployed people back to work. But as tax filing day reminds us, only comprehensive tax reform ensures that we address the needs of American families and all job creators, regardless of how they are structured, and as such we must consider the individual side of the Tax Code if we are to transform today's broken Code from one that impedes to one that improves prospects for job creation.

Last year the IRS processed 142 million tax returns. They also received 10.5 million extension forms, at least in part due to the complex, costly, and time-consuming nature of the Tax Code. With nearly 4,500 changes in the last decade, 579 of them in 2010 alone, the Code is far too complex, and this complexity has led to ever-increasing costs of complying with the Federal Tax Code.

According to the National Taxpayer Advocate, in 2008, taxpayers spent $163 billion complying with the individual and corporate income tax rules. American families are not only spending more money complying with the Tax Code, they are also spending more time. Navigating through the tangled web of tax rules has resulted in taxpayers spending over 6 billion hours annually to comply with the Code. Whether it is the compliance and administrative burdens, the impact of temporary and expiring tax provisions, or the effect of convoluted rules on financial planning decisions, today's Tax Code is not just hampering employers, but it is hampering the ability of individuals and families to plan their finances with reasonable certainty.

Turning to the topic of today's hearing, tax incentives for retirement saving, it quickly becomes clear why we are taking the time to lay the foundation for comprehensive tax reform by gathering input from experts. As many Americans work to meet the tax filing deadline, today's testimony reinforces the wide popularity of these savings vehicles. The overwhelming majority of American workers with access to a workplace retirement plan are participating in that plan. According to the Bureau of Labor Statistics, 78 percent of full-time workers have access to a workplace retirement plan, and 84 percent of those workers participate in the plan, meaning

66 percent of all full-time workers participate. The plans benefit taxpayers of all income levels and from all walks of life.

In 2010, over 70 percent of workers earning $30,000 to $50,000 participated in an employer-sponsored retirement plan if such a plan was available to them, according to data from the Employee Benefit Research Institute. Similarly, IRS data indicates that 38 percent of those participating in defined contribution plans make less than $50,000 a year, while almost three-quarters make less than $100,000 annually.

The proliferation of tax-favored retirement accounts has occurred as specific needs have led Congress to create new types of plans with different rules. Some, however, have questioned whether the large number of plans with different rules and eligibility criteria leads to confusion, reducing effectiveness of the incentives and increasing retirement savings.

In addition, many commentators have offered ideas for increasing participation in retirement plans and better targeting the incentives. These ideas range from simplification and consolidation of existing plans and accounts to changing the default rules governing whether an employee participates, to additional incentives such as the saver's credit. As the Committee continues its work toward comprehensive tax reform, it is important to keep in mind that these savings vehicles affect average people who depend on these resources for their retirement, and we must ensure that we do not inadvertently take steps that result in unintended consequences that could threaten the retirement security of ordinary families.

As this Committee considers tax reform, I believe there are three important principles to keep in mind when evaluating tax-favored retirement vehicles: one, simplification; two, increased participation, particularly by low- and middle-income taxpayers; and three, whether the tax benefits are effectively and properly targeted.

Regarding the first of these principles, in August 2010 the President's Economic Recovery Advisory Board, also known as the Volcker Commission, presented options for simplifying savings and retirement incentives in their report on tax reform options. These options are worthy of consideration and discussion. We also have an expert panel of witnesses before us today that will evaluate how existing tax rules measure up to these criteria.

I would like to emphasize that today's hearing isn't about drawing conclusions, but it is about making sure that as Congress approaches comprehensive tax reform, that we do so well armed with information. Washington has spent too much time in previous years acting first and asking later. That has proven to be the wrong approach. America's families and job creators deserve better than a trial-and-error approach to crafting policy. This is our opportunity to gather input and get the facts, and I look forward to the discussion.

And I will now yield to the Ranking Member, Mr. Levin, for the purpose of an opening statement.

Mr. LEVIN. Thank you, Mr. Chairman. Welcome. Thank you for coming.

Today's hearing is this Committee's initial examination of what tax reform might mean for a very specific set of tax provisions, those designed to promote retirement savings. Tax-preferred retirement savings have benefited tens of millions of American families. The estimates of exactly how many vary, but most find that 40 to 50 percent of all workers are covered by an employer-sponsored retirement plan, some 60 to 70 million people. Employer-sponsored plans, including defined contribution and defined benefit plans, private and public sector, hold assets of $9.3 trillion, held that amount as of the end of last year, and an additional 49 million households hold $4.7 trillion in IRAs.

The tax-preferred retirement system is voluntary. Employers are not required to offer retirement plans, but I think we will hear today that employers basically understand the current system and that it works for them in terms of allowing them to offer retirement benefits to their workers. I note that most of this Committee agrees with that.

Mr. Gerlach and Mr. Neal have introduced a resolution essentially in support of our current system. It has been cosponsored by 115 Members, including 26 Members of this Committee, reflecting, I think, bipartisan agreement that these provisions are vital to encouraging retirement savings.

That is not to say the current system cannot be improved. Of course it can be. Today I believe we will hear about several ways to do that, including proposals to expand enrollment in 401(k)s and IRAs, and to expand the saver's credit. But what should be clear is that the basic structure of our current system should be preserved, and that this structure should not be repealed to pay for tax reform. Tax reform should approach retirement savings incentives with an eye toward strengthening our current system and expanding participation, not as an opportunity to find revenue.

I think one of our witnesses, Mr. Hardock, summed this up very nicely in his—in your written testimony, and I quote, "The retirement savings tax expenditures should not be reduced or tinkered with to pay for other initiatives, whether inside or outside of tax reform process. Those funds are the primary retirement nest egg of millions of American families. They should not be taxed in order to finance more government spending, deficit reduction or to offset other tax initiatives, including lower marginal tax rates."

Finally, I want to just note that while today's hearing is focused on defined contribution plans, our retirement security policy in this country has traditionally been a three-legged stool. Personal savings constitute just one of those legs. The other two legs, defined pension benefit pensions and Social Security, are indeed also vital components of ensuring Americans' retirement security.

So thank you again, and all of us look forward to your testimony.

Chairman CAMP. Thank you, Ranking Member Levin.

Next it is my pleasure to welcome the excellent panel of witnesses seated before us today. Today's witnesses have extensive experience studying or working with tax-favored retirement accounts, and their experience will be helpful as we take a look at how the complexities in this part of the Tax Code affect individuals and employers.

First I would like to welcome and introduce Dr. Jack VanDerhei, the research director at the Employee Benefit Research Institute in Washington, D.C. Dr. VanDerhei has been with the Employee Benefit Research Institute since 1988 and has published more than 100 papers on employee benefits.

Second we will hear from Ms. Judy Miller, the chief of actuarial issues and director of retirement policy at the American Society of Pension Professionals and Actuaries. Ms. Miller has specialized in employer-sponsored retirement programs for nearly 40 years.

Third we will welcome Mr. Bill Sweetnam, a principal at the Groom Law Group in Washington, D.C. Mr. Sweetnam specialized in retirement security at Groom and served as benefits tax counsel at the George W. Bush Treasury Department.

Fourth we will hear from Mr. David John, a senior research fellow in retirement security and financial institutions at The Heritage Foundation. Mr. John has published and testified extensively on the improvement of retirement security plans.

Finally, we welcome Mr. Randy Hardock, a partner at Davis & Harman LLP in Washington, D.C. Mr. Hardock is an ERISA and regulatory compliance specialist who maintains a practice focused on advising employers and institutions on retirement and savings issues. Mr. Hardock is testifying today on behalf of the American Benefits Council.

Thank you all again for your time today. The Committee has received each of your written statements, and they will be made a part of the formal hearing record. Each of you will be recognized for 5 minutes for your oral remarks and, Mr. VanDerhei, we will begin with you, and you are recognized for 5 minutes.

STATEMENT OF JACK VANDERHEI, PH.D., RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE, WASHINGTON, D.C.

Mr. VANDERHEI. Thank you. Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to speak with you today on the issues involved in tax reform and tax-favored retirement accounts. I am Jack VanDerhei, research director of the Employee Benefit Research Institute. EBRI is a nonpartisan institute that has been conducting original research on retirement and health benefits for the past 34 years. EBRI does not take policy positions and does not lobby.

My testimony today draws on extensive research conducted by EBRI over the last 13 years with its Retirement Security Projection Model as well as annual analysis of the behavior of tens of millions of individual participants from tens of thousands of 401(k) plans dating back in some cases as far as 1996.

Measuring retirement income adequacy is an extremely important and complex topic, and EBRI started to provide this type of measurement in the late nineties. Figure 1 of my written testimony shows that when we modeled the baby boomers and Gen X-ers earlier this year, 43 to 44 percent of the households were projected to be at risk of not having adequate retirement income for basic retirement expenses plus uninsured healthcare costs. Even though this number is quite large, the good news is that this is 5 to 8 percentage points lower than what we found in 2003.

It would be my pleasure to explain in more detail later why American households are better off today than they were 9 years ago, even after the financial and real estate market crises in 2008 and 2009, but the short answer is the extremely positive impact from automatic enrollment in 401(k) plans.

It is difficult to imagine any voluntary strategy more effective at dealing with retirement income adequacy than increasing the likelihood of eligibility in a qualified retirement plan. Figure 5 of my written testimony shows the importance of defined benefit plans for retirement income adequacy, and figure 6 shows a similar analysis for 401(k) plans. We see that the number of future years that workers are eligible for participation in a defined contribution plan makes a tremendous difference in their at-risk ratings. Gen X-ers, for example, with no future years of eligibility, are simulated to run short of money 61 percent of the time, whereas those with 20 or more years of future eligibility would experience the situation only 18 percent of the time.

Knowing the percentage of households that will be at risk for inadequate retirement income is important for public policy analysis; however, equally important is knowing just how large the accumulated deficits are likely to be. The aggregate deficit number is estimated to be $4.3 trillion for all baby boomers and Gen X-ers.

While trillion-dollar deficits are useful in focusing attention on this problem, they do little to help policymakers understand exactly where these deficits are coming from. For example, figure 3 of my written testimony provides information on the retirement savings shortfalls for Gen X-ers. The average deficit decreases substantially with additional years of future eligibility in a defined contribution plan, and Gen X-ers fortunate enough to have at least 20 years of future eligibility find their average deficits reduced more than 70 percent of the average deficits for those with no future years of eligibility.

EBRI research has shown repeatedly that the additional type of 401(k) plan under current tax incentives has the potential to generate a sum that, when combined with Social Security benefits, would replace a sizable portion of the employee's preretirement income for those with continuous coverage. Our research has also shown that the automatic enrollment type of 401(k) plan, when combined with automatic escalation provisions, appears to have the potential to produce even larger retirement accumulations for most of those covered by such plans.

Recently, however, there have been proposals to modify the existing tax incentives for defined contribution plans by either capping annual contributions or changing the before-tax nature of employee and employer contributions in exchange for a government matching contribution.

Last September the Senate Finance Committee held a hearing that focused to a large extent on the second type of proposal. EBRI presented preliminary evidence at that time of the possible impact of such a proposal on future 401(k) accumulations. In recent months results from two new surveys have allowed EBRI to model these effects even more accurately, and last month we published our new results showing the projected changes in 401(k) balance at retirement age due to expected modifications of plan sponsors and participants in reaction to that proposal. Figure 11 of my written testimony shows a 22 percent reduction in 401(k) balances at retirement for young workers in the lowest income quartile, those most at risk for insufficient retirement income. Results are even more dramatic for small plans. Figure 12 shows the average reduction for low-income employees in these plans is 36 and 40 percent.

In conclusion, given that the financial fate of future generations of retirees appears to be so strongly tied to whether they are eligible to participate in employer-sponsored retirement plans, the logic of modifying either completely or marginally the incentive structure of employees or employers for defined contribution plans at this time needs to be thoroughly examined. The potential decrease of retirement income resulting from either employer modifications to existing retirement plans or employees reducing future contributions to these plans needs to be analyzed carefully when considering the overall impact of such proposals.

Thank you, and I look forward to your questions.

Chairman CAMP. Thank you very much.

[The prepared statement of Mr. VanDerhei follows:]

T-172

House Committee on Ways and Means

Hearing on:

Tax Reform and Tax-Favored Retirement Accounts

10:00 a.m. April 17, 2012

1100 Longworth House Office Building

Testimony by

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Research Institute

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Tax Reform and Tax-Favored Retirement Accounts

Jack VanDerhei, Research Director, Employee Benefit Research Institute

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1 Introduction

Mr. Chairman and members of the committee, thank you for your invitation to testify today on tax reform and tax-favored retirement accounts. I am Jack VanDerhei, research director of the Employee Benefit Research Institute. EBRI is a nonpartisan research institute that has been focusing on retirement and health benefits for the past 34 years. EBRI does not take policy positions and does not lobby.

The testimony draws on the extensive research conducted by EBRI on these topics over the last 13 years with its Retirement Security Projection Model® as well as annual analysis of tens of millions of individual 401(k) participants dating back in some cases as far as 1996.

Today's testimony will deal with the following questions:

- What is the size of American's retirement savings gap?
- What is the impact of tax favored retirement accounts on retirement income adequacy?
- What is the value of tax-favored retirement accounts under current tax incentives (with particular emphasis on 401(k) plans)?
- How might workers react to changing tax incentives?
- What is the potential impact of two recent tax reform proposals on retirement security?

2 What is the size of Americans' retirement savings gap?

The concept of measuring retirement security – or retirement income adequacy – is an extremely important topic. EBRI launched a major project to provide this type of measurement in the late 1990s for several states that were concerned whether their residents would have sufficient income when they reached retirement age. After conducting studies for Oregon, Kansas and Massachusetts, we expanded the simulation model to a full-blown national model in 2003, and in 2010 updated it to incorporate several significant changes, including the impacts of defined benefit plan freezes, automatic enrollment provisions for 401(k) plans and the recent crises in the financial and housing markets.[1]

When we modeled the Baby Boomers and Gen Xers in 2012 (Figure 1) between 43.3–44.3 percent of the simulated lifepaths for retired households were projected to have inadequate retirement income for basic retirement expenses plus uninsured health care costs. This is 5-8 percentage points LOWER than what we found in our 2003 analysis.

While the passage of time allowed more funds to be saved, the improvement over the last nine years is largely due to the fact that in 2003 very few 401(k) sponsors used automatic enrollment (AE) provisions and the participation rates among the lower income employees (those most likely to be at risk) was quite low. With the adoption of AE in the past few years, the participation rates have often increased to values in excess of 80 percent.

While we found no significant trends by age demographic, Figure 2 shows that the lower-income households are much more likely to be at risk for insufficient retirement income (even though we model our basic retirement expenses as a function of the household's expected retirement income). The 2012 baseline ratings for Early Boomers ranges from a projection that 87 percent of the simulated lifepaths for retired lowest-income households are at risk to only 13 percent for the simulated lifepaths for retired highest income households. Similar trends are evidenced for both the Late Boomers and Gen Xers.

Knowing the percentage of households that will be at risk for inadequate retirement income is important for public policy analysis; however, equally important is knowing just how large the accumulated deficits are likely to be. The aggregate deficit number with the current Social Security retirement benefits and the assumption that net housing equity is utilized "as needed" is estimated to be $4.3 trillion for all Baby Boomers and Gen Xers.[2] While trillion dollar deficits are useful in focusing attention on this problem, they do little to help policy makers understand exactly where these deficits are coming from.[3] For example, Figure 3 provides information on the average individual retirement income deficits by the number of future years eligible for coverage in a defined contribution retirement plan for Gen Xers. These Retirement Savings Shortfalls (RSS) are present values at retirement age and represent the additional amount each individual in that group would need to have accumulated at age 65 to eliminate their expected deficits in retirement (which could be a relatively short period or could last decades). The values for those assumed to have no future years of eligibility is approximately $78,000 per individual. The number decreases substantially for those with 1-9 years of future eligibility to $55,000 and even further to $39,000 for those with 10-19 years of future eligibility. Gen Xers fortunate enough to have at least twenty years of future eligibility find their average deficits reduced to only $23,000.

Figure 4 provides similar information for the impact of future eligibility for defined contribution plans for Gen Xers although this time the analysis also controls for relative levels of pre-retirement income. For those in the lowest income quartile, the average deficit declines from approximately $106,000 for those with no years of future eligibility to approximately $66,000 for those with twenty or more years. A similar reduction is found for the higher income quartiles.

3 Impact of tax favored retirement accounts on retirement income adequacy

Previous research by EBRI has demonstrated that one of the most important factors contributing to retirement income adequacy for the Boomers and Gen Xers is eligibility to participate in employment-based retirement plans. VanDerhei (August 2011) provides information on how the relative value of the defined benefit accruals impact retirement income adequacy. Figure 5 categorizes any positive value for a defined benefit accrual into quartiles for each income group. The largest reduction in at-risk ratings between the highest and lowest income-specific defined benefit value quartiles takes place for the lowest-income quartile. For these households, the at-risk ratings drop 36 percentage points, from 82 percent to 46 percent. Households in the second income quartile drop 25 percentage points (from an at-risk rating of 58 percent for those in the lowest defined benefit value quartile to 33 percent for those in the highest defined benefit value quartile) while those in the third and highest income quartile drop 24 and 21 percentage points, respectively.

Figure 6 provides similar information for eligibility in defined contribution plans for Gen Xers in 2012. In this case we see that the number of future years the workers are eligible for participation in a defined contribution plan makes a tremendous difference in their at-risk ratings. For example, Gen Xers with no future years of eligibility are simulated to run short of money 60.7 percent of the time, whereas those with twenty or more years of future eligibility would only experience this situation 18.2 percent of the time.

4 The value of tax-favored retirement accounts under current tax provisions: the case of 401(k) plans

Given the phenomenal growth of defined contribution plans (especially those with a 401(k) feature) in the private sector in the last three decades, it appears that this form of employer-provided retirement plan will provide a substantial percentage of non-Social Security retirement wealth for Baby Boomers and Gen Xers. Unfortunately, the "success" of these plans are sometimes measured by metrics that are not at all relevant to the potential for defined contribution plans to provide a significant portion of a worker's pre-retirement income. For example, some analysts will merely report the average balance in defined contribution plans (most commonly the 401(k) subset of this universe) and attempt to assess the value of these plans by determining the amount of annual income that this lump sum amount could be converted to at retirement age. Of course, this concept does not adjust for the fact that the vast majority of 401(k) participants are years, if not decades, away from retirement age. Moreover, even if one does look at the average balances for workers near retirement age, it is obviously not correct to look only at the 401(k) balance with the employee's current employer. [4]

4.1 Average account balances

In an attempt to provide meaningful statistics on the 401(k) system, EBRI entered into a collaborative effort with the Investment Company Institute (ICI) in 1996 known as the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project. As of December 31, 2010,[5] the database included participant-level information about:

- 23.4 million 401(k) plan participants, in
- 64,455 employer-sponsored 401(k) plans, holding
- $ 1.414 trillion in assets.

Since the inception of the project, average balances have been displayed as a function of both the participant's age and tenure with the current employer to allow a more meaningful assessment of the accumulation potential of these plans. VanDerhei, Holden, Alonso and Bass (2011) computed an overall average account balance at year-end 2010 of $60,329; however, the average value for participants in their 60's was much more representative of what a participant would have available for retirement. Even looking at participants in this age cohort may be misleading unless one controls for tenure with the current employer. For example, participants in their 60's with no more than two years of tenure had an average account balance at the end of 2010 of $26,649.[6] The longest tenured participants in their 60's had been with the current employer for at least 30 years and had an average account balance of $202,329.

While the $202,329 value is considerably larger than the often-reported overall balance of $60,329, it is still not a fair representation of what a full-career's participation in a 401(k) plan might produce in terms of income replacement in retirement for several reasons:

- Some of the participants in their 60's may still plan to work several additional years before they retire.
- Even though a participant has at least thirty years of tenure with the current employer, it does not mean not the 401(k) plan has been in place for the entire period. Moreover, there is no guarantee that the employee who is participating in 2010 has done so the entire time they were eligible.
- Many of the participants in their 60's have already started to withdrawal money from their account balances. Figure 7 shows the average account balance for similarly long-tenured participants who were 55-64 in 2010. However, in this case only participants with a positive value for the sum of employee and employer contributions in 2010 were included. The year-end 2010 average account balance for this group was $255,075. Projections were also performed based on 2010 asset allocation and contribution behavior as well as subsequent market performance. The estimated year-end 2011 average account balance for this group was $272,681 and the value for the end of first quarter 2012 was $292,258.

Since 1999, average balances are also computed for a "consistent sample" of participants to control for the downward bias that would otherwise exist from IRA rollovers when 401(k) participants change jobs.[7] VanDerhei, Holden and Alonso (2010) report on the average account balances among 401(k) participants present from year-end 1999 through year-end 2009 and find the overall average increases from $67,420 at year-end 1999 to $131,438 at year-end 2009, an increase of 95.0%.[8]

4.2 Simulation results for voluntary enrollment 401(k) plans

Even with these empirical techniques, it is difficult to obtain a true value of the 401(k) system's potential to generate significant 401(k) accumulations over an entire working career when many of today's retirees only had access to a 401(k) plan for a portion of their career.[9] In an attempt to control for these problems, EBRI and ICI produced a joint publication in 2002[10] with simulation results showing that under a continuous coverage situation, 401(k) participants could expect to replace someplace between 51 and 69 percent (depending on income quartile) of their pre-retirement income assuming the purchase of a (nominal) annuity at age 65. The lower savings rate for low-income participants is somewhat ameliorated by their Social Security payments representing a relatively large measure of what their pre-retirement income had been. When Social Security benefits (using the current statutory formulae) are added in, the median combined replacement rates in the first year of retirement are 103 percent for the lowest income quartile and between 83 and 86 percent for the highest three income quartiles.[11]

4.3 The "controversy" over automatic enrollment decreasing retirement savings

In an article that appeared in the Wall Street Journal last July, Anne Tergesen[12] suggested that the automatic enrollment (AE) provision for 401(k) plans, a plan design expanded and clarified in the Pension Protection Act of 2006 (PPA), and designed to broaden participation in these programs, was actually suppressing retirement savings. What that article failed to mention is that automatic enrollment is actually increasing savings for many more—especially the lowest-income 401(k) participants.

EBRI has been publishing studies on the likely impact of AE for seven years. In a joint 2005 study with ICI,[13] we looked at the potential change in 401(k)/IRA[14] accumulations as a result of changing traditional voluntary enrollment (VE) 401(k) plans to AE plans. Although we had the advantage of using a database of tens of millions of 401(k) participants (going back in some cases to 1996), data was unavailable with respect to how workers would react to AE provisions, and thus simulated the likely response based on the results of academic studies.[15] What we found was that the overall expected improvement in retirement accumulations—especially for the lower-income quartiles—were nothing less than spectacular.

One point that had previously been made clear in the academic literature was that some workers defaulted into a 401(k) AE plan (without automatic escalation provisions) would continue to contribute at the defaulted contribution rate that the plan sponsor had chosen (typically in the range of 3 percent of compensation). Traditionally, and in the absence of these AE provisions, many workers have chosen to start contributing at a 6 percent rate (largely in response to the matching contribution incentive provided by the employer). However, some participants in AE plans – who otherwise might have voluntarily chosen to participate at a higher contribution level –instead might simply allow their savings to start – and remain – at the default rate. As a result, they were likely contributing at a lower rate than if they been working for a plan sponsor offering a VE 401(k) plan AND had made a positive election to participate.

This anchoring effect can be seen by looking at the top-income quartile in the 2005 study, where the median replacement rate for the top-income quartile decreased by 4 percentage points for the scenario with a 3 percent contribution rate and default investment in a money market fund.[16] However, it would appear that this was more than offset by the increase in participation for the lower-income quartiles due to auto-enrollment, resulting in substantial increases in their retirement accumulations (for the same scenario as mentioned above, the third-income quartile's median replacement rate increased 2 percentage points, the second-income quartile increased 7 percentage points, and the lowest-income quartile increased 14 percentage points). In sum, while some workers saved less than they might otherwise, more workers saved.

A year after this study was released, Congress passed the Pension Protection Act of 2006, or PPA, which eased some of the administrative barriers to providing AE and for the first time outlined safe harbor provisions for automatic escalation. Although it was too soon to know how plan sponsors would respond to this new clarity, EBRI published a study in 2007[17] that showed how automatic escalation – the systematic increase of deferral rates over time - would render even more favorable results for AE designs under a number of different scenarios.

In 2008, EBRI included all the new PPA provisions in a study[18] that compared potential accumulations under AE and VE for several different age groups. Again, we found certain (high-income) groups were likely to do better under VE than AE, but overall, the AE results dominated.[19] Note that the AE design itself in no way precludes these high-income groups from increasing their initial default rates.

By 2009, many of the 401(k) sponsors who previously had VE plans had shifted to AE plans and EBRI was able to track the changes in plan provisions for hundreds of the largest 401(k) plans. This information was used in an April 2010 EBRI Issue Brief[20] to show, once again, the significant impact of moving to AE plans: for those currently ages 25–29, the difference in the median accumulations at normal retirement age would be approximately 2.39 times final salary in an AE plan relative to a VE plan.

Later that year, VanDerhei and Lucas (2010) focused on how to improve plan design and worker education to optimize the results under AE plans with automatic escalation of contributions. While it is difficult to determine a precise "target" for retirement savings, we tried to demonstrate these designs' ability to produce what, by most financial planning standards, appears to be quite generous: an 80 percent real income replacement rate in retirement, when 401(k) accumulations are combined with Social Security. Figure 8 demonstrates that if the most pessimistic[21] combination of plan design and worker behavioral assumptions were used in the AE plans studied, 45.7 percent of the lowest-income quartile would obtain this threshold,[22] and in view of the way in which Social Security benefits are designed, an even lower percentage of the highest-income quartile (27 percent) would reach the 80 percent threshold.

The study found that with the all-optimistic assumptions, the percentage of lowest-income quartile workers achieving the 80 percent threshold increased to 79.2 percent, while that of the highest-income quartile workers increased to 64 percent.

Surprisingly, the Wall Street Journal article reported only the most pessimistic set of assumptions, and did not cite any of the other 15 combinations of assumptions in the study. The article also reported only results under the threshold of a real replacement rate of 80 percent, while Figure 9 shows that even decreasing the threshold to a 70 percent real replacement rate would increase the percentage of "successful" retirement events by 19 percentage points for the lowest-income quartile and 12 percentage points for the highest-income quartile under the all-pessimistic set of assumptions.

The other statistic attributed to EBRI in the article dealt with the percentage of AE-eligible workers who would be expected to have larger tenure-specific worker contribution rates had they been VE-eligible instead. The simulation results we provided showed that approximately 60 percent of the AE-eligible workers would immediately be better off in an AE plan than in a VE plan, and that over time (as automatic escalation provisions took effect for some of the workers) that would increase to 85 percent.

The Wall Street Journal article did not report the positive impact of auto-enrollment 401(k) plans on many workers who began to save for retirement due to AE. As with any change, some people will not have the most desirable results; but if the focus of auto-enrollment is to increase participation among lower-income participants (and, as a result, their retirement financial preparedness), objective analysis suggests auto-enrollment does indeed achieve that goal.

4.4 Summary

To summarize, it appears from both empirical analysis and simulation results based on tens of millions of individual participant observations (dating all the way back to 1996 in many cases), that the traditional (VE) type of 401(k) plan under the current set of tax incentives has the potential to generate a sum that, combined with Social Security benefits. would replace a sizeable portion of the employee's preretirement income for those fortunate enough to have continuous coverage during their working careers. Moreover, the AE type of 401(k) plan when combined with automatic escalation provisions appears to have the potential to produce even larger retirement accumulations for many of those covered by such a plan during a significant portion of their working careers.

5 Changing tax incentives

5.1 Results From the 2011 Retirement Confidence Survey

VanDerhei (March, 2011) provides an analysis of two new questions from the 21st wave of the Retirement Confidence Survey (RCS)[23] showing how workers[24] would likely react if they were no longer allowed to deduct retirement savings plan contributions from taxable income.

Although analysis based on financial economics suggests that higher-income employees would be the most likely to be negatively affected by a proposal to cut or eliminate the deductibility of 401(k) contributions (at least to the point they are constrained with respect to the annual funds available to contribute to a 401(k) plan),[25] behavioral economics has shown that the reaction of employees in situations similar to this can be at odds with what might be predicted by an objective focused strictly on optimizing a particular financial strategy. In an attempt to better understand potential employee behavior with respect to a proposed elimination of deductions for 401(k) contributions, the 2011 RCS included two new questions. The first asked respondents how important is being able to deduct their retirement savings plan contributions from their taxable income in encouraging them to save for retirement. When confined to full-time workers (n=591), the weighted results were as follows:[26]

Not at all important	4.3%
Not too important	5.0%
Somewhat important	27.8%
Very important	61.5%

If one were to look at this from a strictly financial perspective, one would assume that the lower-income individuals (those most likely to pay no or low marginal tax rates and therefore have a smaller financial incentive to deduct retirement savings contributions from taxable income) would be least likely to rate this as "very important." However, those in the lowest household income category ($15,000 to less than $25,000) actually have the largest percentage of respondents classifying the tax deductibility of contributions as very important (76.2 percent).

The second question asked of those currently saving for retirement was "Suppose you were no longer allowed to deduct retirement savings plan contributions from your taxable income. What do you think you (and your spouse) would be most likely to do?" When confined to full-time workers (n=460), and eliminating those who refused to answer or responded that they did not know, approximately 1 in 4 full-time workers (25.6 percent) indicated that they would reduce (in some cases completely) their contributions if the ability to deduct them was eliminated. The lowest-income category ($15,000 to less than $25,000) has the largest negative reaction to this proposal, with 56.7 percent indicating a savings reduction.

A similar occurrence takes place when the percentage of those stating they would reduce the amount they are saving or stop saving altogether is displayed by the amount they currently have in savings and investments, not including the value of their primary residence or the value of defined benefit plans. There is a significant increase in the self-reported propensity to reduce savings for those in the lowest savings categories. For example, of the full-time workers who are currently saving for retirement who report that they currently have less than $1,000, 71.3 percent indicate they would reduce the amount saved. This value declines to 38.8 percent for those with savings of $1,000 to less than $10,000.

6 The Potential Impact of Tax Reform on Retirement Security

Prior to estimating the potential reductions in accumulations resulting from reduced 401(k) contributions, a set of baseline results first needs to be run to determine the likely values if the various tax reform options are not imposed on the current 401(k) system. The model used in this article is based on the 401(k) voluntary enrollment modules from the EBRI Retirement Security Projection Model® (RSPM) and is similar in many respects to the one used in Holden and VanDerhei (2002) in that it looks only at current 401(k) participants and does not attempt to include eligible nonparticipants[27] or workers who are currently not eligible.[28] However, unlike the 2002 model, this analysis assumes no job turnover, withdrawals, or loan defaults.[29]

Using the 401(k) voluntary enrollment modules from RSPM, VanDerhei (November 2011) shows that the median real-replacement rates at age 67 from 401(k) balances exclusively for participants currently ages 25–29 by income quartiles.[30] The values vary from a low of 53 percent for the lowest-income quartile to a high of 77 percent for the highest-income quartile.[31] The simulated rates of return are explained in more detail in VanDerhei and Copeland (2010), but they are based on a stochastic process with a mean equity return of 8.9 percent and a mean fixed-income return of 6.3 percent (expressed in nominal terms).

6.1 20/20 Caps

In December 2010, the National Commission on Fiscal Responsibility and Reform released their long-awaited document on federal debt reduction, "The Moment of Truth." Although their guiding principles and values (pages 13–14) specifically mention the need to keep America sound over the long run by implementing "policies today to ensure that future generations have retirement security, affordable health care, and financial freedom," the document puts forth an example that would modify retirement plans by capping annual "tax-preferred contributions to [the] lower of $20,000[32] or 20% of income" (page 31). This is often referred to as the "20/20 cap."

Even if one were to ignore the potential interaction of the proposed limitations with the present values of accruals under defined benefit plans and/or the existing tax preferences available to some IRA contributions, this alternative formulation of capping tax-preferred contributions would substantially reduce the current limits available under qualified defined contribution plans. Currently, the combination of employee and employer contributions is the lesser of a dollar limit of at least $50,000 per year[33] and a percentage limit of 100 percent of an employee's compensation.[34]

VanDerhei (July, 2011) provides preliminary evidence of the impact of these "20/20 caps" on projected retirement accumulations. If the 20/20 caps are assumed to be imposed starting in 2012, the annual percentage reductions in 401(k) account balances at Social Security normal retirement age are displayed in Figure 10 by age and age-specific income quartiles for all 401(k) participants with salaries in excess of $10,000 and tenure of at least two years.

Two points stand out immediately:

- With the exception of the earliest age cohort[35] (those currently 26–35), the average reduction for any income quartile decreases for older age cohorts. This is due to the fact that those closest to retirement age will have fewer years of future contributions subject to potential reduction as a result of the 20/20 caps.
- Within each of the four age cohorts, the highest-income quartile experiences the largest average percentage reduction from the 20/20 caps. This reaches a maximum value of 15.1 percent for the highest-income quartile for those currently ages 36–45 and falls to 8.6 percent for the highest-income quartile for those currently ages 56–65.

The finding that the highest-income quartile within each age cohort experiences the largest average percentage reduction is no surprise, given the increased likelihood that workers in this cohort either currently exceed the $20,000 (indexed) limit when their contributions are combined with employer contributions or are predicted to do so in the future. However, for each age cohort other than the oldest one, the lowest-income quartile has the second-highest average percentage reductions. Although this may be due to several considerations,[36] it is almost always a result of their current or expected future contributions exceeding 20 percent of compensation when combined with employer contributions. Phrased another way, the 20/20 cap would, as expected, most affect the highest-income workers, but it also would cause a significant reduction in retirement accumulations for the lowest-income workers.

6.2 Modifying the existing tax treatment of worker and employer 401(k) contributions

In September 2011, the U.S. Senate Finance Committee held a hearing on "Tax Reform Options: Promoting Retirement Security." One of the primary topics during the hearing was an assessment of the potential benefits and consequences that may result from a proposal to modify the federal tax treatment of 401(k) plan contributions in exchange for a flat-rate government match. Gale (2011) updated a 2006 analysis by Gale, Gruber, and Orszag and analyzed a plan that would change the treatment of retirement saving in three ways:[37]

> "First, unlike the current system, workers' and firms' contributions to employer-based 401(k) accounts would no longer be excluded from income subject to taxation, contributions to IRAs would no longer be tax-deductible, and any employer contributions to a 401(k) plan would be treated as taxable income to the employee (just as current wages are). Second, all qualified employer and employee contributions would be eligible for a flat-rate refundable tax credit, given to the employee. Third, the credit would be deposited directly into the retirement saving account, as opposed to the current deduction, which simply results in a lower tax payment than otherwise."

Regarding the proposed tax credit, Gale (2011) reports estimates from the Tax Policy Center for both an 18 percent credit and a 30 percent credit. The paper includes a distributional analysis of the winners and losers under the two versions of the proposal; however, the underlying analysis holds retirement saving contributions constant for both employers and participants (page 6). Gale mentions that the proposal "could conceivably affect incentives for firms to offer 401(k)s or pensions" (page 7) but concludes that this seems unlikely. He also dismisses as likely overstated the concern that the tax credit/matches called for in the proposal may discourage employer matches to 401(k) plans, but offers no supporting data for this assumption

These two papers provide an interesting analysis of a proposal with profound public-policy implications. The assumptions based on responses (or lack thereof), both from individual workers and the plan sponsors themselves, will likely be the focus of serious debate. Moreover, public policy consideration of this proposal will undoubtedly be subject to a cost-benefit analysis beyond the assumption that retirement savings contributions will remain constant on the part of participants and/or plan sponsors.

On a cautionary note, it is admittedly very difficult to determine how those workers not currently covered and/or participating in a defined contribution plan would react to this set of incentives, and EBRI will continue to work with actual participant data to better assess some of the behavioral tendencies of this group. Until this type of information is available, it will be quite difficult to fully assess the "benefit" portion of the cost-benefit analysis suggested above. EBRI did provide an analysis of some of the likely "costs" in terms of reduced retirement benefits for those currently in the 401(k) system at a September 2011 Senate Finance Committee hearing. However, no information on plan sponsor reaction to the proposal was available at that time. Consequently, the 2011 EBRI analysis presented there was based on several alternative scenarios.[38] Moreover, the information used to model potential 401(k) participant reaction to the proposal was limited to "an analysis of two new questions from the 21st wave of the Retirement Confidence Survey (RCS) reflecting how workers indicated they would likely react if they were no longer allowed to defer retirement savings plan contributions from taxable income."[39]

6.2.1 New Survey Analysis

6.2.1.1 Plan Sponsors

In recent months, two surveys have provided additional information on potential responses from plan sponsors with respect to this type of proposed modification of the 401(k) system. A survey conducted on behalf of The Principal Financial Group (2011) determined that if workers' ability to deduct any amount of the 401(k) contribution from taxable income was eliminated, 65 percent of the plan sponsors responding to the survey would have less desire to continue offering their 401(k) plan.[40]

A separate survey by AllianceBernstein (2011) provided plan sponsors with the following question:[41]

> Suppose U.S. legislation were enacted such that employees were no longer allowed to deduct retirement savings plan contributions from their federal taxable income. In addition, suppose that the employee had to pay federal income tax on anything an employer contributed to the employee's retirement savings account in the year it was contributed. In exchange for this modification of the current tax incentives, assume the U.S. government would match 18% of whatever was contributed to a retirement savings plan. What do you believe would be the most likely change to your plan?

Responses were obtained from 1,018 plan sponsors grouped into six size categories based on total retirement plan assets.

6.2.1.2 Participants

With respect to potential worker reactions to this proposal, a new set of questions concerning participant behavior in response to the specific federal tax modifications proposed in Gale (2011) was included in the 2012 RCS. Specifically, workers currently contributing to a workplace retirement plan were asked:

1. Suppose you were no longer allowed to deduct your retirement savings plan contributions for federal income tax purposes and that anything your employer contributed to your retirement savings this year on your behalf was also treated as part of your taxable income. Suppose the government matched 18% of contributions so that for every $100 you or your employer contributed to your retirement savings plan this year, the government would contribute $18. What do you think you would be most likely to do?[42]

a. Stop contributing altogether

b. Reduce the amount you contribute

c. Continue to contribute what you do now

d. Increase the amount you contribute

Follow-up questions were asked of those who indicated they would either increase or decrease the amount they currently contribute:

2. By about how much do you think you would reduce your contribution? Would you:

   a. Reduce it by about a quarter

   b. Cut it in half, or

   c. Reduce it by about three-quarters

3. By about how much do you think you would increase your contribution? Would you increase it by about

   a. A quarter

   b. Half

   c. Three-quarters, or

   d. Double it

6.2.1.3 Impact on 401(k) Balances at Retirement Age

VanDerhei (March 2012) utilizes the defined contribution participant responses to the RCS questions above, as well as the plan sponsor responses to the AllianceBernstein survey, to parameterize the voluntary enrollment module of RSPM in order to estimate the likely impact of the proposed federal-tax modifications on projected 401(k) balances at retirement age, assuming the modifications took effect immediately.

6.2.1.3.1 Age and Salary

Figure 11 shows the baseline average percentage reductions in 401(k) account balances at Social Security normal retirement age due to expected modifications of plan sponsors and participants in reaction to the proposal to modify the federal tax treatment of employer and worker contributions for 401(k) plans in exchange for an 18 percent match from the federal government, by age and age-specific salary quartiles.[43] The average percentage reductions for the youngest cohort (those currently 26–35) are largest for those in the lowest-income quartile (22.2 percent).[44] The reductions for the youngest cohort decrease to 13.0 percent for those in the second-income quartile and reach a minimum of 6.1 percent for those in the third-income quartile. The reductions increase to 10.8 percent for those in the highest-income quartile.

Measuring the impact on older cohorts (those over age 35) is somewhat problematic in that the values are influenced by plan-sponsor and participant reactions to the tax proposal as well as the distribution of tenure with the current employer within each age group. For example, if a 401(k) participant in the oldest cohort (those currently 56–65) has recently changed jobs and has a relatively low account balance in his or her current 401(k) plan, any reported decrease in contributions would have a much larger impact than it would on the same individual (with the same survey response) had that worker not recently changed jobs and had a significantly larger 401(k) balance. Therefore, the analysis in VanDerhei

(March 2012) filters out anyone over age 35 whose tenure with their current employer is less than their current age minus 30.[45]

The average-percentage reductions for the "long-tenure" cohort currently ages 36–45 are again largest for those in the lowest-income quartile (24.9 percent). The reductions for this age cohort decrease to 7.2 percent for those in the second-income quartile and then increase to 10.0 percent for those in the third-income quartile. The reductions increase to 17.1 percent for those in the highest-income quartile.

The average-percentage reductions for the "long-tenure" cohort currently ages 46–55 are largest for those in the lowest-income quartile (21.1 percent). The reductions for this age cohort decrease to 9.9 percent for those in the second-income quartile and then increase to 11.6 percent for those in the third-income quartile. The reductions increase to 14.1 percent for those in the highest-income quartile.

Analysis of the oldest cohort (those currently 56–65) show a marked decrease in the average percentage reductions for the "long-tenure" cohort in the lowest-income quartile (12.7 percent), although it should be noted that the average reduction will be most muted by previous account balances for 401(k) participants in this age group. Moreover, the lowest-income quartile no longer has the largest reduction, as the reduction for the second-income quartile is slightly larger at 13.3 percent. The reductions for this age cohort decrease to 11.4 percent for those in the third-income quartile and then decrease to 8.7 percent for those in the highest-income quartile.

6.2.1.3.2 Plan Size

An interesting finding of the AllianceBernstein survey of plan sponsors with respect to potential federal tax modifications is the impact of plan size on the expected plan sponsor response. The reasons to expect an increased sensitivity by smaller plans to federal tax modifications have previously been documented by others.[46] However, Figure 12 shows the average percentage reductions in 401(k) account balances at Social Security normal retirement age due to expected modifications in response to the proposal to modify the federal tax treatment of employer and worker contributions for 401(k) plans in exchange for an 18 percent match from the federal government, by plan size and age-specific salary quartiles for workers currently ages 26–35.[47] For all four income quartiles, the average percentage reduction for plan sponsors in the two smallest plan size categories (less than $1 million and $1–$10 million in assets) are more than 1.5 times the value of the average percentage reduction for plans sponsors in any of the larger-size categories.

6.2.2 Caveats for This Research

6.2.2.1 Plan Size

Given the much larger simulated account balance reductions for smaller plans shown in Figure 12, it is important to note that the plan-size distribution used in this simulation model is based on those found in the EBRI/Investment Company Institute (ICI) 401(k) database, not the universe of 401(k) plans. Evidence of the magnitude of possible statistical bias in this regard can be found in VanDerhei, Holden, Alonso and Bass (2011). The third panel of Figure 4 (page 8) in that publication shows the distribution of plans in the EBRI/ICI 401(k) database in 2010 vs. 2008 Department of Labor (DOL) Form 5500 for all 401(k) plans and suggests an under-representation of small plans for the EBRI/ICI 401(k) database.[48] The plan-size variable was specified in terms of participants instead of assets, but a similar distribution would be expected in the latter case. If this is indeed the case, the RSPM estimates for overall average benefit reductions presented here would be expected to be smaller than those that would be evidenced by the full 401(k) universe.

6.2.2.2 Automatic Enrollment

The previous results assumed none of the 401(k) participants were automatically enrolled in these retirement plans; instead, they presumed that workers' rate of contribution after the first year were driven primarily by age and income characteristics rather than tenure with the current employer, as they might be in auto-enrollment plans with an automatic escalation of worker contributions.

The exclusion of auto-enrollment plans in this analysis was necessary given the current modeling assumption of no job change. It would be very difficult to provide an accurate analysis of the average percentage reductions in 401(k) balance under auto-enrollment if the plans included an automatic escalation provision. For example, if a participant's contribution rate had already been escalated to 8 percent of compensation at one employer, and upon job change was automatically enrolled into another 401(k) plan, would they "remember" their current rate of deferral and start deferring in the new plan at that rate, or would their contribution rate drop to the default rate of the new plan? Undoubtedly many 401(k) participants in this automatic enrollment situation follow the latter approach. As additional information becomes available on workers' behavioral responses to auto-enrollment, EBRI will update this analysis to provide a more robust model.

7 Future work

In addition to the expansion of the model used for the two analyses above to include 401(k) plans with automatic enrollment, EBRI plans to continue to conduct research in this area as public policy evolves.

The potential reaction of employees not currently participating in 401(k) plans will be extremely difficult to model for new incentive structures. For example, does the current experience under 401(k) plans allow researchers to extrapolate behaviors to this population with respect to:

- Initial participation choices.
- Decisions to opt out once participation has begun.
- Contribution behavior.
- Asset allocation.
- Cash outs at time of job change.

Many of EBRI's previous simulation projects (see Appendix B for a brief chronology) will be directly applicable to such additional research and we will be happy to work with the Committee on Ways and Means to provide cost/benefit assessments of these type proposals in the future.

8 Conclusions

EBRI has documented a significant reduction in the percentage of simulated lifepaths for retired households "at risk" for inadequate retirement income between 2003 and 2012, based in large part on the advent of auto-enrollment in 401(k) plans; however, for Gen Xer households in the two lowest-indexed[49] pre-retirement income quartiles, the at-risk percentages, while much smaller (they were 85 percent for the lowest income quartile and 65 percent for the second lowest income quartile in 2003) are still extremely high (78 percent for the lowest income quartile and 46 percent for the second lowest income quartile in 2012). Of course, when one limits the analysis to those who are simulated to be saving in the future, the numbers improve substantially: among Gen Xer households without any future eligibility for participation in a defined contribution plan, the at-risk percentage is 60.7 percent, but it drops all the way to 18.2 percent for those with 20 or more years of future eligibility.[50]

Given that the financial fate of future generations of retirees appears to be so strongly tied to whether they are eligible to participate in employer-sponsored retirement plans,[51] the logic of modifying (either completely or marginally) the incentive structure of employees and/or employers for defined contribution plans at this time needs to be thoroughly examined. EBRI studies[52] have documented that defined contribution plans (and the IRA rollovers they produce) are the component of retirement security that appears to be generating the most non-Social Security retirement wealth for Baby Boomers and Gen Xers. However, the potential increase of at-risk percentages resulting from (1) employer modifications to existing plans, and (2) a substantial portion of low-income households decreasing or eliminating future contributions to savings plans as a reaction to the exclusion of employee contributions for retirement savings plans from taxable income, needs to be analyzed carefully when considering the overall impact of such proposals.

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10 Appendix A: Brief Description of RSPM[53]

One of the basic objectives of RSPM is to simulate the percentage of the population that will be "at risk" of having retirement income that is inadequate to cover basic expenses and pay for uninsured health care costs for the remainder of their lives once they retire.[54] However, the EBRI Retirement Readiness Rating™ also provides information on the distribution of the likely number of years before those at risk "run short of money," as well as the percentage of compensation they would need in terms of additional savings to have a 50, 70, or 90 percent probability of retirement income adequacy.

Appendix C describes how households (whose heads are currently ages 36–62) are tracked through retirement age, and how their retirement income/wealth is simulated for the following components:

- Social Security.
- Defined contribution balances.
- IRA balances.

- Defined benefit annuities and/or lump-sum distributions.
- Net housing equity.[55]

A household is considered to run short of money in this model if aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures, which are defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income), and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living calculations, and other ad hoc thresholds.

The version of the model used for the analysis in this testimony assumes all workers retire at age 65 and immediately begin to withdraw money from their individual accounts (defined contribution and cash balance plans, as well as IRAs) whenever the sum of their basic expenses and uninsured medical expenses exceed the after-tax[56] annual income from Social Security and defined benefit plans (if any). If there is sufficient money to pay expenses without tapping into the tax-qualified individual accounts,[57] the excess is assumed to be invested in a non-tax-advantaged account where the investment income is taxed as ordinary income.[58] The individual accounts are tracked until the point at which they are depleted; if the Social Security and defined benefit payments are not sufficient to pay basic expenses, the entity is designated as having "run short of money" at that time.

11 Appendix B: Brief Chronology of RSPM

The original version of RSPM was used to analyze the future economic well-being of the retired population at the state level. EBRI and the Milbank Memorial Fund, working with the governor of Oregon, set out in the late 1990s to see if this situation could be addressed for Oregon. The analysis[59] focused primarily on simulated retirement wealth with a comparison to ad hoc thresholds for retirement expenditures, but the results made it clear that major decisions lie ahead if the state's population was to have adequate resources in retirement.

Subsequent to the release of the Oregon study, it was decided that the approach could be applied to other states as well. Kansas and Massachusetts were chosen as the next states for analysis. Results of the Kansas study were presented to the state's Long-Term Care Services Task Force on July 11, 2002,[60] and the results of the Massachusetts study were presented on Dec. 1, 2002.[61] With the assistance of the Kansas Insurance Department, EBRI was able to create Retirement Readiness Ratings based on a full stochastic decumulation model that took into account the household's longevity risk, post-retirement investment risk, and exposure to potentially catastrophic nursing-home and home-health-care risks. This was followed by the expansion of RSPM and the Retirement Readiness Ratings to a national model and the presentation of the first micro-simulation retirement-income-adequacy model built in part from administrative 401(k) data at the EBRI December 2003 policy forum.[62] The basic model was then modified for testimony for the Senate Special Committee on Aging in 2004 to quantify the beneficial impact of a mandatory contribution of 5 percent of compensation.[63]

The first major modification of the model was presented at the EBRI May 2004 policy forum. In an analysis to determine the impact of annuitizing defined contribution and IRA balances at retirement age, VanDerhei and Copeland, 2004, were able to demonstrate that for a household seeking a 75 percent probability of retirement income adequacy, the additional savings that would otherwise need to be set aside each year until retirement to achieve this objective would decrease by a median amount of 30 percent. Additional refinements were introduced in 2005 to evaluate the impact of purchasing long-term care insurance on retirement income adequacy.[64]

The model was next used in March of 2006 to evaluate the impact of defined benefit freezes on participants by simulating the minimum employer-contribution rate that would be needed to financially indemnify the employees for the reduction in their expected retirement income under various rate-of-return assumptions.[65] Later that year, an updated version of the model was developed to enhance the EBRI interactive Ballpark E$timate[*] worksheet by providing Monte Carlo simulations of the necessary replacement rates needed for specific probabilities of retirement-income adequacy under alternative-risk-management treatments.[66]

RSPM was significantly enhanced for the May 2008 EBRI policy forum by allowing automatic enrollment of 401(k) participants with the potential for automatic escalation of contributions to be included.[67] Additional modifications were added in 2009 for a Pension Research Council presentation that involved a winners/losers analysis of defined benefit freezes and the enhanced employer contributions to defined contribution plans provided at the time the defined benefit plan was frozen.[68]

A new subroutine was added to the model to allow simulations of various styles of target-date funds for a comparison with participant-directed investments in 2009.[69] In April 2010, the model was completely re-parameterized with 401(k) plan-design parameters for sponsors that have adopted automatic-enrollment provisions.[70] A completely updated version of the national model was produced for the May 2010 EBRI policy forum and used in the July 2010 *Issue Brief.*[71]

The new model was used to analyze how eligibility for participation in a defined contribution plan impacts retirement income adequacy in September 2010.[72] It was also used to compute retirement savings shortfalls for Baby Boomers and Generation Xers in October 2010.[73]

In October 2010 testimony before the Senate Health, Education, Labor and Pensions Committee on "The Wobbly Stool: Retirement (In)security in America," the model was used to analyze the relative importance of employer-provided retirement benefits and Social Security.[74]

In February 2011, the model was used to analyze the impact of the 2008-2009 crisis in the financial and real estate markets on retirement income adequacy.[75]

An April 2011 article introduced a new method of analyzing the results from the RSPM.[76] Instead of simply computing an overall percentage of the simulated life paths in a particular cohort that will not have sufficient retirement income to pay for the simulated expenses, the new method computed the percentage of households that would meet that requirement more than a specified percentage of times in the simulation.

As explored in the June 2011 *Issue Brief,* the RSPM allowed retirement-income adequacy to be assessed at retirement ages later than 65.[77]

In a July 2011 *Notes* article[78], it provided preliminary evidence of the impact of the "20/20 caps" proposed by the National Commission on Fiscal Responsibility and Reform on projected retirement accumulations.

The August 2011 *Notes* article[79] evaluated the importance of defined benefit plans for households, assuming they retire at age 65, while demonstrating the impact of defined benefit plans in achieving retirement income adequacy for Baby Boomers and Gen Xers.

Finally, the September 2011 Senate Finance testimony[80] analyzed the potential impact of various types of tax-reform options on retirement income adequacy. This was expanded in the November 2011 EBRI Issue Brief[81] and a new set of survey results were added to the model in the March 2012 Notes article.[82]

12 Appendix C: Impact of the financial and housing market crisis in 2008 and 2009 on retirement readiness

The analysis in VanDerhei (February 2011) was designed to answer two questions:

1. What percentage of U.S. households became "at risk" of insufficient retirement income as a result of the financial market and real estate market crisis in 2008 and 2009?
2. Of those who are at risk, what additional savings do they need to make each year until retirement age to make up for their losses from the crisis?

As one would expect, the answer to the first question depends to a large extent on the size of the account balance the household had in defined contribution plans and/or IRAs as well as their relative exposure to fluctuations in the housing market. The resulting percentages of households that would not have been "at risk" without the 2008/9 crisis that ended up "at risk" vary from a low of 3.8 percent to a high of 14.3 percent.

The answer to the second question also depends on the size of account balances and exposure to the equity market; however, it is a more complicated question involving both the proximity of the household to retirement age (the closer to retirement age, the fewer years of additional savings available), the relative level of preretirement income, and the desired probability of adequate retirement income.

Looking at all households that would need to save an additional amount (over and above the savings already factored into the baseline model), the median percentage of additional compensation for Early Boomers desiring a 50 percent probability of retirement income adequacy would be 3.0 percent of compensation each year until retirement age to account for the financial and housing market crisis in 2008 and 2009. Similar values are 0.9 percent for Late Boomers and 0.3 percent for Gen Xers. A 90 percent probability of retirement income adequacy would require an even larger increase: The median percentage of additional compensation for Early Boomers desiring a 90 percent probability of retirement income adequacy would be 4.3 percent, to account for the financial and housing market crisis in 2008 and 2009.

Looking only at those households that had exposure to the market crisis in 2008 and 2009 from all three fronts (defined contribution plans, IRAs, and net housing equity) shows a median percentage for Early Boomers of 5.6 percent for a 50 percent probability and 6.7 percent for a 90 percent probability of retirement income adequacy. Younger cohorts experience a similar increase, going from the all-household analysis to the more select group.

13 Endnotes

1 A brief description of the EBRI Retirement Security Projection Model® (RSPM) is provided in Appendix A followed by a chronology of its development and utilization in Appendix B. See Appendix C for additional detail on the impact of the 2008-2009 crises in the financial and real estate markets on retirement income adequacy.

2 This number is somewhat smaller than the $4.6 trillion reported in VanDerhei (October 2010); however, the baseline assumptions used in the 2010 analysis did not allow for the utilization of net housing equity to ensure retirement income adequacy. When the 2012 analysis is repeated with the same assumptions as used in 2010, the aggregate deficit increases to $4.8 trillion.

3 Unfortunately one of the most significant components of Retirement Savings Shortfalls comes from an exposure that faces most retirees, however, very few of them choose to actively treat this risk. VanDerhei (October 2010) provides a first-order approximation of the impact of the stochastic nature of the nursing home and home health care expenses on the RSS values by age cohort, gender and marital status. Adding the nursing home and home health care expense <u>increases</u> the average individual RSS for married households by $25,317. Single males experience an average <u>increase</u> of $32,433 while single females have an <u>increase</u> of $46,425. A precise evaluation of the impact would involve a comparison of the values supplemented with the premia required to fully insure the financial consequence of nursing home and home health care expenses. For an example of this comparison with a different output metric, see VanDerhei (2005).

4 For example, an employee age 60 may have very recently changed jobs and rolled over a substantial account balance from his previous employer to an IRA.

5 Year-end 2011 data is currently being analyzed and the annual update will be available later in the year.

6 This value increased to $37,560 for participants in their 60's with 2-5 years of tenure and $53,108 for those with 5-10 years of tenure. Participants in their 60's with 10-20 years of tenure had an average account balance of $89,956 and those with 20-30 years had an average account balance of $159,654.

7 EBRI is currently in the process of integrating year-end 2010 account balances of 401(k) participants with their 2010 IRA account balances. Preliminary findings suggest the need for analyzing the combined IRA and 401(k) balances when attempting to assess any form of comprehensive retirement income adequacy. For example, VanDerhei (April 2012) analyzed the median ratios of combined 401(k) and IRA balances as a multiple of 401(k) balance by age and tenure for individuals with both 401(k) and IRA balances at the end of 2010. For individuals in their 60's, a median ratio of 1.23 was found for individuals with at least thirty years of tenure with the current employer. This number increased to 8.53 for those with no more than two years of tenure with the current employer.

8 Year-end 2010 data is currently being merged with the consistent sample.

9 The proposed regulations for 401(k) plans were published in November 1981 and much of the growth in these plans took place in the next few years.

10 Holden and VanDerhei (2002).

11 It should be noted that this combination is in essence adding a nominal annuity for the 401(k) accumulations with a real annuity from Social Security. Given the larger replacement rates for the lowest income quartile under Social Security, the disparity in favor of the lower income would increase as the retirees grow older.

12 Tergesen (2011).

13 Holden and VanDerhei (2005).

14 IRA rollovers that originated from 401(k) plans are included in the projected accumulations.

15 Choi, Laibson, Madrian, and Metrick (2001) and Choi, Laibson, Madrian, and Metrick (2004).

16 Figure 1 of Holden and VanDerhei (2005).

17 VanDerhei (September 2007).

18 VanDerhei and Copeland (2008).

19 Figures 6 and 7 of VanDerhei and Copeland (2008)

20 VanDerhei (April 2010)

21 The lowest rates are experienced by employees who do not "remember" their previous contribution rates when they change jobs, have a stochastic opt-out of the automatic escalation, and participate in plans that limit the automatic contributions to 6 percent of compensation and increase the contributions by 1 percent per year (the "all-pessimistic" assumption scenario). In contrast, the highest rates are experienced by employees who do "remember" their previous contribution rates when they change jobs, do not opt-out of the automatic escalation, and participate in plans that allow the automatic contributions to increase to 15 percent of compensation and increase the contributions by 2 percent per year (the "all-optimistic" assumption scenario).

22 Results are limited to employees currently ages 25–29 and assumed to have 31–40 years of eligibility

23 These findings are part of the 21st annual Retirement Confidence Survey (RCS), a survey that gauges the views and attitudes of working-age and retired Americans regarding retirement, their preparations for retirement, their confidence with regard to various aspects of retirement, and related issues. The survey was conducted in January 2011 through 20-minute telephone interviews with 1,258 individuals (1,004 workers and 254 retirees) age 25 and older in the United States. Random digit dialing was used to obtain a representative cross section of the U.S. population. To further increase representation, a cell phone supplement was added to the sample. Starting with the 2001 wave of the RCS, all data are weighted by age, sex, and education to reflect the actual proportions in the adult population. Data for waves of the RCS conducted before 2001 have been weighted to allow for consistent comparisons; consequently, some data in the 2011 RCS may differ slightly with data published in previous waves of the RCS. Data presented in tables in this report may not total to 100 due to rounding and/or missing categories. In theory, the weighted sample of 1,258 yields a statistical precision of plus or minus 3 percentage points (with 95 percent certainty) of what the results would be if all Americans age 25 and older were surveyed with complete accuracy. There are other possible sources of error in all surveys, however, that may be more serious than theoretical calculations of sampling error. These include refusals to be interviewed and other forms of nonresponse, the effects of question wording and question order, and screening. While attempts are made to minimize these factors, it is impossible to quantify the errors that may result from them. The RCS was co-sponsored by the Employee Benefit Research Institute (EBRI), a private, nonprofit, nonpartisan public policy research organization, and Mathew Greenwald & Associates, Inc., a Washington, DC, based market research firm. The 2011 RCS data collection was funded by grants from more than two dozen public and private organizations, with staff time donated by EBRI and Greenwald. RCS materials and a list of underwriters may be accessed at the EBRI Web site: www.ebri.org/rcs. For more detail, see Helman, Copeland, and VanDerhei (March 2011, online at www.ebri.org/surveys/rcs/2011/).

24 In the RCS, retiree refers to individuals who are retired or who are age 65 or older and not employed full time. Worker refers to all individuals who are not defined as retirees, regardless of employment status.

25 Actually, the constraints would need to be compared to the 402(g) limit as well as any plan-specific constraints on tax contributions (primarily for the Highly Compensated Employees).

26 1.4 percent responded that they did not know.

27 See Holden and VanDerhei (2005).

28 See VanDerhei and Copeland (2008).

29 The full stochastic nature of the model will be included in future analysis.

30 It is important to note that the annuitized accumulations in this analysis are from 401(k) contributions exclusively and do not include projected Social Security retirement benefits. This is in contrast to other EBRI research (e.g., VanDerhei and Lucas, 2010) that includes both components. However, in the previous analysis, all workers were simulated and job change was allowed.

31 These estimates compare quite favorably to those in Holden and VanDerhei (2002) when the difference between nominal and real replacement rates are considered. However, this is to be expected given the assumptions listed above (especially the lack of job turnover and therefore the suppression of cashouts prior to retirement).

32 Presumably, the $20,000 figure would be indexed for inflation in the future similar to current treatment of IRC Sec. 415(c) limits.

33 Employees age 50 or over may be allowed to contribute up to an additional $5,500 per year.

34 Sec. 415(c) of the Internal Revenue Code.

35 The reason that the youngest age cohort does not follow this trend is due to their relatively lower current wages than older cohorts after adjusting for historic age/wage profiles.

36 Although additional analysis needs to be performed before assessing relative importance of these factors, it appears that this result is caused by at least two factors. First, the definition of income quartile in RSPM is determined in a manner similar to the average indexed monthly earnings computation for Social Security with the following modifications: (a) All earned income is included up to the age of retirement (i.e., there is no maximum taxable wage base constraint and the calculation terminates at retirement age); (b) Instead of indexing for changes in average national wages, the model indexes based on assumed after-tax rate of return based on asset allocations that are a function of the individual's age in each year; and (c) Percentile distributions are established based on population statistics for each age cohort. Therefore, it is possible that an individual whose preretirement income ranks in the lowest quartile over their remaining work history may indeed end up with an income that would rank higher than the bottom quarter in one or more specific years. Second, the impact of the 20 percent limitation for the lowest-income quartile may fall disproportionately on the part-time workers. For example, a worker who enters the work force part time whose spouse already has a full-time job may be in a better situation to attempt to maximize retirement contributions on his/her income. Although EBRI is in the process of attempting to model the impact on part-timers on a longitudinal basis, the current analysis filtered out any 401(k) participants with annual income of less than $10,000 as well as those with less than two years of tenure.

37 Gale (2011).

38 The analysis for the Senate Finance Committee hearing modeled the following scenarios:

- Employer contributions are modified in such a manner that the total match (employer plus government match) remains constant.
- All plan sponsors drop the plan match, and all employees receive a 30 percent match from the government.
- All plan sponsors drop the plan match, and all employees receive an 18 percent match from the government.

In later EBRI analysis (VanDerhei, November 2011), the following scenarios were added:

- No plan sponsors drop the plan match, and all employees receive an 18 percent match from the government.
- No plan sponsors drop the plan match, and all employees receive a 30 percent match from the government.

39 VanDerhei (September 2011). The 2011 RCS questions were fielded in January 2011 and therefore did not ask 401(k) participants about the specific provisions used in the September 2011 Gale proposal.

40 This survey was conducted online within the United States by Harris Interactive commissioned by the Principal Financial Group from May 17– June 17, 2011. It surveyed 798 employee-benefit decision makers for companies with three to 1,000 employees that do offer defined contribution retirement plans. These decision makers were selected from a Principal Financial Group client list, and their data were not weighted.

41 A similar question was asked with the 30 percent government match provision suggested in Gale, Gruber, and Orszag (2006).

42 A similar question was asked for a 30 percent government match. However, follow-up information for those indicating an increase or decrease in contributions is not available.

43 The baseline results in Figures 11 and 12 were simulated assuming the midpoint value for each category in the AllianceBernstein survey. Sensitivity analysis of this assumption is shown in Figures 3 and 4 of VanDerhei (March 2012) for the minimum reduction in account balances, and in Figures 5 and 6 of the same publication for the maximum reduction in account balances. The average percentage reductions in account value in Figure 3 vary from 3.1 to 19.7 percent (depending on income quartile) for 401(k) participants currently 26–35 under the minimum reduction scenario. Figure 5 shows that they vary from 8.8 to 24.4 percent (depending on income quartile) for 401(k) participants currently 26–35 under the maximum reduction scenario

44 Under the baseline assumptions, the average percentage reduction in employee contributions for this group in response to the proposal is 14.3 percent. Account balances will also be reduced due to the plan-sponsor reaction.

45 For example, a 40-year-old participant would need to have a tenure of at least 10 years with the current employer to be included in this analysis. Alternative specifications of minimum tenure were used with essentially the same results.

46 See pages 10–11 of Miller (2011) for an example.

47 Given the much larger simulated account balance reductions for smaller plans shown in Figure 12, it is important to note that the plan-size distribution used in this simulation model is based on those found in the EBRI/Investment Company Institute (ICI) 401(k) database, not the universe of 401(k) plans. Evidence of the magnitude of possible statistical bias in this regard can be found in VanDerhei, Holden, Alonso and Bass (2011). The third panel of Figure 4 (page 8) in that publication shows the distribution of plans in the EBRI/ICI 401(k) database in 2010 vs. 2008 Department of Labor (DOL) Form 5500 for all 401(k) plans and suggests an under-representation of small plans for the EBRI/ICI 401(k) database. The plan-size variable was specified in terms of participants instead of assets, but a similar distribution would be expected in the latter case. If this is indeed the case, the RSPM estimates for overall average benefit reductions presented here would be expected to be smaller than those that would be evidenced by the full 401(k) universe.

48 The EBRI/ICI Participant-Directed Retirement Plan Data Collection Project (the EBRI/ICI 401(k) database) is the largest, most representative repository of information about individual 401(k) plan participant accounts. See VanDerhei, Holden, Alonso and Bass (2011).

49 See endnote 17 of VanDerhei and Copeland (July 2010) for more detail.

50 VanDerhei (September 2010) also demonstrates that eligibility for a defined contribution retirement plan has a significant positive impact on reducing the additional compensation most families need to achieve the desired level of retirement income adequacy.

51 See VanDerhei (August 2011) for evidence of the importance of participating in a defined benefit plan.

52 VanDerhei and Copeland (2002a).

53 This material first appeared in VanDerhei and Copeland (July 2010).

54 The nominal cost of these expenditures increases with component-specific inflation assumptions. See the appendix for more details.

55 Net housing equity is introduced into the model in three different mechanisms (explained below).

56 IRS tax tables from 2009 are used to compute the tax owed on the amounts received from defined benefit plans and Social Security (with the percentage of Social Security benefits subject to Federal Income Tax proxied as a function of the various retirement income components) as well as the individual account withdrawals.

57 Roth IRA and 401(k) accounts are not used in this version of the model but will be incorporated into a forthcoming EBRI publication.

58 Capital gains treatment is not used in this version of the model.

59 VanDerhei and Copeland (2001).

60 VanDerhei and Copeland (July 2002).

61 VanDerhei and Copeland (December 2002).

62 VanDerhei and Copeland (2003)

63 VanDerhei (January 2004).

64 VanDerhei (2005).

65 VanDerhei (March 2006).

66 VanDerhei (September 2006)

67 VanDerhei and Copeland (2008).

68 Copeland and VanDerhei (2010).

69 VanDerhei (2009).

70 VanDerhei (April 2010).

71 VanDerhei and Copeland (2010).

72 VanDerhei (September 2010).

73 VanDerhei (October 2010a).

74 VanDerhei (October 2010b).

75 VanDerhei (February 2011).

76 VanDerhei (April 2011).

77 VanDerhei and Copeland (June 2011).

78 VanDerhei (July 2011).

79 VanDerhei (August 2011).

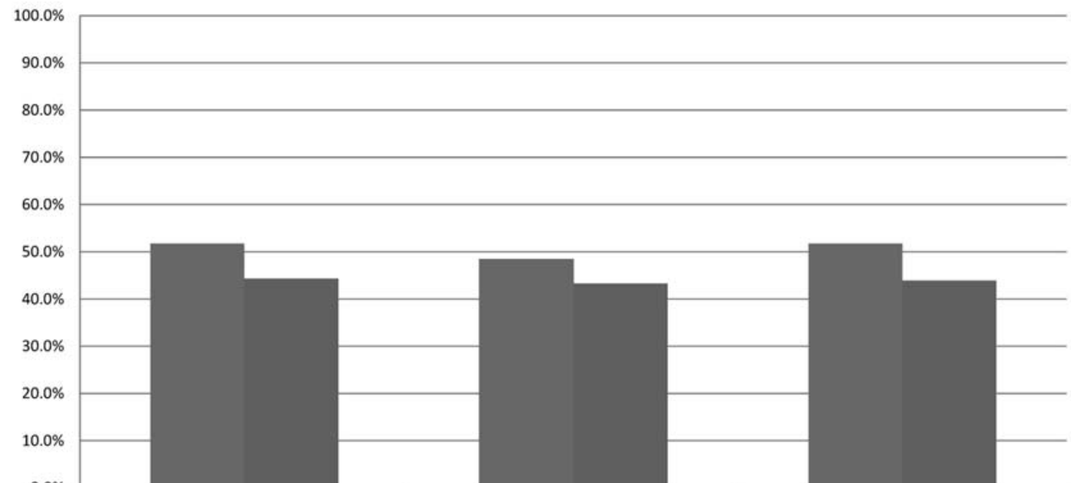
80 VanDerhei (September 2011).

81 VanDerhei (November 2011)

82 VanDerhei (March 2012).

Figure 1

EBRI Retirement Readiness Rating™ (RRR): 2003 vs. 2012
(Status Quo for Social Security, Housing Equity Used "As Needed")
Percentage of population at risk* for inadequate retirement income, by age cohort (baseline assumptions)

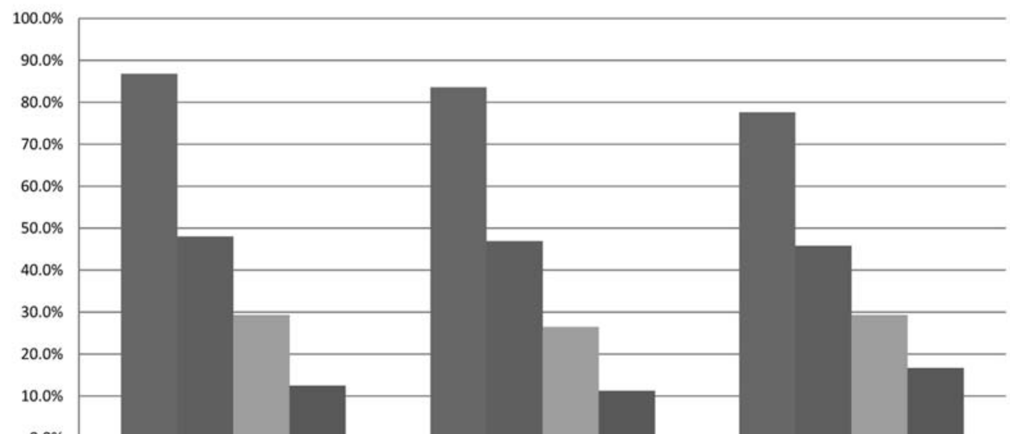


	Early Boomers	Late Boomers	Gen Xers
EBRI 2003 RRR	51.7%	48.5%	51.7%
EBRI 2012 RRR	44.3%	43.3%	43.9%

Sources: EBRI Retirement Security Projection Model™ versions 1501 and 1502.
* See text for definition of "at risk"

Figure 2

EBRI Retirement Readiness Rating™ (RRR): 2012
(Status Quo for Social Security, Housing Equity Used "As Needed")
Percentage of population at risk* for inadequate retirement income, by age cohort and income quartile (baseline assumptions)

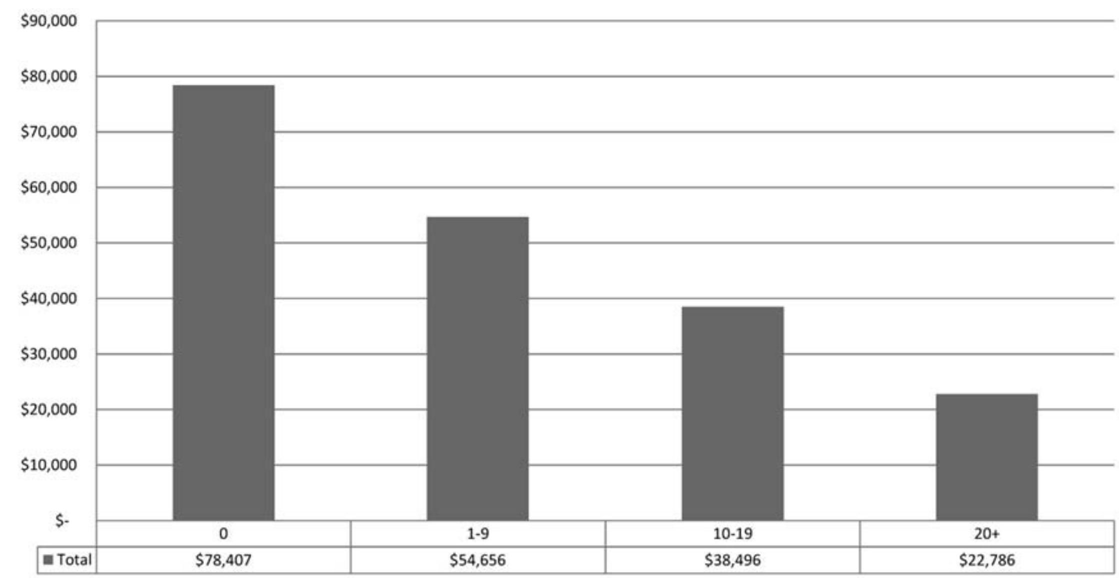


	Early Boomers	Late Boomers	Gen Xers
Lowest income quartile	86.8%	83.6%	77.7%
2	48.0%	46.9%	45.8%
3	29.3%	26.5%	29.3%
Highest income quartile	12.5%	11.2%	16.7%

Sources: EBRI Retirement Security Projection Model® versions 1501 and 1502.
* See text for definition of "at risk"

Figure 3

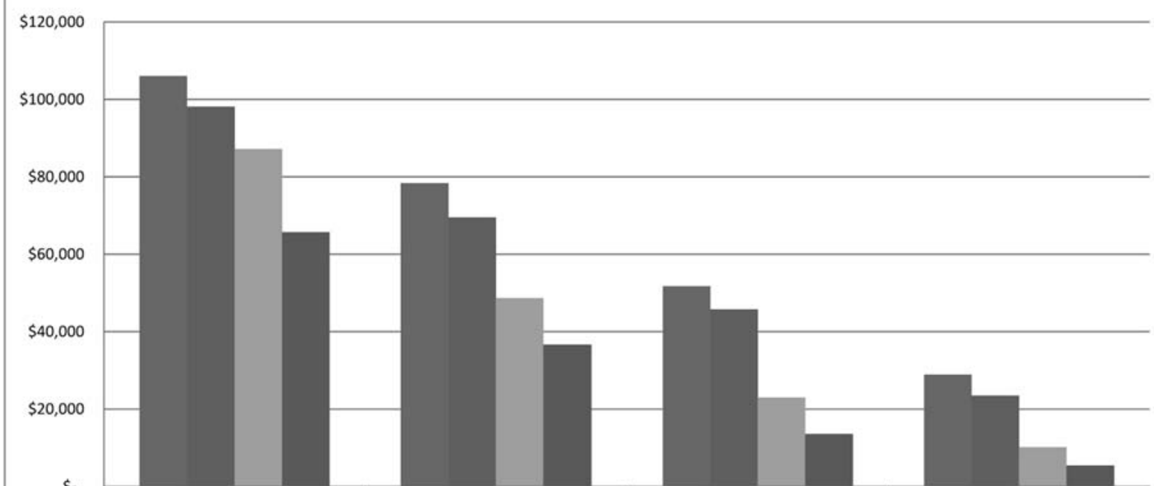
2012 Unconditional Retirement Savings Shortfall* numbers for GenXers by years of future eligibility for participation in a defined contribution plan



*The Retirement Savings Shortfalls (RSS) are determined as a present value of retirement deficits at age 65.
Sources: EBRI Retirement Security Projection Model®versions 1501 and 1502.

Figure 4

2012 Unconditional Retirement Savings Shortfall* numbers for GenXers by income quartile and years of future eligibility for participation in a defined contribution plan



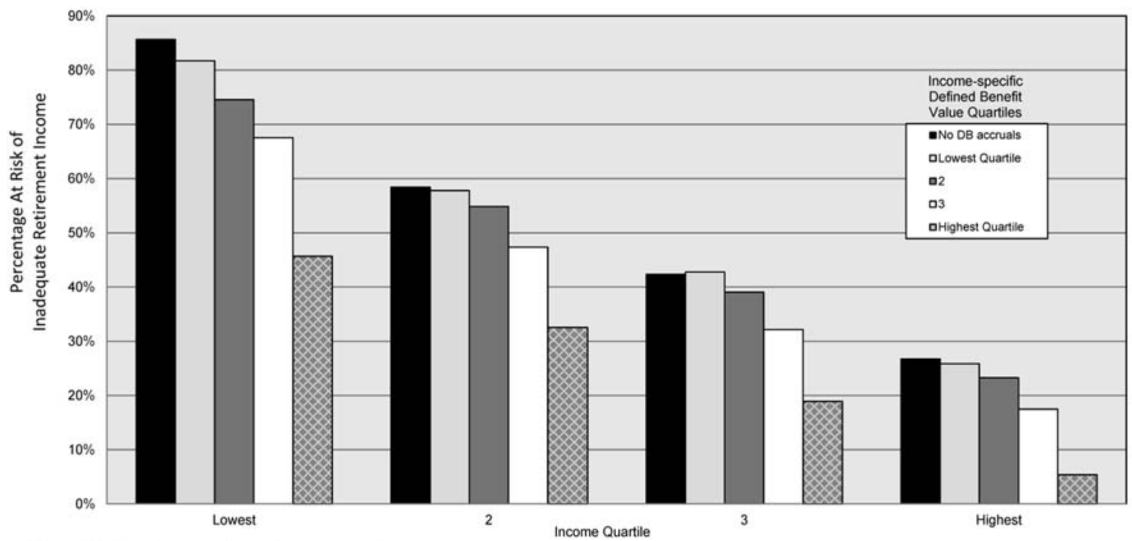
	lowest income quartile	2	3	highest income quartile
0	$106,026	$78,366	$51,778	$28,908
1-9	$98,157	$69,509	$45,801	$23,522
10-19	$87,212	$48,704	$22,962	$10,163
20+	$65,700	$36,690	$13,574	$5,430

*The Retirement Savings Shortfalls (RSS) are determined as a present value of retirement deficits at age 65.S ources: EBRI Retirement Security Projection Model®versions 1501 and 1502.

Figure 5

Impact of Income and Relative Value of Defined Benefit Accrual at Retirement Age on At-Risk* Probabilities

Percentage of population "at risk" for inadequate retirement income, by age-specific remaining career income quartiles and income-specific defined benefit value quartiles (baseline assumption)

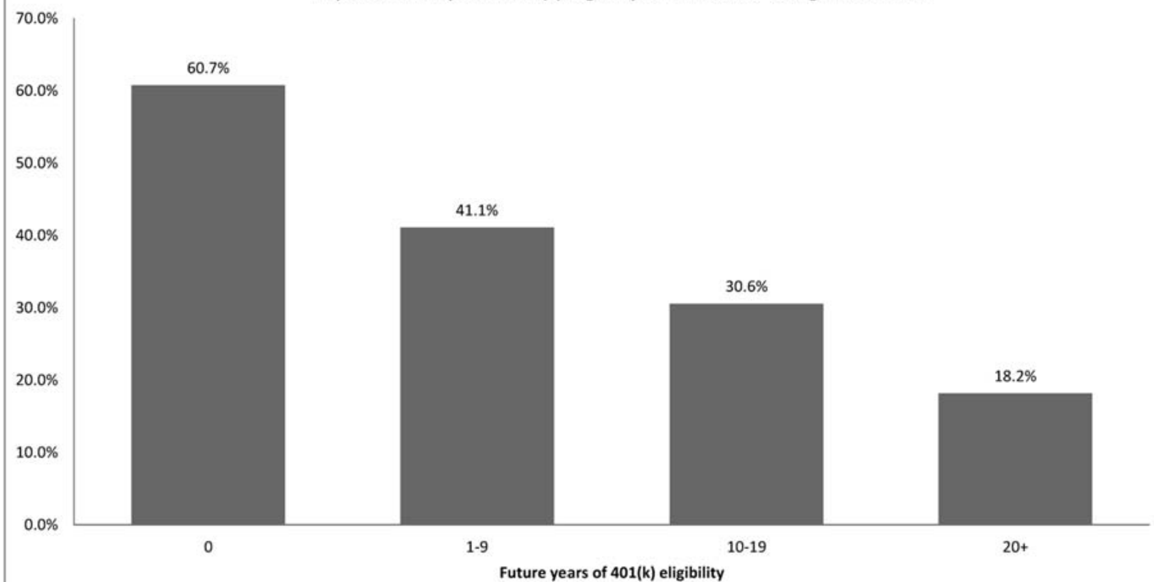


Source: EBRI/ERF Retirement Security Projection Model® version 110714e.

* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

Figure 6

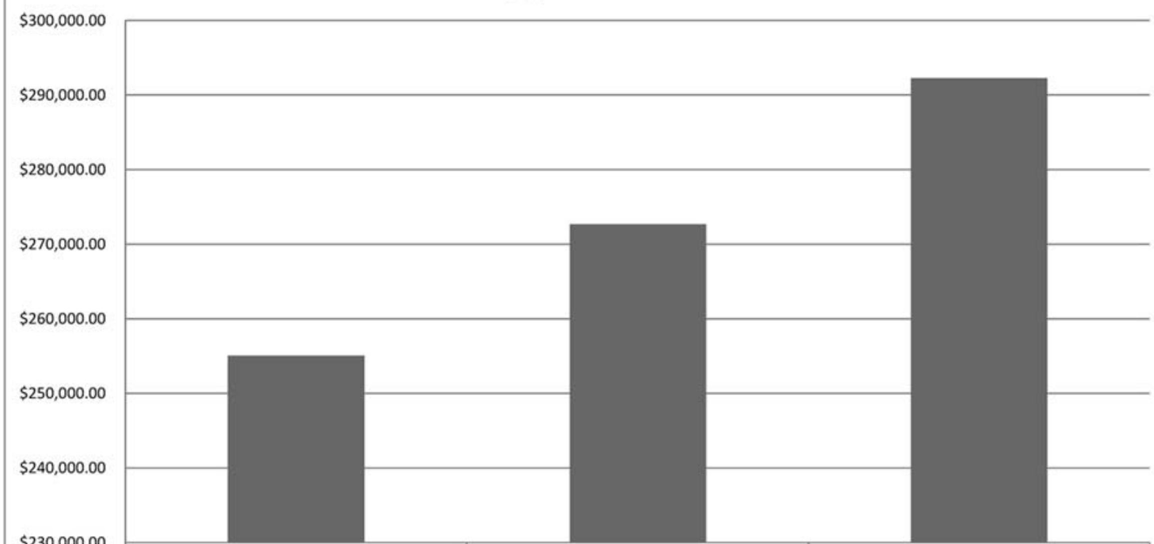
Impact of future years of 401(k) eligibility on 2012 at-risk* ratings for Gen Xers



*An individual is considered to be at-risk in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and net housing equity (in the form of a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living and other thresholds.

Source: EBRI Retirement Security Projection Model,® Version 120201.

Figure 7
Average account balances for 401(k) participants 55-64 with at least thirty years of tenure



	12/31/2010	12/31/2011 estimated	3/31/2012 estimated
average	$255,074.90	$272,680.81	$292,258.22

Sources: 2010 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2011 and 2012 Account Balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2010 and positive values for the sum of employee and employer contributions for that year.

Figure 8

Success Rates of Achieving an 80 Percent Real Replacement Rate From Social Security and 401(k) Accumulations Combined Under Various Assumptions

Lowest Quartile

	6.0%	6.0%	6.0%	6.0%	9.0%	9.0%	9.0%	9.0%
	Don't Remember	Don't Remember	Remember	Remember	Don't Remember	Don't Remember	Remember	Remember
Auto-Escalation Delta	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out
1.0%	46.5%	45.7%	48.5%	47.5%	59.2%	56.4%	63.2%	59.4%
2.0%	47.5%	47.0%	48.9%	48.3%	62.1%	60.6%	64.2%	62.5%

Lowest Quartile

	12.0%	12.0%	12.0%	12.0%	15.0%	15.0%	15.0%	15.0%
	Don't Remember	Don't Remember	Remember	Remember	Don't Remember	Don't Remember	Remember	Remember
Auto-Escalation Delta	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out
1.0%	66.7%	61.0%	71.8%	65.1%	70.4%	62.1%	76.6%	66.8%
2.0%	70.6%	68.0%		70.6%	75.5%	71.4%	79.2%	74.7%

Highest Quartile

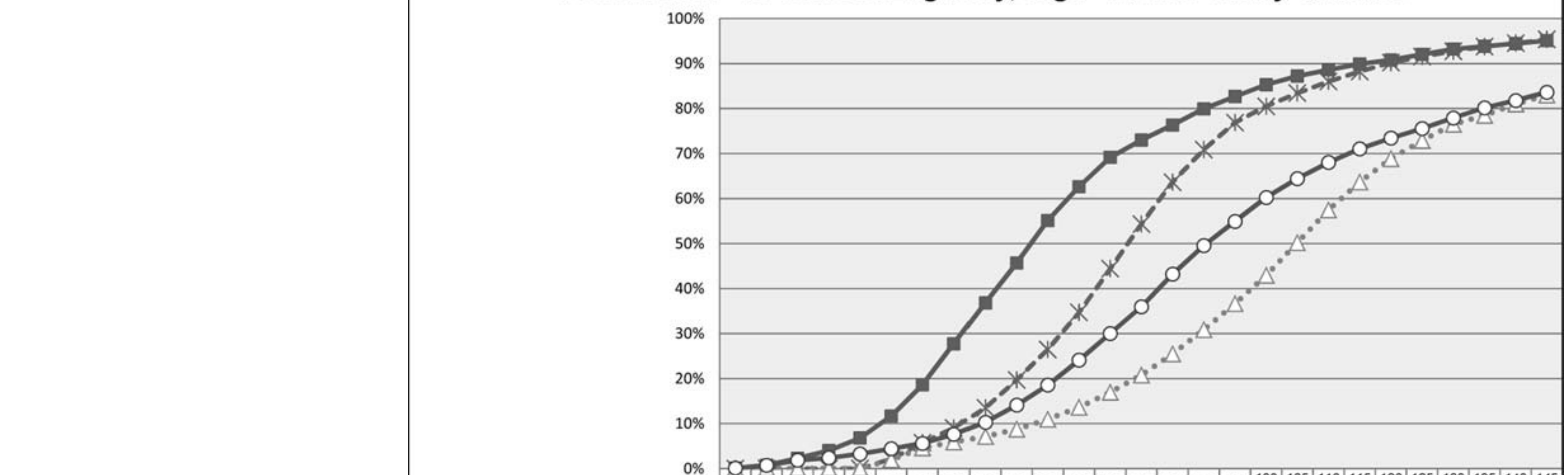
	6.0%	6.0%	6.0%	6.0%	9.0%	9.0%	9.0%	9.0%
	Don't Remember	Don't Remember	Remember	Remember	Don't Remember	Don't Remember	Remember	Remember
Auto-Escalation Delta	Don't Opt Out	Opt Out*	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out
1.0%	27.4%	27.0%	28.6%	28.2%	35.9%	34.1%	39.4%	37.1%
2.0%	27.9%	27.6%	28.9%	28.6%	38.6%	37.8%	41.0%	39.9%

Highest Quartile

	12.0%	12.0%	12.0%	12.0%	15.0%	15.0%	15.0%	15.0%
	Don't Remember	Don't Remember	Remember	Remember	Don't Remember	Don't Remember	Remember	Remember
Auto-Escalation Delta	Don't Opt Out	Opt Out*	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out	Don't Opt Out	Opt Out
1.0%	43.7%	38.8%	50.1%	43.6%	50.0%	41.1%	58.6%	47.1%
2.0%	49.1%	46.9%		50.4%	57.5%	52.9%	64.0%	58.4%

Source: EBRI/ERF Retirement Security Projection Model, versions 100810a1-100810a16.
* See VanDerhei (2007) for distribution of opt-out rates from the Retirement Confidence Survey.

Figure 9
CDFs* of the Two Extreme Combinations of Design Variables and Employee Response Assumptions for Employees Currently Ages 25–29 and Assumed 31–40 Years of Eligibility, High- vs. Low-salary Quartiles



	15%	20%	25%	30%	35%	40%	45%	50%	55%	60%	65%	70%	75%	80%
Lowest–income quartile, all pessimistic	0%	0%	0%	0%	0%	2%	6%	9%	13%	20%	26%	35%	44%	54%
Highest-income quartile, all pessimistic	0%	1%	2%	4%	7%	12%	19%	28%	37%	46%	55%	63%	69%	73%
Lowest-income quartile, all optimistic	0%	0%	0%	0%	0%	2%	5%	6%	7%	9%	11%	14%	17%	21%
Highest-income quartile, all optimistic	0%	1%	2%	2%	3%	4%	6%	8%	10%	14%	19%	24%	30%	36%

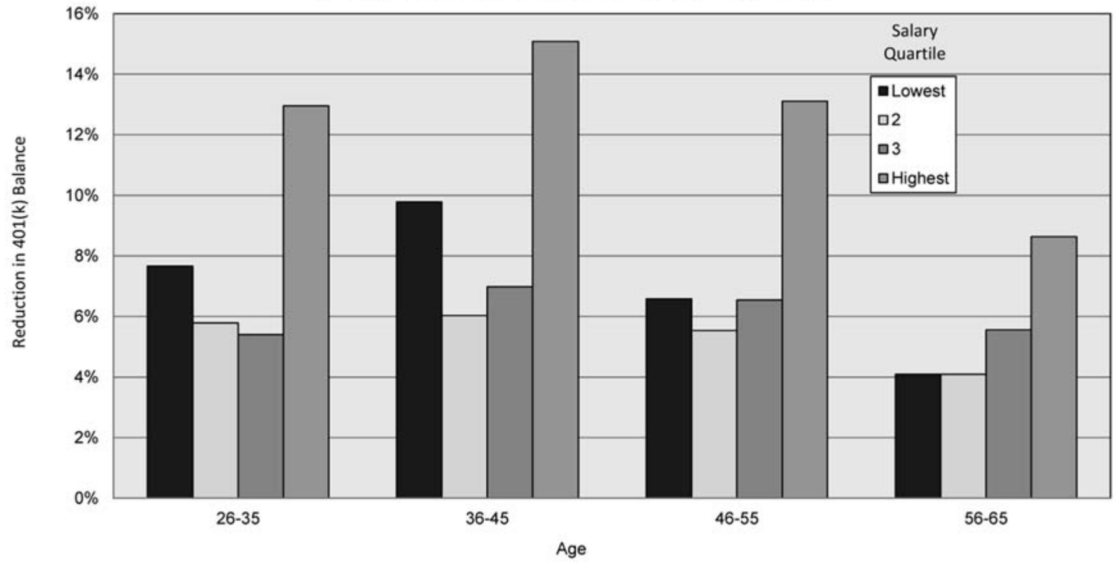
	85%	90%	95%	100 %	105 %	110 %	115 %	120 %	125 %	130 %	135 %	140 %	145 %
Lowest–income quartile, all pessimistic	64%	71%	77%	80%	83%	86%	88%	90%	92%	93%	94%	95%	95%
Highest-income quartile, all pessimistic	76%	80%	83%	85%	87%	89%	90%	91%	92%	93%	94%	94%	95%
Lowest-income quartile, all optimistic	25%	31%	37%	43%	50%	57%	64%	69%	73%	77%	78%	81%	83%
Highest-income quartile, all optimistic	43%	50%	55%	60%	64%	68%	71%	73%	76%	78%	80%	82%	84%

Combined Real Replacement Rate

Source: EBRI/ERF Retirement Security Projection Model, versions 100810a1–100810a16.
* Cumulative distribution functions.

Figure 10

Average Percentage Reductions in 401(k) Account Balances at Social Security NRA* by Imposing 20/20 Limits in 2012, by Age and Age-specific Salary Quartiles

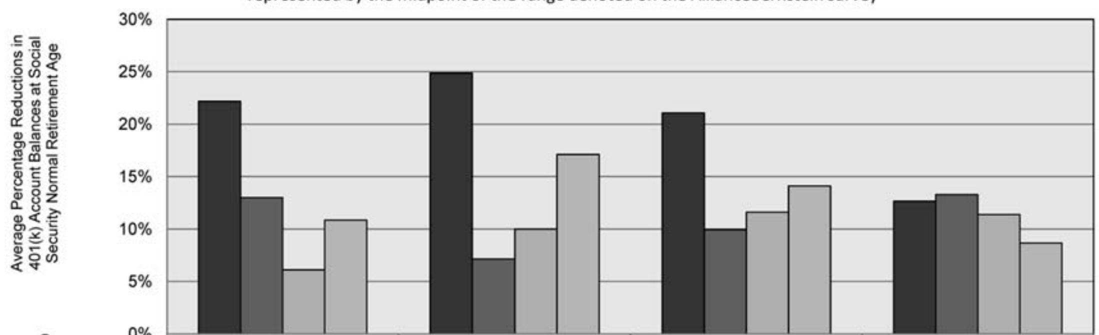


Source: EBRI Retirement Security Projection Model Version 110627c1.
NB: this simulation only models the financial impact of the expected reduction in 401(k) contributions for employees who are not automatically enrolled by imposing the new limits and does not attempt to assess behavioral modifications on the part of either the plan sponsor nor the employees assumed to be eligible for participation in the plan. The simulated rates of return are the same as in VanDerhei and Copeland (July 2010). This version of the analysis assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in future analysis.
* Normal retirement age.

Figure 11

Simulated Impact of Proposal to Modify the Federal Tax Treatment of Employer and Employee Contributions for 401(k) Plans In Exchange for an 18% Match From the Federal Government, by Age and Age-specific Salary Quartiles: Midpoint estimates

Assumption for this run: Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey



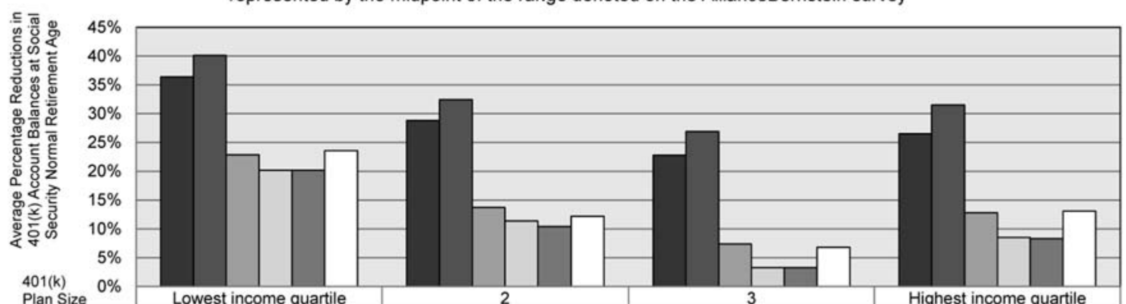
Income Group	26-35	36-45	46-55	56-65
Lowest income quartile	22.2%	24.9%	21.1%	12.7%
2	13.0%	7.2%	9.9%	13.3%
3	6.1%	10.0%	11.6%	11.4%
Highest income quartile	10.8%	17.1%	14.1%	8.7%

Source: Author's calculations based on results from EBRI Retirement Security Projection Model Version 1471, and responses to AllianceBernstein (2011) and Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2012 Retirement Confidence Survey.
Note: This simulation models only the financial impact of the expected reduction in 401(k) account balances for employees who are not automatically enrolled by modifying the behavior of plan sponsors and participants and does not attempt to assess behavioral modifications on the part of eligible nonparticipants. The simulated rates of return are the same as in VanDerhei and Copeland (July 2010). This version of the analysis assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in a future analysis. Results for participants currently older than 35 are limited to high-tenure participants as explained in the text. Plan sponsor and participant reactions to the proposal are explained in the text. Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey.

Figure 12

Simulated Impact of Proposal to Modify the Federal Tax Treatment of Employer and Employee Contributions for 401(k) Plans In Exchange for an 18% Match From the Federal Government for Employees Currently 26–35, by Plan Size and Age-specific Salary Quartiles: Midpoint Estimates

Assumption for this run: Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey



401(k) Plan Size	Lowest income quartile	2	3	Highest income quartile
<1M	36.4%	28.8%	22.8%	26.5%
1–10M	40.1%	32.4%	26.9%	31.5%
10–50M	22.8%	13.7%	7.4%	12.8%
50–250M	20.2%	11.4%	3.3%	8.5%
250–500M	20.2%	10.4%	3.2%	8.3%
>500M	23.5%	12.2%	6.8%	13.1%

Source: Author's calculations based on results from EBRI Retirement Security Projection Model Version 1472, and responses to AllianceBernstein (2011) and Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2012 Retirement Confidence Survey.

Note: This simulation models only the financial impact of the expected reduction in 401(k) account balances for employees who are not automatically enrolled by modifying the behavior of plan sponsors and participants and does not attempt to assess behavioral modifications on the part of eligible nonparticipants. The simulated rates of return are the same as in VanDerhei and Copeland (July 2010). This version of the analysis assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in a future analysis. Plan sponsor and participant reactions to the proposal are explained in the text. Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey.

Chairman CAMP. Ms. Miller, you are recognized for 5 minutes.

STATEMENT OF JUDY A. MILLER, CHIEF OF ACTUARIAL ISSUES AND DIRECTOR OF RETIREMENT POLICY, AMERICAN SOCIETY OF PENSION PROFESSIONALS AND ACTUARIES, ARLINGTON, VIRGINIA

Ms. MILLER. Thank you, Chairman Camp, Ranking Member Levin, and Members of the Committee. I am Judy Miller, chief of actuarial issues and director of retirement policy for the American Society of Pension Professionals and Actuaries. ASPPA's more than 8,000 members work with retirement plans of employers of all types, but our primary focus is plans for small business.

Two key features distinguish retirement savings tax incentives from other incentives in the Code: The deferral nature of the incentive and the nondiscrimination rules that make employer-sponsored plans very efficient at delivering benefits across the income spectrum.

First, unlike other tax incentives, incentives for retirement savings are deferrals, they are not permanent exclusions. When employer-paid health benefits are excluded from income or mortgage interest is deducted, those amounts will never be taxed. With the traditional retirement savings account, no income taxes are paid on contributions when they are added to the account, but those same contributions are included in taxable income when the amounts are paid from the plan. In other words, every single dollar that is exempt from tax now will be subject to income tax in the future. Since most of those retirement years are outside the government's 5- or 10-year budget window, looking at the so-called tax expenditure for defined contribution retirement plans on a short-term cash basis greatly overstates the cost of this incentive. In fact, new estimates by former JCT staff show that a better measure of the expenditure for defined contribution plans is more than 50 percent less than the JCT cash-basis estimate over a 5-year period. So as you consider these issues, let us not forget that this is a deferral. The amount of revenue you might think you are raising if you cut retirement savings incentives today is not real revenue gain. It is a bookkeeping fiction.

The second distinguishing feature is the nondiscrimination rules that make sure incentives for retirement plans don't discriminate in favor of the highly paid. The result is this tax incentive is more progressive than the current progressive Tax Code. Households making less than $100,000 pay 26 percent of all income taxes, but they get over 60 percent of the tax benefit of this incentive for defined contribution plans, and this analysis actually understates the benefits for these households because it doesn't recognize that a good part of a small business owner's so-called tax savings is actually transferred to workers in the form of contributions. Let me explain.

A small business owner usually considers a plan when the businesses finally become profitable. The owner has shown how setting up a retirement plan can save enough money on their personal income taxes to pay most of the cost of contributions, like matching contributions that are going to be required for employees by nondiscrimination rules. It is a beautiful thing really. Deferred income taxes for the owner become current contributions for the workers.

Data clearly shows the key to promoting retirement security is workplace savings. Over 70 percent of workers earning from $30- to $50,000 do participate in a plan at work, but less than 5 percent go save on an IRA on their own. Bureau of Labor Statistics data show 78 percent of full-time workers have access to a workplace retirement plan, with 84 percent participating.

Almost 80 percent coverage is a success story. More needs to be done, but the Committee should build on the success of the system. We support the auto IRA proposal in Mr. Neal's bill, for example, as a way to expand workplace savings by building on the current structure.

Recent tax reform proposals include dramatic cuts in maximum contribution limits, a cap on the value of the current year's exclusion for households making over a certain dollar amount, or conversion of the current year's income exclusion to a credit. All of these proposals would reduce the incentive for small business owners to sponsor a workplace retirement plan and would be a big step in the wrong direction.

I have over 20 years experience actually selling plans to small business owners. With rare exceptions, the current year's tax savings was a critical factor and often the only factor supporting their decision to put in a plan. Now, it is not that small business owners are selfish. Quite the contrary. But in real life they aren't sitting on lots of cash. Savings generated from the retirement plan tax incentives provides cash to help make contributions required by the nondiscrimination rules. Reducing the incentive literally reduces the cash the small business owner has to work with. Now, there is not a doubt in my mind that reduced incentives would mean fewer plans and less contributions toward workers' retirement.

One of the questions posed for this hearing is whether or not there are too many types of plans. The simple answer is no. A proposal to combine all defined contribution plans into a single type of plan might look like simplification on paper, but in practice combining 401(k), 403(b), and 457(b)s into a single plan would disrupt savings for employees of State and local governments and other nonprofits. And believe me, when you are talking to an employer about setting up a plan, options and flexibility are not the enemy, and one size definitely does not fit all.

Now, that is not to say simplification isn't needed. For example, we support the Small Business Pension Promotion Act sponsored by Representatives Gerlach, Kind and others, and would be pleased to work with the Committee on these and other simplifications.

In summary, the road to improved retirement security for working Americans is expanded workplace savings. Reducing incentives for small business owners to sponsor retirement plans is the opposite of what needs to be done.

I would be pleased to discuss these issues further with the Committee or to answer any questions that you may have. Thank you very much.

Chairman CAMP. Thank you very much.

[The prepared statement of Ms. Miller follows:]

ASPPA®
WORKING FOR AMERICA'S RETIREMENT

Testimony Submitted by Judy A. Miller on behalf of the American Society of Pension Professionals and Actuaries

Committee on Ways and Means Hearing on Tax Reform and Tax-favored Accounts

April 17, 2012

Thank you Chairman Camp, Ranking Member Levin and members of the Committee for the opportunity to speak with you about the current tax incentives for employer-sponsored retirement plans – how they are working to promote retirement security, and how the Committee might streamline the law and regulations to make them work better. I am Judy Miller, Chief of Actuarial Issues and Director of Retirement Policy for the American Society of Pension Professionals and Actuaries ("ASPPA"). ASPPA is a national organization of more than 8,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

I also am speaking on behalf of the Council of Independent 401(k) Recordkeepers (CIKR), as well as ASPPA's sister organizations, the National Tax Sheltered Accounts Association (NTSAA), the National Association of Plan Advisors (NAPA) and the ASPPA College of Pension Actuaries. CIKR is a national organization of 401(k) plan service providers. CIKR members are unique in that they are primarily in the business of providing retirement plan services as compared to financial services companies who primarily are in the business of selling investments. As a consequence, the independent members of CIKR offer plan sponsors and participants a wide variety of investment options from various financial services companies without an inherent conflict of interest. By focusing their businesses on efficient retirement plan operations and innovative plan sponsor and participant services, CIKR members are a significant and important segment of the retirement plan service provider marketplace. Collectively, the members of CIKR provide services for over 70,000 retirement plans covering 3 million participants with approximately $130 billion in retirement assets. NTSAA's members share a strong interest in the 403(b) and 457(b) marketplace. NAPA is an organization of advisors serving employer-sponsored retirement plans. ACOPA represents enrolled actuaries who are credentialed members of ASPPA.

The goals of simplification, efficiency, and increasing retirement and financial security for American families are goals we share with the Committee. The primary message I want to convey today is that the current tax incentives are working very efficiently to promote retirement security for millions of working Americans. The most important factor in determining whether or not taxpayers across the income spectrum save for retirement is whether or not there is a workplace retirement plan. If increasing retirement and financial security is the goal, increasing the availability of workplace savings is the way to get there, and modifications to the current incentives should be evaluated based on whether or not the changes will encourage more businesses to sponsor retirement plans for their employees.

In ERISA, Congress decided to direct tax incentives for employer-sponsored plans toward coverage of substantially full-time employees. Nearly 80% of full time civilian workers now have access to workplace savings, so the incentives have been effective in providing coverage for the targeted group. The incentives are also very efficient at providing coverage to all income groups. This efficiency is derived in large part from two features that set the retirement savings incentives apart from other individual tax incentives:

- The retirement savings incentive is income *deferral*, not a permanent exclusion. Every dollar that is excluded from income this year will be included in income in a future year. Unfortunately, that is not reflected in the cash basis measurement of the retirement savings "tax expenditure". In fact, the current methodology overstates the true cost by over 50%.
- Nondiscrimination rules for employer-sponsored plans assure the plans do not discriminate in favor of highly compensated employees, and limit the amount of compensation that can be included in determining benefits and testing for nondiscrimination. As a result, this tax incentive is *more progressive* than the current progressive tax code.

The hearing notice raised the question as to whether the "large number of plans with different rules and eligibility criteria leads to confusion, reducing the effectiveness of the incentives in increasing retirement savings." The answer is a resounding "No".

- If an individual has a workplace plan, he or she is not asked to choose between a 401(k) or SIMPLE, or a 401(k) or 403(b) arrangement. Employees are simply asked if they want to enroll in the plan being offered by the employer – or are automatically enrolled. Consolidating all types of defined contribution plans into one type of plan would not be simplification. It would disrupt savings, and force state and local governments and nonprofits to modify their retirement savings plans and procedures.

- Small employers that do not sponsor a retirement plan consistently point to business concerns as the main reason they do not sponsor a plan[1], not "confusion" about available options. Flexibility in plan design gives practitioners the tools to design arrangements that are attractive to more employers than a "cookie cutter" approach. Less flexibility would reduce coverage, not enhance it.

The discussion of simplification needs to be expanded beyond consolidation or otherwise limiting employer-sponsored plan design options. There are legislative and regulatory changes that could smooth the way for more small employers to adopt plans, and ease compliance concerns, but consolidation and loss of flexibility in plan design are not on that list. Improved retirement security, and meaningful simplification, will be accomplished through thoughtful modifications to the existing structure, without wasting resources on cosmetic overhauls that produce more change than gain.

[1] See for example:

- The Principal Financial Group *Retirement Readiness Survey 2011, slides 29-30,* available at http://www.principal.com/about/news/documents/2011retirement-readiness-summary.pdf
- *Statement for the record of the March 7, 2012 Senate Special Committee on Aging Hearing "Opportunities for Savings::Removing Obstacles for Small Business",* from Michael Kiley founder of PAI, available at http://www.asppa.org/document-vault/pdfs/GAC/2012/Kiley0307sfr.aspx
- EBRI *Small Employer Retirement Survey (2003)* available at http://ebri.org/pdf/surveys/sers/2003/03sersf1.pdf

Background

The current system of tax incentives has been very successful at accumulating assets to improve the retirement security of millions of American households. Seventy percent of U.S. households now have an IRA or an employer-sponsored retirement plan. At the end of 2010, private employer-sponsored defined contribution plans held about $4.5 trillion in assets, private employer-sponsored defined benefit plans held $2.2 trillion and state and local retirement plans held $3.0 trillion. There was another $4.7 trillion held in IRA accounts. Although IRAs include contributions made by individuals to the IRA on their own behalf, a substantial portion of IRA assets are attributable to rollovers from employer-sponsored plans and direct employer contributions. Of the 49 million households that own IRAs, 55% report that their IRA accounts include a rollover from another retirement plan, and 9 million of the IRAs are employer-sponsored retirement savings arrangements such as SEPs and SIMPLE IRA plans.[2]

The past 20 years has seen a gradual shift in employer-sponsored arrangements from defined benefit plans to defined contribution plans. The number of participants (active, retired and deferred vested) reported as covered by defined benefit plans has been fairly stable - about 40 million in 1986, and 42 million in 2006, but an increasing proportion of those are retired participants. Over the same period, the reported number of participants in defined contribution plans increased from 37 million to 80 million. In 2009, about 61 million *active* workers participated in employer-sponsored retirement plans.[3]

Data shows that 401(k) and similar plans (such as 403(b) and 457(b) arrangements) have been very successful in getting workers to save for retirement. In ERISA, Congress decided to target tax incentives toward substantially full-time workers, and the incentives have worked well. Contrary to the common assertion that only half of working Americans are covered by a retirement plan, Bureau of Labor Statistics (BLS) data shows that 78 percent of all full time workers have access to a workplace retirement plan, with 84 percent of those workers participating. The success of saving through an employer-sponsored plan extends to low to moderate income workers. The chart below, based on data prepared by the Employee Benefit Research Institute (EBRI) updated to 2010, shows that over 70% of workers earning from $30,000 to $50,000 participated in employer-sponsored plans when a plan was available, whereas less than 5% of those without an employer plan contributed to an IRA.

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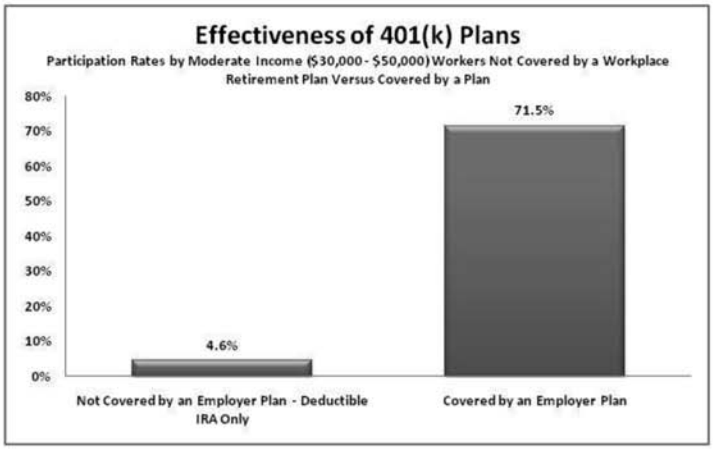
[2] *2011 Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*, Investment Company Institute, available at http://ici.org/pdf/2011_factbook.pdf.

[3] *EBRI Databook on Employee Benefits*, Employee Benefit Research Institute, available at http://ebri.org/publications/books/?fa=databook .

Figure 1



Source: Employee Benefit Research Institute (EBRI) (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan-IRA only)

Current Tax Incentives

What are the incentives?

Employer contributions made to qualified retirement plans are deductible to the employer when made. Income tax on investment earnings on those contributions is deferred until amounts are distributed from the plan. When a distribution is made to a plan participant, all amounts are subject to ordinary income tax. Employer contributions made on a participant's behalf are not subject to FICA. In addition, individuals with adjusted gross income ("AGI") of less than $27,750, and married couples with AGI of less than $55,500, may qualify for a Saver's Credit ranging from 10% to 50% of the first $2,000 the individual contributes to an IRA or employer-sponsored defined contribution plan.

Limits are placed on contributions to defined contribution plans, and on benefits payable from defined benefit plans:

- Certain defined contribution plans permit employees to contribute on their own behalf by electing to have a certain dollar amount or percentage of compensation withheld from pay and deposited to the plan. These "elective deferrals" are excludable from income for income tax purposes, but FICA is paid on the amounts by both the employer and the employee. For 2012, the maximum elective deferral to a 401(k) or similar plan is $17,000. Employees age 50 or over can also make a "catch-up contribution" of up to $5,500. Elective deferrals to a SIMPLE plan are limited to $11,500, plus a $2,500 catch-up contribution for those age 50 or over.

- If the employer also contributes to a defined contribution plan (such as a 401(k) plan), the maximum contribution for any employee is $50,000. This limit includes any elective deferrals other than catch-up contributions. This means a participant that is age 50 or over, and who makes the full $5,500 catch-up contribution, would have a total limit of $55,500.
- The maximum annual benefit payable from a defined benefit plan cannot exceed the lesser of the average of three year's pay or $200,000. If retirement is before age 62, the dollar limit is reduced. Employers can deduct the amount required to fund promised benefits.
- Annual IRA contributions are limited to $5,000, plus "catch-up" contributions of $1,000 for those age 50 or over.

Compensation in excess of $250,000 cannot be considered in calculating contributions or in applying nondiscrimination rules under either defined benefit or defined contribution plans. For example, if a business owner makes $400,000, and the plan provides a dollar for dollar match on the first 3% of pay the participant elects to contribute to the plan, the match for the owner is 3% of $250,000, not 3% of $400,000.

The higher contribution limits for qualified retirement plans – both defined contribution and defined benefit plans – come with coverage and non-discrimination requirements. For example, a small business owner with several employees cannot simply put in a defined contribution plan and only contribute $50,000 to his or her account. Other employees who have attained age 21 and completed 1 year of service with at least 1000 hours of work must be taken into consideration, and the employer must be able to demonstrate that benefits provided under the plan do not discriminate in favor of "Highly Compensated Employees" ("HCEs"), which would include the owner.

Safe harbors are available. For example, if all employees covered by a 401(k) plan are provided with a contribution of 3% of pay that is fully vested, the HCE can make the maximum elective deferral, regardless of how much other employees choose to contribute on their own behalf.

Age can also be considered when determining the amount of contributions that can be made on a participant's behalf. A larger contribution (as a percentage of pay) can be made for older employees because the contribution will have less time to earn investment income before the worker reaches retirement age (usually age 65).

<u>How do retirement savings tax incentives differ from other incentives?</u>

Unlike many tax incentives, the income tax incentives for retirement savings are not permanent deductions or exclusions from income. Taxes are *deferred* as long as the savings remains in the plan, but tax must be paid in later years when distributions are made from the plan. Furthermore, the distributions are subject to tax at *ordinary income* tax rates, even though lower capital gains and dividends rates may have applied if the investments had been made outside of the plan.

The tax incentives for qualified employer-sponsored retirement plans also come with stringent non-discrimination rules. These rules, coupled with the limit on compensation that can be considered under these arrangements, are designed to insure that qualified employer-sponsored retirement plans do not discriminate in favor of HCEs. Non-discrimination rules do not apply to other forms of tax-favored retirement savings. For example:

- IRAs share the incentive of tax deferral. However, if a small business owner makes a personal contribution to an IRA, there is no corresponding obligation to contribute to other employees' IRAs. However, under the current rules, the contribution limit for IRAs is set low enough (and the limit for employer-sponsored plans high enough) to make a qualified retirement plan attractive to a business owner who can afford it.
- Annuities purchased outside of a qualified plan share the benefit of "inside buildup" - the deferral of income tax on investment earnings until distributed from the arrangement – but have *no limit on contributions or benefits, and no non-discrimination requirements*. This means the attraction of a qualified retirement plan for a small business owner is heavily dependent on the interaction of non-discrimination rules and the contribution limits for a qualified retirement plan. [Note that at the end of 2010, there was $1.6 trillion in annuity reserves held *outside of* retirement plans.[4]]

How does tax deferral work to incent coverage?

The tax incentive for a small employer to sponsor a qualified retirement plan is a critical component to the establishment of a 401(k), defined benefit or other qualified retirement plan. The tax savings for the company's owner (or owners) can generate all or part of the cash flow needed to pay required contributions for other employees, which substantially reduces the cost of the plan to the owner (and transfers much of the apparent tax benefit to covered employees). Consider the following situation:

> ABC Company has been in operation for 5 years. The owner has some retirement savings in an IRA, but has never taken time to think about retirement. The business has other employees earning from $35,000 to $70,000. The owner takes compensation of $10,000 per month during the year, then takes a year-end bonus of the amount of company profits. The owner pays individual income taxes on the full amount of the profits at a marginal rate of 28%.
>
> The owner meets with a retirement plan consultant. The owner is older than most of the other workers, so the consultant recommends a safe harbor 401(k) plan with an additional "cross-tested" contribution. Thanks to the nondiscrimination rules that apply to qualified retirement plans, putting $50,000 of the profits into the 401(k) plan for the owner means the owner must contribute at least 5% of pay for the employees. However, tax savings on the $50,000 will substantially cover that 5% contribution, and the tax credit for the cost of setting up and operating a new plan helps defray any startup and initial operating costs.

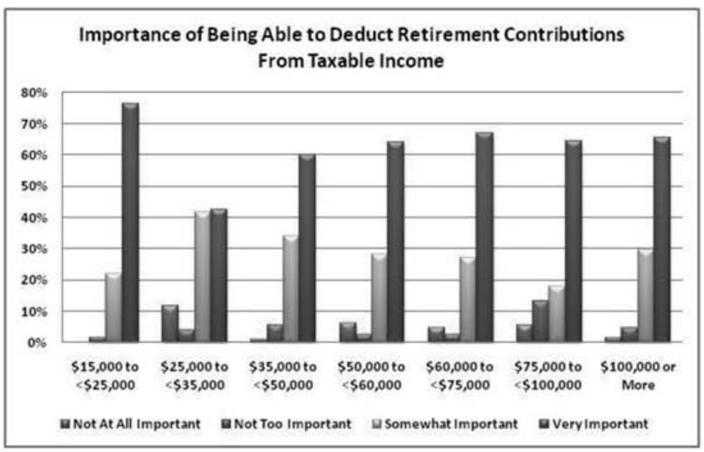
[4] *Retirement Assets Total $17.5 Trillion in Fourth Quarter 2010*, Investment Company Institute (Apr. 13, 2011), available at http://www.ici.org/pressroom/news/ret_10_q4.

Setting up the plan becomes a simple question of "Do you want to give that money to your employees? Or add it to the check you are sending to IRS?"

The current tax incentives transform what would have been a bonus to the business owner, subject to income taxes, into a retirement savings contribution for the owner *and the employees*. Not only will the employees receive an employer contribution of 5% of pay, most will also make additional contributions on their own behalf. This incentive for the business owner to contribute for other employees results in a distribution of tax benefit that is *more progressive* than the current income tax structure. Just how progressive is illustrated in Figure 6 (on page 13), showing the share of this tax benefit going to households earning under $50,000 is almost *four times* the share of income taxes paid by these households.

The tax incentives are also used to encourage employees to join 401(k) plans and similar plans. Educational materials encouraging participants to enroll in, and contribute to, plans typically show the worker how tax savings will help them save more than they could through another savings arrangement. For example, materials will show how contributing $100 to your 401(k) account will only cost $85 (or $72 for higher income workers). As shown in the chart below, over 80% of workers in all income categories find this incentive somewhat or very important.

Figure 2



Source: Jack VanDerhei, *The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results From the 2011 Retirement Confidence Survey*, ebri.org Notes (Mar. 2011), available at http://ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=4785.

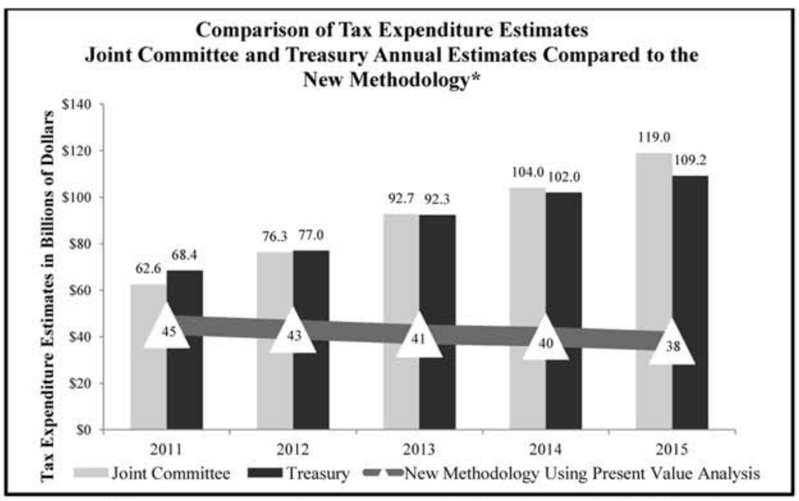
The importance of the tax deferral on retirement contributions was also born out in a recent Investment Company Institute (ICI) survey in which more than 80% of households owning DC plan accounts said the immediate tax savings from their retirement plans were a big incentive to contribute.[5]

True Cost Overstated

Current budget rules require that the cost of most tax incentives be determined on a cash flow basis. Because the tax incentive for retirement savings is a *deferral*, not a permanent exclusion, basing the cost on current cash flow analysis – taxes not paid on contributions and investment earnings for the current year less taxes paid on current year distributions – misrepresents the true cost of the retirement savings incentives. Using a present value method, which recognizes that taxes will eventually be paid on distributions, produces very different estimates – *more than 50% lower than JCT or Treasury estimates for a 5-year budget window*.[6]

The following chart illustrates the results.

Figure 3



* The new methodology estimates the tax benefit of the deferral and inside buildup, in present value terms. The Joint Committee and Treasury estimates rely on cash-flow analysis.

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[5] Investment Company Institute, *America's Commitment to Retirement Security: Investor Attitudes and Actions January 2012* available at http://www.ici.org/pdf/ppr_12_retir_sec_update.pdf

[6] Judy Xanthopoulos and Mary Schmidt, *Retirement Savings and Tax Expenditure Estimates* (April 2012), available at http://www.asppa.org/Main-Menu/govtaffairs/RET2012.aspx

The danger in using the cash flow measurement is not just that the current cost is overstated, but the long-term impact of modifying the incentives is also hidden. Reducing the limits will generate revenue in the budget window, but will also lead to reduced revenue – and more demand for low income benefits such as Medicaid and Supplemental Security Income ("SSI") - in later years.

Who Benefits

Who is participating?

The Bureau of Labor Statistics ("BLS") found that 78 percent of all full time civilian workers had access to retirement benefits at work, with 84 percent of those workers participating in these arrangements. For private sector workers, BLS found the access and participation rates are 73 percent and 80 percent respectively. Availability and take up rates are substantially lower for part-time workers, so if part time workers are included, BLS found that 68 percent of civilian workers had access to retirement plans, and 80 percent of those actually participate in the offering. For the private sector only, the access and participation rates for all workers are 64 percent and 76 percent respectively.[7] However, alternative research suggests these estimates are less than what is actually happening in the workplace.

A report from SSA shows that 72 percent of *all* employees who worked at private companies in 2006 had the ability to participate in a retirement plan, and 80 percent of those participated.[8] The SSA used data from a Census survey merged with W-2 tax records to correct for respondents' reporting errors. SSA found "among private-sector wage and salary workers, both employer offer rates and employee participation rates in *any* type of pension plan considerably increase when W-2 records are used, an indication of substantial reporting error." [9] The SSA results indicate the BLS statistics on availability are likely understated.

Part-time workers are far less likely to have a retirement plan available at work, and less likely to participate in a plan when it is available. BLS data shows only 37% of part-time private sector workers have a retirement plan available at work, and 54% of those participate in the plan. Similarly, employees that work for smaller employers are less likely to have a plan available. BLS data shows 49 percent of private sector employees who work for employers with less than 100 employees have a plan available at work. Sixty-nine percent of those workers do participate when a plan is offered, though. Employer surveys indicate business concerns are the primary driver of this low rate of sponsorship among smaller employers.

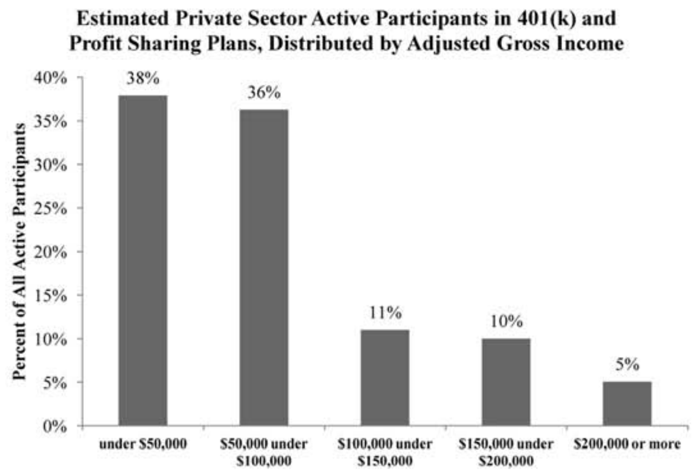
[7] Bureau of Labor Statistics, *Employee Benefits Survey: Retirement Benefits, March 2011: Retirement benefits: access, participation, and take-up rates: National Compensation Survey March 2011* available at http://www.bls.gov/ncs/ebs/sp/ebnr0017.pdf (hereinafter "BLS Survey").

[8] Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Records*, Social Security Bulletin (2011), available at http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf.

[9] *Id*. at 1 (noting "We find substantial reporting error with respect to both offer and participation rates in a retirement plan. About 14 percent of workers who self-reported nonparticipation in a defined contribution (DC) plan had contributed as indicated by W-2 records, whereas 9 percent of workers self-reported participation in a DC plan when W-2 records indicated no contributions.").

Participation in employer-sponsored defined contribution plans is heavily weighted toward middle class Americans. As the chart below shows, 38% of participants in defined contribution plans make less than $50,000 per year. Nearly three-quarters make less than $100,000.

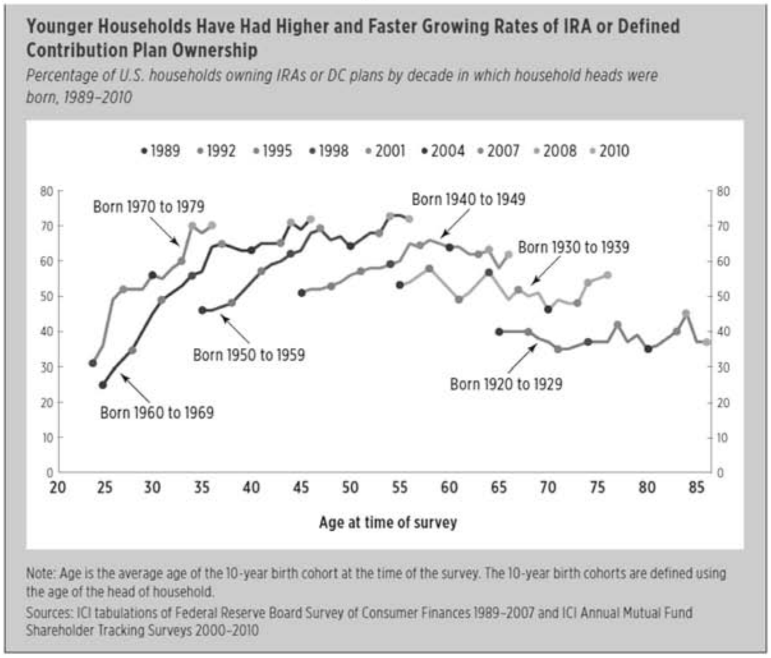
Figure 4



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI)

There is reason for optimism that coverage will increase over time. The following chart shows that younger workers have shown dramatic gains in ownership of retirement savings accounts over the past decade. The increasing use of automatic enrollment is also expected to increase take-up rates. (Most plans only automatically enroll new hires, so recognition of participation gains will occur gradually).

Figure 5



Source: 2011 Investment Company Factbook, Figure 7.4, page 103

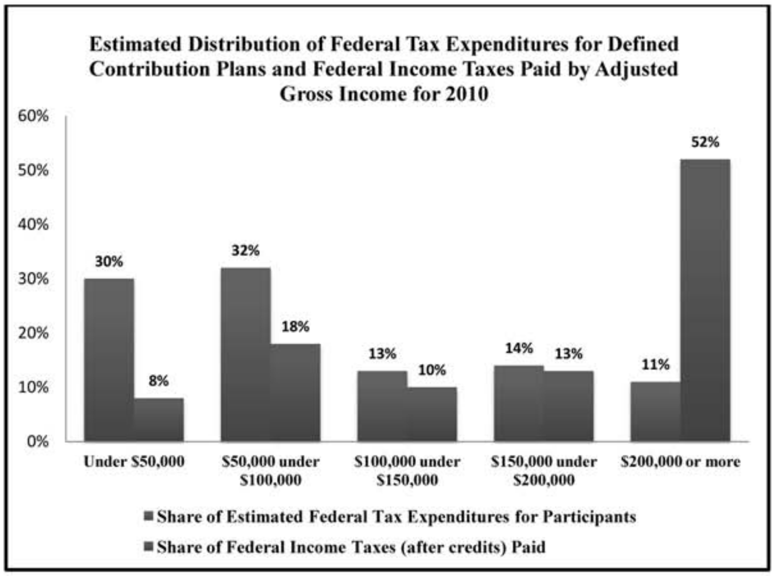
How is the tax benefit distributed?

Distribution of the tax benefit is typically analyzed by applying the marginal tax rate to contributions allocated to an individual's account multiplied by the marginal tax rate.[10] Because the U.S. income tax system is progressive, the value of the tax incentive on a dollar of retirement savings *in the year of deferral* increases as the marginal tax rate increases. This progressive income tax structure, coupled with the assumption that the more income a worker has, the more he or she can afford to save, would lead one to expect the tax benefit for retirement savings would be more skewed than the incidence of income tax. However, the non-discrimination rules that apply to employer-sponsored retirement plans, coupled with the limit on compensation that may be considered for purposes of determining contribution allocations, leads to a very different result. The distribution of the tax incentive for retirement savings is *more progressive* than the current progressive income tax system. As the following chart shows,

[10] For example, see Table 1 of the Hamilton Project paper "Improving Opportunities for Savings and Incentives for Middle- and Low-Income Households" by William Gale, Jonathan Gruber and Peter Orszag.

households with incomes of less than $50,000 pay only about 8% of all income taxes, but receive 30% of the defined contribution plan tax incentives. Households with less than $100,000 in AGI pay about 26% of income taxes, but receive about 62% of the defined contribution plan tax incentives. [11]

Figure 6



What this clearly shows is that, contrary to one common myth, the tax incentives for retirement are *not* upside down at all. Thanks to the balance imposed by the current law contribution limits and stringent nondiscrimination rules, these tax incentives are *right side up – even before properly considering other components of this incentive.*

The standard methodology for measuring the benefit of the tax incentive (multiplying marginal rate times income deferred) shows that the tax incentives for employer-sponsored retirement savings are more progressive than the current income tax code. However, because of the unique nature of this tax incentive, this methodology actually *understates* how progressive the current tax incentives are:

- First, as illustrated in the "ABC Company" example on page 5, this measurement fails to consider that much, if not all, of this apparent tax savings to a small business

[11] *Estimated Benefits of Tax Expenditure Estimates for Defined Contribution Plan Participants and Retirees with Account Balances*, available at http://www.asppa.org/Main-Menu/govtaffairs/Testimony/2011/DistTaxExp_TaxesPaid_3-18-11.pdf.aspx.

owner is transferred to employees in the form of employer contributions. The standard methodology credits the small business owner contributing $50,000 on her own behalf with $14,000 "tax savings" (28% marginal rate times $50,000). If payroll for other covered employees is $200,000, the nondiscrimination rules require the employer to contribute at least 5% of pay, or $10,000, to the accounts of these other employees. Assuming for the sake of simplicity that the business tax rate is the same as the owner's rate of 28%, the net cost of the $10,000 contribution is $7,200. The small business owner's net benefit for the current tax year is therefore only $6,800 ($14,000 - $7,200). Assume the average marginal rate for the other employees is 15%. The rate times contribution method results in an apparent tax benefit of $1,500 (15% of $10,000). In fact the benefit is the full $10,000. So, although standard methodology would measure the tax incentive in the current year as $14,000 for the owner and $1,500 for the other employees, the true allocation is $6,800 for the owner and $10,000 for employees.

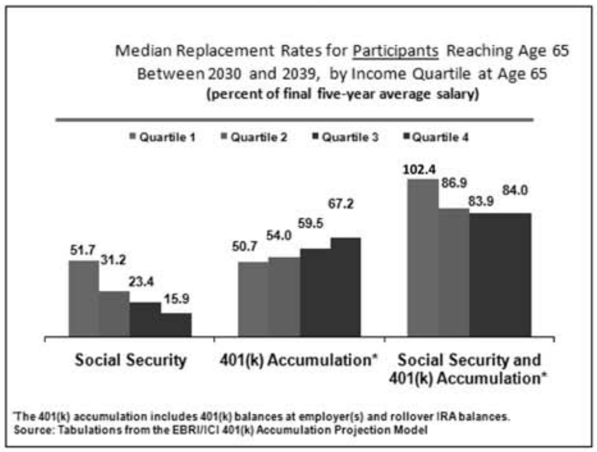
- Part of the cost of the retirement savings tax incentive is the deferral of income taxes on investment income. However, if a small business owner elected not to set up a qualified plan, and had simply paid income taxes instead of making retirement contributions for herself and the other employees, she could have gained identical deferral of income tax on investment earnings by investing the $50,000 in an individual annuity, or benefitted from lower capital gains and dividend tax rates on investment income by purchasing investments outside of a retirement savings vehicle. Therefore, the cost of the qualified retirement plan tax incentive should only reflect the cost of excluding the deferral in the year the contribution is made, plus deferral of tax on investment income on contributions in excess of an after-tax contribution amount, *less* the difference between ordinary income tax and capital gains and dividend taxes on investment income. (Note that for this small business owner, the after-tax value of the *employee* contributions would be available for investment outside of the qualified retirement plan, not just the after-tax value of the $50,000 contribution for the owner.)
- Analyzing the benefit for any given year during an accumulation period also fails to recognize the deferral nature of the savings tax incentive. When an individual saving $50,000 per year reaches retirement and distributions begin, the marginal income tax rate of those distributions will be substantially higher than for those with a history of lower contributions. (The fact that the amount of Social Security benefits includible in income, if any, depends on the amount of other retirement income received during a year increases the rate differential for retirees). As a result, this failure to consider taxes to be paid at a later date tends to overstate the relative benefits offered by the current system to those who make higher levels of contributions to these plans.

An analysis of the distribution of the tax incentives that considers these factors would show the current tax incentives for retirement savings are extremely efficient at distributing benefits to low- and moderate- income workers.

Adequacy of Benefits

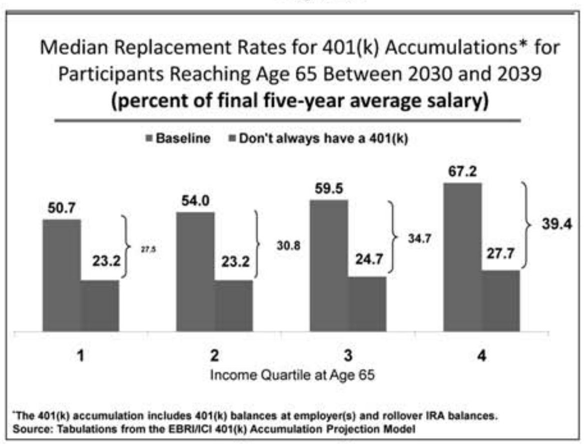
The availability of a defined contribution plan at work is a key determinant in the likelihood for having a secure retirement. Benefits can be very meaningful ….

Figure 7



if there is consistent availability of workplace savings.

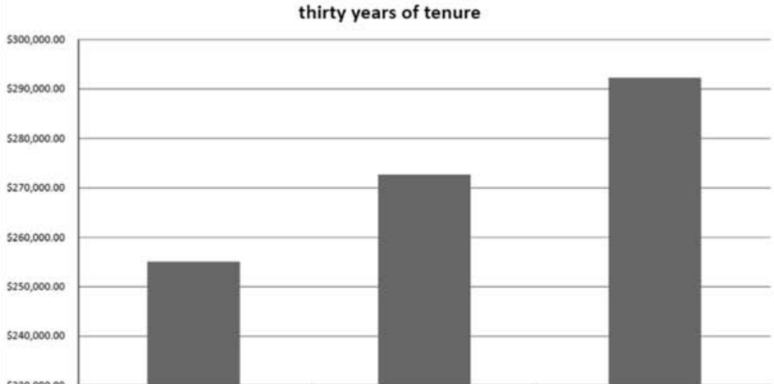
Figure 8



One of the challenges faced in analyzing the adequacy of retirement savings is that the usual method of measuring savings is based on average or median 401(k) accounts or IRA accounts. The result is often an understatement of individual's accumulations since many individuals have retirement savings held in more than one account. For example, I have only been employed by ASPPA for a little over 4 years, and considering only my ASPPA 401(k) balance would present a very different picture than considering my funds in an IRA, another 401(k) plan and TSP. Since it is not possible to consolidate accounts for everyone from everywhere, the adequacy of a life time of retirement savings through an employer-sponsored plan can be estimated by looking only at individuals nearing retirement age with long tenure with their current employer. As shown in the following table, substantial account balances are accumulating for these older active participants with long tenure in 401(k) plans:

Figure 9

Average account balances for 401(k) participants 55-64 with at least thirty years of tenure



	12/31/2010	12/31/2011 estimated	3/31/2012 estimated
average	$255,074.90	$272,680.81	$292,258.22

Sources: 2010 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2011 and 2012 Account Balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2010 and positive values for the sum of employee and employer contributions for that year.

Note that these are not "final" balances – many of these individuals are still working, with additional contributions being made to these arrangements. Also, "tenure" is years of service with the employer, not years of participation in a 401(k) plan. Since 401(k) plans did not become widely used until the early 1990's, employees with 30 years tenure with an employer today are not likely to have had 30 years of participation in a 401(k) plan.

Impact of Proposed Changes

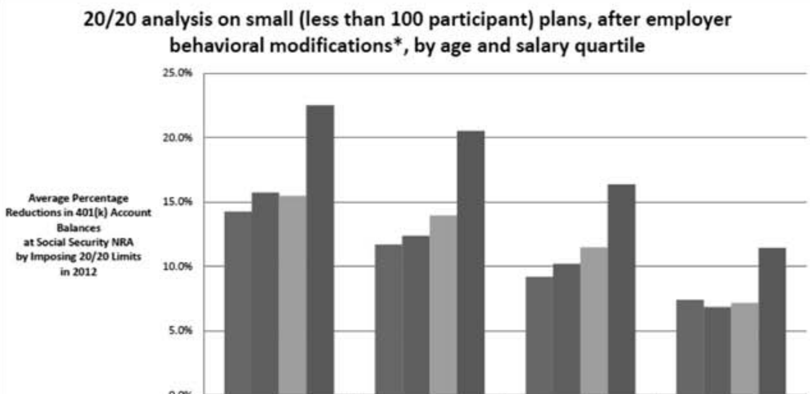
20%/$20,000 Cap

The Deficit Reduction Commission and the President's Economic Recovery Advisory Board ("PERAB") both floated the idea of reducing the current $50,000 maximum contribution for defined contribution plans to the lesser of 20% of pay or $20,000. Reducing the maximum contribution from the current $50,000 to $20,000 would mean the qualified retirement plan no longer makes financial sense for many small business owners. The result would be less access to retirement savings opportunities at work for rank and file employees. In a survey of "cross-tested" plans conducted by the American Society of Pension Professionals and Actuaries (ASPPA), 65% of plan sponsors indicated they were likely to terminate the cross-tested plan if the plan design were no longer available. A dramatic reduction in the limit would effectively make not only a cross-tested plan, but most other qualified defined contribution plans, unattractive to small business owners.

Even if some plans survived, contribution rates, and so projected balances, would decline. Employer contributions are often based on the level of contribution required to meet the nondiscrimination rules. Lower maximum contributions will mean nondiscrimination testing passes with a lower level of employer contributions, which means lower employer contributions for employees. Nonetheless, the reality for many small business retirement plans is that the reduced limits will mean the end of the plan. For many small businesses, even after reducing the level of employer contributions made on behalf of non-owner employees, the reduced tax incentive due to the lower limits will simply not create enough cash flow to justify continuing the plan at all.

The following chart shows the decline in projected account balances for participants in small plans (less than100 participants) , considering both changes in employee behavior and employer behavior, including the termination of plans, if the maximum contributions for defined contribution plans were reduced to the lesser of 20% of pay or $20,000.

Figure 10



	26-35	36-45	46-55	56-65
Lowest	14.2%	11.7%	9.2%	7.4%
2	15.7%	12.4%	10.2%	6.8%
3	15.5%	14.0%	11.5%	7.2%
Highest	22.5%	20.5%	16.4%	11.4%

Source: EBRI RSPM, version 110906c.

* This includes both reduced employer contribuion behavior as well as the plan termination scenario when there is a negative "net benefit" as a result of the 20/20 constraints, even after adjustments to contribuion levels.

Convert current exclusion to refundable credit

Another recurring proposal would convert the current-year contribution exclusion from income into a uniform tax credit. How a proposal such as this affects plan sponsors and participants depends, of course, on what the level of credit is, and whether or not it is deposited to a retirement savings account or directly offsets income tax liability. A recent proposal from William Gale[12] offers both a 30 percent credit, which the paper says would be revenue neutral, and an eighteen percent credit. This proposal purports to create additional savings by providing more incentive for taxpayers below the 23 percent and 15 percent marginal tax brackets to save. There appear to be several basic flaws in this proposal:

- Data shows the primary problem to be addressed in improving retirement security is increasing *access to workplace savings*, not a lack of incentive for take-up by participants with access. The proposal itself indicates that the current tax incentive for many decision makers would be reduced under the proposal. In other words, the "problem" being addressed by this proposal is not the problem, and the "solution" will only make the situation worse.

[12] William G. Gale, *A Proposal to Restructure Retirement Savings Incentives in a Weak Economy with Long-Term Deficits* (Sep. 8, 2011).

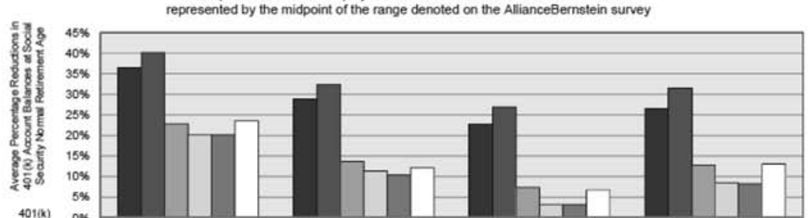
- If the credit is an offset from income tax liability, the size of the credit for a small business owner would determine if setting up or maintaining the plan is still worthwhile. If the credit were deposited to a retirement account, in many cases the resulting drain on cash would necessarily result in lower contributions for the small business owner and employees, or termination of the plan.
- If the proposal applies to all defined contribution plan contributions, not just elective deferrals, the administrative problems would be severe. Some employer contributions are not vested when contributed, so the incidence of taxable income would depend on the year of vesting, not the year of contribution. Consider an employee of modest income in a plan where employer contributions are fully vested after three years of service, and not vested before three years of service are completed. The employee would have to have income tax withheld on two or three years of employer contributions in one year, which would place a financial burden on the worker. Note that this problem would apply to any proposal that includes employer contributions in taxable income. The problem would be exacerbated if the employer contribution also becomes subject to FICA.

The following chart shows the decline in projected account balances for participants considering both changes in employee behavior and employer behavior, including the termination of plans, if the current year's exclusion were modified to an 18% refundable credit. As expected, participants in smaller plans would suffer most, with the lowest income quartile showing the largest reduction for all plan sizes.

Figure 11

Simulated Impact of Proposal to Modify the Federal Tax Treatment of Employer and Employee Contributions for 401(k) Plans In Exchange for an 18% Match From the Federal Government for Employees Currently 26–35, by Plan Size and Age-specific Salary Quartiles: Midpoint Estimates

Assumption for this run: Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey



401(k) Plan Size	Lowest income quartile	2	3	Highest income quartile
<1M	36.4%	28.8%	22.8%	26.5%
1–10M	40.1%	32.4%	26.9%	31.5%
10–50M	22.8%	13.7%	7.4%	12.8%
50–250M	20.2%	11.4%	3.3%	8.5%
250–500M	20.2%	10.4%	3.2%	8.3%
>500M	23.5%	12.2%	6.8%	13.1%

Source: Author's calculations based on results from EBRI Retirement Security Projection Model Version 1472, and responses to AllianceBernstein (2011) and Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2012 Retirement Confidence Survey.
Note: This simulation models only the financial impact of the expected reduction in 401(k) account balances for employees who are not automatically enrolled by modifying the behavior of plan sponsors and participants and does not attempt to assess behavioral modifications on the part of eligible nonparticipants. The simulated rates of return are the same as in VanDerhei and Copeland (July 2010). This version of the analysis assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in a future analysis. Plan sponsor and participant reactions to the proposal are explained in the text. Employer increases or decreases to contributions are represented by the midpoint of the range denoted on the AllianceBernstein survey.

From EBRI Notes March 2012 available at http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5019

Simplification

Proposals to modify the retirement savings tax incentives have included proposals to "simplify" the system by consolidating various types of plans into a single plan, by restricting plan designs to a limited number of safe harbor contribution formulas– in some cases a single safe harbor, or both. The effort is generally couched in statements regarding how the large number of options is confusing to employees and employers, and discourages participation in the system.

For example, proponents of combining all defined contribution plans into a single type of plan claim it would lead to higher participation rates, apparently based on a theory that employees don't join a plan at work because they are confused about the difference between a 401(k), a 403(b) or a 457(b) arrangement. That theory makes no practical sense, since employees are not asked to choose between these types of arrangements. The employee is asked whether or not they want to contribute to the plan the employer has made available – or the employee may even be automatically enrolled. Although combining 401(k), 403(b) and 457(b)'s into a single type of plan might look like simplification on paper, in practice it would disrupt savings and require state and local governments, nonprofits, and possibly private plan sponsors, to modify their defined contribution arrangements.

I spent over 20 years working with small businesses that were considering whether or not to set up a retirement plan. I can assure the Committee that "complicated" testing does *not* discourage employers from establishing plans, and employers would be *less* likely to establish plans that include employer contributions if the employer had less flexibility in plan design. The truth is, it is that flexibility that creates sufficient tax savings for the small business owner to fund the contributions for employees, and the availability of general nondiscrimination testing is key to this flexibility.

There are, however, complexities that discourage small business owners from taking advantage of the tax incentives for maintaining a plan, or incorporating features that would make the plan more effective as a savings vehicle for all employees. These complications are not rigidity in plan design, but the significant red tape, fines and penalties that can accompany even the most basic of these arrangements.

Some complications are statutory and some are regulatory. For example, multiple employer plans (MEPs) are one approach that is gaining favor in the marketplace. However, the growth is hindered by regulatory confusion that is a perfect example of how a business operating in good faith can be tripped up by conflicting regulations. The Internal Revenue Code clearly states that a retirement plan operated by more than one unrelated employers is a multiple employer plan. ERISA doesn't clearly contradict this definition, but the ERISA definition applies to welfare plans as well as retirement plans, and guidance on welfare plans has established that the employers must have a relationship other than joint sponsorship of the plan to participate in a "multiple employer plan". The sad thing is, if DOL doesn't conclude that MEP under the Code is also a MEP under ERISA, it's the small business owners that have in good faith joined these arrangements that could be faced with penalties for not filing an annual Form 5500. Mr. Kind and Mr. Reichart have a provision in their SAVE Act that addresses this concern, and if DOL does not take care of it, Congress will need to fix the problem.

Another regulatory issue that may require a legislative fix is electronic delivery of information. ASPPA has been a strong supporter of disclosure. We also think information delivered in a thick stack of paper is unlikely to be read. If a participant wants paper, they should be able to get it. However, the default delivery system should be the one that provides the most useful form of information to most participants, and that is not a pile of paper. We thank Mr. Neal for including default electronic disclosure in HR 4050.

There are numerous other examples of how the framework for operating a small qualified plan could be simplified, but here are a few suggestions:

- Eliminate mandatory "interim amendments"[13] which increase the cost and burden of maintaining a plan without any corresponding benefit. The current process is

[13] Qualified retirement plans are governed by written documents that must meet certain requirements under the Internal Revenue Code to maintain tax-favored status. Revenue Procedure 2005-66, as modified by Rev. Proc. 2008-56, provides staggered dates for plan documents to be submitted to IRS for review as to a plan's qualified status. Individually designed plans are on five-year cycles, and pre-approved documents are on six-year cycles. During these five or six-year cycles, plans must adopt amendments to reflect legislative and regulatory changes to the qualification requirements. Except as provided by law or other guidance, these "interim amendments" must gene rally be adopted by the due date (including extensions) for filing the income tax return for the taxable year the change is effective. There is no coordination of the due dates of these required "interim amendments" with the cycle for submission of documents to IRS.

incredibly complicated, with different amendment deadlines that vary based upon the type of amendment and the plan's fiscal year. This leads to mistakes being made by well meaning plan sponsors (who are voluntarily providing this benefit). Small plan sponsors in particular are shocked and surprised when asked to pay thousands of dollars in sanctions when an inadvertent amendment mistake is uncovered during an IRS audit. Amendment deadlines co-ordinated with the plan's 5 or 6 year review cycle would be user friendly and cost-effective.

- Don't penalize small employers for allowing employees to start contributing to a 401(k) plan immediately upon employment. This could easily be accomplished by excluding employees the statute would have allowed to be excluded from participation in the plan[14] from the 3% minimum "top heavy"[15] contribution requirement.
- Make it less "dangerous" for small employers to use automatic enrollment by making it less expensive when the plan inadvertently fails to automatically enroll an employee. Small employers shy away from automatic enrollment, often because a mistake can cost the employer 3% of the employee's pay for the year, in addition to any matching contribution the employer would have made if the employee had been enrolled and contributed the default amount. It is reasonable to require the employer to make any matching contributions that would have been due if the employee had contributed the default amount, but to impose an additional cost because the employer voluntarily adopts automatic enrollment simply discourages adoption of automatic enrollment.
- Eliminate unnecessary notices, such as the notice requirements for the 3% safe harbor. The safe harbor information is already provided to participants in the Summary Plan Description, and since employees receive the contribution whether or not they contribute to the plan, it does not cause participants to change their behavior.
- Simplification should not be limited to defined contribution plans. Enactment of the proposal to eliminate reduction of assets by credit balances in applying the benefit restrictions of Code section 436 would not only make sense from a policy standpoint, but would dramatically simplify the operation of that provision. (This proposal is included in H.R. 3561 – The Small Business Pension Promotion Act, sponsored by Representatives Kind, Gerlach and Neal.)

ASPPA looks forward to working with the Committee to simplify the rules and regulations surrounding retirement savings incentives, and to help American workers, especially small business owners and their employees, take advantage of workplace savings.

[14] Employees who have not attained age 21 or who have not completed a year of employment with at least 1000 hours of service may be excluded from plan participation.

[15] A plan is considered top heavy if over 60% of the accrued benefits are for "key employees". Many small business plans are top heavy and, as a result, must provide all participants in a defined contribution plan with a contribution of at least 3% compensation. For a defined benefit, the requirement is a minimum accrued benefit of 2% of pay per year of service, with a 20% maximum. Special rules apply to participants covered under both types of plans.

Auto-IRA

ASPPA supports the auto-IRA proposal developed by the Retirement Security Project, and proposed in HR 4049 sponsored by Representative Neal (D-MA). The proposal does not require employers to contribute to a retirement plan, or impose fiduciary responsibilities on business owners. It does give employees an opportunity to contribute to an IRA on their own behalf through payroll deduction. Providing a payroll deduction arrangement will also make it more of a natural step for employers to consider sponsoring a SIMPLE or 401(k) plan when the business reaches the point that, with the assistance of the tax incentives, it can support employer contributions.

Summary

The current system is working very well for millions of working Americans. Expanding *availability* of workplace savings is the key to improving retirement security. There is no need for dramatic changes, but measures should definitely be considered to make it easier for employers, particularly small businesses, to offer a workplace savings plan to their employees. ASPPA looks forward to working with the Committee to achieve meaningful simplification, and retirement security for American families.

I would be pleased to discuss these issues further with the Committee or answer any questions that you may have.

Chairman CAMP. Mr. Sweetnam, you are recognized for 5 minutes.

STATEMENT OF WILLIAM F. SWEETNAM, PRINCIPAL, GROOM LAW GROUP, WASHINGTON, D.C.

Mr. SWEETNAM. Chairman Camp and Ranking Member Levin, thank you for the opportunity to testify at this hearing. I am a principal in the Groom Law Group, a law firm that focuses exclusively on employee benefits law. Prior to joining Groom, I was the benefits tax counsel at the Office of Tax Policy at the Department of Treasury from 2001 to 2005. I will testify today about the simplification proposals for retirement savings accounts that we developed at the Office of Tax Policy and that were included in the Bush administration's budget proposals for fiscal years 2004 and 2005. Please note that I am speaking today on my own behalf and not speaking on behalf of the firm or any firm client in my testimony.

One of the reasons to simplify, the Code currently provides various incentives for individual retirement savings, for employer-based retirement savings, and for other savings objectives, such as the payment of medical expenses or educational expenses. All these savings vehicles have different eligibility requirements, and the amount of the tax benefits could change based on the individual's income status or his or her participation in other savings programs.

Employer-provided retirement savings vehicles present their own level of complexity. Under the Internal Revenue Code, there are a number of retirement savings vehicles that employers can adopt, including 401(k) plans, 403(b) plans, and 457(b) plans. Some rules vary depending on the type of plan, and there are limitations on the type of entity that can adopt certain types of plans.

Multiple nondiscrimination rules add complexity to the administration of these plans. While nondiscrimination rules are a means of making sure that lower-paid employees share in the benefits provided under these savings plans, some commentators argue that the level of complexity is excessive in relation to the benefits that lower-paid employees receive.

The Administration's 2004 budget proposal outlined a simplified system of retirement savings, with only three types of tax-favored vehicles: Lifetime savings accounts, LSAs; retirement savings accounts, RSAs; and employer retirement savings accounts, ERSAs.

Lifetime savings accounts. Individuals would be able to contribute $5,000 on an after-tax basis to an LSA. Amounts contributed would grow on a tax-free basis. There would be no income limitations on who could contribute to an LSA. Distributions from these accounts could be made at any time regardless of the individual's age and could be used for any reason by the account owner. Those individuals with limited means to save might be more willing to contribute to an LSA because they could access the money saved in the LSA in the event of an emergency, which is different than making contributions to a retirement-based system.

Our next was retirement savings accounts, RSAs. Individuals could contribute $5,000 on an after-tax basis to an RSA, with account earnings growing on a tax-free basis. Like the LSA, no income limits would apply to contributions to an RSA. Qualified distributions, i.e., those made after an individual attained age 58 or in the event of death or disability, would be tax free. All other distributions would be considered nonqualified distributions and would be included in income to the extent that the distribution exceeds basis.

Finally, employer retirement savings accounts, ERSAs, would be available to all employees regardless of the type of employee entity. ERSAs generally would follow the existing rules for 401(k) plans, including the 401(k) contribution limit, the catch-up contribution limit for employees age 50 and above, and the availability of Roth contributions. The nondiscrimination testing rules would be simplified and would be eliminated if lower-paid employees had high savings rates under the plan. Although these simplification efforts did not advance in Congress, our efforts to review and recommend comprehensive changes to the current retirement savings system was, I believe, worthwhile.

Any effort to advance tax reform will likely include a review of retirement savings initiatives. If one goal of tax reform is to simplify the current system, I would recommend that the Committee examine the work of the Office of Tax Policy during the Bush administration.

Thank you for this opportunity to address the Committee. I will be happy to answer any of your questions.

Chairman CAMP. Thank you, Mr. Sweetnam.

[The prepared statement of Mr. Sweetnam follows:]

Statement of
William F. Sweetnam
Principal, Groom Law Group, Chartered
Before the
Committee on Ways and Means
United States House of Representatives
April 17, 2012

Chairman Camp and Ranking Member Levin -- thank you for the opportunity to testify at this hearing. I am a principal in the Groom Law Group, a law firm located in Washington, DC that focuses exclusively on employee benefits law. Prior to joining the Groom Law Group, I was the Benefits Tax Counsel in Office of Tax Policy at the U.S. Department of the Treasury from 2001 to 2005. I will testify today about the simplification proposals for retirement savings accounts we developed in the Office of Tax Policy and that were included in the Bush Administration's budget proposals for Fiscal Year 2004 and 2005. Please note that I am speaking today on my own behalf and am not speaking on behalf of the firm or any firm clients in my testimony.

The Joint Committee on Taxation estimates that tax expenditure for pension contributions and earnings is over $700 billion and over $87 billion for traditional and Roth IRAs.[1] Retirement savings is the largest tax expenditure after the tax exclusion for employer provided health care.

While some critics suggest that the current system – and tax expenditure -- do not result in adequate retirement replacement rates, it is important to note that other studies show that these plans can and do provide adequate retirement replacement income, particularly when taking into account the income form Social Security. [2]

Reasons for Simplification

The Internal Revenue Code currently provides various savings incentives for individual retirement savings, for employer-based retirement savings and for other savings objectives, such as the payment of medical expenses or education expenses. All these different savings vehicles have different eligibility requirements and the amount of the tax benefit could change based on the individual's income status or his or her participation in other savings programs.

Individual Retirement Savings Vehicles. For individual retirement savings, the choice is whether to make a pre-tax contribution to a traditional individual retirement account (IRA), make an after-tax contribution to a traditional IRA or make an after-tax

[1] Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015 prepared for the House Committee on Ways and Means and the Senate Committee on Finance by the Staff of the Joint Committee on Taxation, January 17, 2012.
[2] Peter J. Brady. Can 401(k) Plans Provide Adequate Retirement Resources? *Public Finance Review* March 2012 40: 177-206.

contribution to a Roth IRA. The type of contribution an individual is eligible to make and the amount of the contributions is dependent on the individual's modified adjusted gross income and whether the individual is covered by an employer-sponsored retirement plan. The following charts (taken from IRS publications and websites) will illustrate the difficulty in knowing whether an individual is eligible to contribute to the various types of IRAs.

2011 IRA Deduction Limits - Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work

If Your Filing Status Is...	And Your Modified AGI Is...	Then You Can Take...
single or **head of household**	$56,000 or less	a full deduction up to the amount of your contribution limit.
	more than $56,000 but less than $66,000	a partial deduction.
	$66,000 or more	no deduction.
married filing jointly or **qualifying widow(er)**	$90,000 or less	a full deduction up to the amount of your contribution limit.
	more than $90,000 but less than $110,000	a partial deduction.
	$110,000 or more	no deduction.
married filing separately	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.
If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.		

2011 Deduction Limit - Effect of Modified AGI on Deduction if You Are NOT Covered by a Retirement Plan at Work

If Your Filing Status Is...	And Your Modified AGI Is...	Then You Can Take...
single, **head of household**, or **qualifying widow(er)**	any amount	a full deduction up to the amount of your contribution limit.
married filing jointly or **separately** with a spouse who **is not** covered by a plan at work	any amount	a full deduction up to the amount of your contribution limit.
married filing jointly with a spouse who **is** covered by a plan at work	$169,000 or less	a full deduction up to the amount of your contribution limit.
	more than $169,000 but less than $179,000	a partial deduction.
	$179,000 or more	no deduction.
married filing separately with a spouse who **is** covered by a plan at work	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.
If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.		

2011 Deduction Limit – Effect of Modified AGI on Roth IRA Contribution		
This table shows whether your contribution to a Roth IRA is affected by the amount of your modified adjusted gross income (modified AGI).		
If you have taxable compensation and your filing status is…	**AND your modified AGI is…**	**THEN…**
married filing jointly or qualifying widow(er)	less than $169,000	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	at least $169,000 but less than $179,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$179,000 or more	you cannot contribute to a Roth IRA.
married filing separately and you lived with your spouse at any time during the year	zero (-0-)	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	more than zero (-0-) but less than $10,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$10,000 or more	you cannot contribute to a Roth IRA.
single, head of household, or married filing separately and you did not live with your spouse at any time during the year	less than $107,000	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	at least $107,000 but less than $122,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$122,000 or more	you cannot contribute to a Roth IRA.

Employer-Sponsored Retirement Savings Vehicles. Employer-sponsored retirement savings vehicles present their own level of complexity. The first level of complexity is the choice of retirement savings vehicle. Under the Internal Revenue Code, there are a number of tax-favored, defined contribution retirement savings vehicles that employers can adopt, including the following types of plans: 401(k) plans, 403(b) plans, 457(b) plans, SIMPLE 401(k) and IRAs, thrift plans, and salary reduction simplified employee pensions (SARSEPs).

401(k) plans. Private employers may establish 401(k) plans, which allow participants to choose to take compensation in the form of cash or a contribution to a defined-contribution plan (elective deferral). Annual deferrals under a 401(k) plan may not exceed $17,000 in 2012. Participants aged 50 or over may make additional "catch-up" deferrals of up to $5,500. Elective deferrals are fully vested immediately.

401(k) plans are subject to an actual deferral percentage (ADP) test, which generally measures and compares highly compensated and non-highly compensated employees' elective-deferral rates. Three 401(k)-plan "safe-harbor" designs based on the employer matching contribution provided are deemed to satisfy the ADP test automatically. "Catch-up" contributions are not subject to the ADP test.

SIMPLE 401(k) Plans and IRAs. Employers with 100 or fewer employees and no other retirement plan may establish a SIMPLE 401(k) plan or IRA. Deferrals by SIMPLE participants may not exceed $11,500 in 20012. SIMPLE participants aged 50 or over may make additional "catch-up" deferrals of up to $2,500. All contributions are immediately fully vested. In lieu of the ADP test, SIMPLE plans are subject to special contribution requirements, including a lower annual elective deferral limit and either a matching contribution not exceeding 3 percent of compensation or a non-elective contribution of 2 percent of compensation (with certain special rules for SIMPLE IRAs).

Thrift plans. Employers may establish thrift plans under which participants may choose to make after-tax cash contributions. Such after-tax contributions, along with any matching contributions that an employer elects to make, are subject to the actual contribution percentage (ACP) test (without the availability of an ACP safe harbor). Employee contributions under a thrift plan are not subject to the $17,000 limit that applies to employee pre-tax deferrals.

Roth-treatment of contributions. Participants in 401(k), 403(b) and governmental 457(b) plans can elect Roth treatment for their contributions – i.e., contributions are made on an after-tax basis and distributions are excludible from income. Roth contributions must be accounted for in a separate account. There are no required minimum distributions during an employee's lifetime.

Salary reduction simplified employee pensions (SARSEPs). Employees can elect to have contributions made to a SARSEP or to receive the amount in cash. The amount the employee elects to have contributed to the SARSEP is not currently includible in income and is limited to the dollar limit applicable to employee deferrals in a 401(k) plan. SARSEPs are available only for employers who had 25 or fewer eligible employees at all times during the prior taxable year and are subject to a special nondiscrimination test. The rules permitting SARSEPs were repealed in 1996, but employee deferral contributions can still be made to SARSEPs that were established prior to January 1, 1997.

403(b) plans. Section 501(c)(3) organizations and public schools may establish tax-sheltered annuity plans, also called 403(b) plans. In general these plans are subject to similar but slightly different rules than 401(k) plans. Benefits may be provided through the purchase of annuities or contributions to a custodial account invested in mutual funds. Contribution limits (including catch-ups), deferral limits, and minimum distribution rules are generally the same as for 401(k) plans. However, certain employees with 15 years of service may defer additional amounts under a complicated three-part formula. Certain 403(b) plans are subject to nondiscrimination rules.

Governmental 457(b) plans. State and local governments may establish Section 457(b) plans. In general, these plans are subject to similar but different rules than 401(k) plans. Participant contributions and plan earnings generally are tax-deferred until withdrawal. Participant elective contributions may not exceed the lesser of 100 percent of compensation or $17,000 in 2012. However, participants may make additional contributions of up to twice the standard amount in the last three years before normal retirement age. Participants aged 50 or over may make additional "catch-up" contributions of up to $5,500.

Nondiscrimination Rules and Employer-Sponsored Plans. Multiple nondiscrimination rules add complexity to the administration of these plans. The nondiscrimination rules are a means of making sure that lower-paid employees share in the benefits provided under retirement savings plans. However, commentators have noted that the benefit accruing to lower-paid workers due to the nondiscrimination rules needs to be weighed against the cost to workers who do not have a 401(k) plan due to the nondiscrimination rules. The Office of Tax Policy during the Bush administration recognized that complexity in the administration of establishing and administering a 401(k) plan is cited as a primary reason that small businesses were reluctant to establish savings plans, so we looked to eliminate requirements that were overly complicated or redundant.

Congress has changed the nondiscrimination rules several times over the years. For example, SIMPLE 401(k) plans, introduced in 1996 and available to employers with fewer than 100 employees, have less administrative burdens and more flexible rules than standard 401(k) plans. Congress has also provided "safe harbor" plan designs whereby if the employers that provide certain levels of matching or nonelective contributions are deemed to satisfy the nondiscrimination test.

Administration's Savings Proposals.

The Bush Administration's 2004 budget proposal outlined a simplified system of tax-favored savings with only three types of tax-favored savings vehicles: Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs), and Employer Retirement Savings Accounts (ERSAs). In the following year's budget proposal, the Administration proposed similar simplification measures – modified to reflect comments we received from retirement policy experts.

Lifetime Savings Accounts. Individuals would be able to contribute $5000 on an after-tax basis to an LSA. Amounts contributed would grow on a tax-free basis. There would be no income limitations on who could contribute to an LSA.

Distributions from these accounts could be made at any time regardless of the individual's age and could be used for any reason by the account holder. Survey data has shown that younger and lower-income households are less likely to cite retirement as the primary reason that they save. Every three years, the Federal Reserve Board conducts the Survey of Consumer Finance (SCF), which asks households detailed questions about their balance sheets and incomes. The survey also asks households what they consider their most important reason for saving. According to the most recent SCF data (2007), 37 percent of households headed by an individual aged 21 to 64 reported that the most important reason for savings was for retirement. Another 29 percent of households reported they were primarily saving for "liquidity" or precautionary savings to guard against unexpected circumstances. The next most common reasons for savings were education, home purchases and future purchases. Based on this data, we believed that individuals with limited means to save would be more willing to contribute to an LSA because they would be comfortable that the money saved in the LSA could be used in the event of an emergency.

Retirement Savings Accounts. Individuals also could contribute $5,000 (or earnings includible in gross income, if less) on an after-tax basis to an RSA, with account earnings growing on a tax-free basis. Like the LSA, no income limits would apply to contributions to an RSA. Qualified distributions – i.e., any distributions made after an individual attained age 58 or in the event of death or disability -- would be tax free. All other distributions would be considered non-qualified distributions and would be included in income to the extent that the distribution exceeds basis and would be subject to a 10 percent additional tax.

Transition Issues with LSAs and RSAs. While simplification was the goal, moving from the current tax regime to another raised transition issues. For example, existing Roth IRAs would be renamed RSAs and subjected to the new RSA rules, whereas existing traditional IRAs would be converted into RSAs with the conversion amount includible in income – much like the conversion rules when Roth IRAs were enacted. The income recognized by these conversions could be spread over a 4-year period. Medical Savings Accounts, Archer MSAs, Coverdell Education Saving Accounts, and Qualified State Tuition Plans also could be converted to an LSA.

Modification of the LSA and RSA Proposal. After the Bush Administration's proposal was first released in the Fiscal Year 2004 budget proposal, the Office of Tax Policy meet with many interested parties, some of whom pointed out that the proposals could result in fewer savings opportunities available for employees who worked in small businesses. Some groups noted that the savings opportunities available through the LSA and RSA might result in small business owners deciding that their retirement savings needs were adequately addressed through the LSA and RSA and opting not to offer employees an employer-based savings vehicle. Changes were made in the Fiscal Year 2005 budget proposal to address those concerns and help ensure that simplification did not to result in fewer savings opportunities.

Employer Retirement Savings Accounts. ERSAs would be available for all employees regardless of the type of employing entity. ERSAs generally would follow the existing rules for §401(k) plans, including the 401(k) contribution limit,[3] the catch-up contribution limit for employees age 50 and above and the availability of Roth-type contributions.

The nondiscrimination testing rules would be simplified. Under the proposal, the average contribution percentage of highly compensated employees could not exceed 200 percent of the non-highly compensated employees' average contribution percentage. However, if the non-highly compensated employees average contribution percentage exceeded 6 percent, the plan would be considered to be effectively providing savings opportunities for the non-highly compensated employees and, like the current law safe harbor plan designs, no further nondiscrimination testing would be required. Like current law, the proposal would provide for design-based safe harbors based on the amount of employer matching contributions. Finally, as under current law, there would be different nondiscrimination testing rules for state and local governments and certain tax-exempt organizations and the proposal did not attempt to change those requirements.

* * *

Even though these simplification efforts did not advance in Congress -- although it is worthwhile noting that Rep. Sam Johnson (R-3rd TX) did introduce legislation regarding the LSAs -- the effort to review and recommend comprehensive changes to the current savings system was, I believe, worthwhile. Any effort to advance tax reform will likely include a review of the retirement savings incentives. If one goal of tax reform is to simplify the current system, I would recommend that the Committee examine the work of the Office of Tax Policy during the Bush administration.

Thank you for this opportunity to address the Committee. I will be happy to answer any questions the Committee may have.

[3] Support among American Households for maintaining current contribution limits is substantial. See, for example, *America's Commitment to Retirement Security: Investor Attitudes and Actions*, January 2012, a report by The Investment Company Institute, showing among other things, that 83 percent of households surveyed do not want the contribution limits lowered.

Chairman CAMP. Mr. John, you are recognized for 5 minutes.

STATEMENT OF DAVID C. JOHN, SENIOR RESEARCH FELLOW IN RETIREMENT SECURITY AND FINANCIAL INSTITUTIONS, THE HERITAGE FOUNDATION, WASHINGTON, D.C.

Mr. JOHN. Thank you. Chairman Camp and Ranking Member Levin, I appreciate the opportunity to testify before you this morning on ways to ensure that all Americans have the opportunity to save for retirement. I am David John, a senior research fellow at The Heritage Foundation and also the deputy director of the Retirement Security Project.

This is an issue that transcends ideological and partisan differences. For those who have access to a payroll deduction retirement savings account, the current system works fairly well. However, millions of Americans still lack that ability. In theory they can save in an IRA, but as Jack and Judy have shown, only a maximum of about 5 percent actually do so on a regular basis. Many of these workers who lack the ability to save through payroll deduction are part-time employees of smaller businesses, women, members of minority groups, younger workers, or all four.

Social Security, even if it was fully funded, only provides about half the retirement income needs of an average-income worker. Either we can ensure that everyone has the ability to save to provide for themselves in retirement, or a Congress in the near future will face demands for additional taxpayer-paid benefits. Those demands will be very hard to resist.

Ensuring that all Americans have the opportunity to save will require some hard decisions. The proposal developed by Mark Iwry, who was then at Brookings, and I for automatic IRAs would provide a relatively simple, cost-effective way to increase retirement security for millions of Americans. The automatic IRA would enable these Americans to save for retirement by allowing them to regularly contribute amounts from their own paychecks to an IRA. The plan is simple for both employers and employees. Employees would be automatically enrolled into their employer's automatic IRA. Automatic enrollment is a process that has proven to build participation, which employees like, and under which employees have complete control ultimately of their own retirement savings decisions.

To avoid confusion and to keep costs low, all automatic IRAs would offer three, and only three, investment choices. For employers, the plan is also very simple. They would be asked to do the same thing they now do, to withhold income and other taxes from an employee's paycheck, except that the money would go into an IRA instead of to the Treasury. Employer contributions would neither be required nor permitted. Employers would not be required to comply with ERISA rules or other types of regulations that apply to 401(k)s or a variety of other things. These simplifications eliminate almost all the costs associated with an automatic IRA, but the plan also includes a tax credit designed to cover any remaining start-up and administrative costs.

While the automatic IRA is especially valuable for new savers, it would be equally valuable for older savers who change jobs from a company that offers a 401(k) plan to a smaller company that currently has no type of retirement savings plan. Right now these workers stand to have gaps, which cripple their ability to build retirement security. However, under the automatic IRA, they could roll their 401(k)-type accounts into the automatic IRA and continue savings. That would also work if they went to a larger company.

This is not a partisan or an ideological proposal. The concept has been endorsed by a number of varied publications, such as *National Review* and the *New York Times*. It has been endorsed by significant conservative and liberal officials and other types of officials.

Earlier this year Representative Richard Neal introduced H.R. 4049, the Automatic IRA Act of 2012. While The Heritage Foundation, as a 501(c)(3) nonprofit, does not and cannot endorse any legislation, let me say that the policy contained in his bill would significantly improve our retirement savings system.

My written statement also discusses the value of simplifying the current confusing series of retirement savings accounts so that ordinary Americans and employers can better understand them. In addition, my statement discusses two modest proposals, first to use tax information to encourage taxpayers to consolidate their retirement accounts if they desire to do so, and second to include Social Security on an annual 401(k) or IRA statement so that the account owner has a complete picture of their expected total retirement income in time to make a change so that they could actually increase savings and improve their potential outcome. It also discusses the desirability of allowing multiple employers to share a retirement savings platform, and a thought or two about the tax treatment of retirement savings. I would be happy to discuss them at any point.

Thank you for giving me this opportunity to testify. I look forward to your questions.

Chairman CAMP. Thank you very much.

[The prepared statement of Mr. John follows:]

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CONGRESSIONAL TESTIMONY

Pursuing Universal Retirement Security Through Automatic IRAS and Account Simplification

Testimony before
The Committee on Ways and Means
United States House of Representatives

April 17, 2012

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The Heritage Foundation

I am David C. John, the Senior Research Fellow for Retirement Security and Financial Institutions at The Heritage Foundation. In addition, I am also the Deputy Director of the Retirement Security Project (RSP). The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation or RSP.

Chairman Camp and Ranking Member Levin, I appreciate the opportunity to testify before you on ways to increase retirement savings opportunities for all Americans. With the continued decline in the number of Americans covered by employer sponsored defined benefit plans, millions of individuals whose employers don't offer any way for them to save for retirement at work, and Social Security's continued financial problems[1], it is crucial that the Congress develops a common strategy to expand retirement savings in a manner that transcends ideological and partisan differences.

In 2006, a bipartisan majority in Congress eliminated barriers to the use of automatic enrollment and similar automatic techniques in retirement savings plans with the result that millions more Americans are both saving and building retirement security. The results have been stunningly good. With automatic features, enrollment in 401(k)-type accounts has grown to average over 80 percent of eligible employees. In addition, every major income, age, racial or ethnic, and gender has shown an increase in participation rates.

However, the job is not complete. As I will discuss in a moment, there are still millions who do not have access to a payroll deduction retirement savings account, the best and most effective way to build a retirement nest egg. It is true that these workers could save in an IRA, but studies show that only about 5 percent to at most 10 percent of those workers who have access only to a non-payroll deduction IRA actually have such an account and make regular contributions to it.

Meeting this challenge will require some hard decisions, and the longer those decisions are delayed, the harder they will become. While Social Security provides a benefit that is sufficient to meet the retirement income needs of most lower income retirees, it only provides a fairly modest proportion of the retirement income needs of average and above average income retirees. Even if Social Security was fully funded and had all of the resources necessary to pay all of its promised benefits, which it does not, those benefits would still provide only about half of what the average income retiree needs for a comfortable retirement.

Most retirees will need some other means of additional retirement income, and given today's realities, that means it will be either come from an expanded and improved retirement savings system or from additional government-provided benefits. In a future

[1] For a discussion of Social Security's finances, see "Social Security 2011 Trustees Report Shows Permanent Deficits" by David C. John, Heritage Foundation Webmemo #3256, May 16, 2011 at: http://www.heritage.org/research/reports/2011/05/social-security-2011-trustees-report-shows-permanent-deficits.

where massive deficits will remain commonplace, it will be difficult to impossible for the government to provide additional retirement benefits. But, as it takes time for savings to accumulate to the point where they can finance a decent level of income, delay makes it much more likely that a future Congress will face a demand for additional government benefits.

With the looming retirement security crisis facing our country, policy-makers from both parties are focused on ways to strengthen pensions and increase savings. The proposal developed by Mark Iwry, who was then at Brookings, and I for Automatic IRAs would provide a relatively simple, cost-effective way to increase retirement security for the 75 million Americans working for employers (usually small businesses) that do not offer a retirement plan. Many of these workers are part-time employees of smaller businesses, women, members of minority groups, or all three. The Automatic IRA would enable these employees to save for retirement by allowing them to regularly transfer amounts from their paycheck to an IRA.

This fact, a national saving rate that has been too low since the 1980s, and the expectation that Social Security is unlikely to provide increased benefits, make inadequate retirement saving a major national problem. Research and experience both point to a simple and effective solution, the Automatic IRA.

The Automatic IRA is certainly not the only step that should be taken to expand retirement savings for small business workers or others, but it would be a good start. In fact, both Mark Iwry and I have long believed that employer-sponsored retirement plans including 401(k)-type retirement savings accounts are the best way for individuals to build retirement security. Additionally, both The Heritage Foundation and the Retirement Security Project continue to advocate strongly for expanded participation in employer sponsored retirement savings accounts through automatic features in 401(k) and similar retirement savings plans and for several other initiatives designed to expand retirement security, especially for the moderate- and lower-income households that comprise a majority of the U.S. population.

Making saving easier by making it automatic has been shown to be remarkably effective at boosting participation in 401(k) plans, but they are of no use to the millions of US workers who are not offered a 401(k) or any other type of employer-sponsored plan. We could and should extend the benefits of automatic saving to a far wider array of the population by combining several key elements of our current system: payroll deposit saving, automatic enrollment, low-cost, diversified default investments, and IRAs.

The Automatic IRA offers most employees who are not covered by any form of employer-sponsored retirement plan the opportunity to save through the powerful mechanism of regular payroll deposits that continue automatically. The employer's administrative functions are minimal and under our proposal should involve no out of pocket cost for the employer. In addition, the arrangement is market-oriented and realistic: it uses a well established and familiar vehicle, IRAs, provided by the same banks, mutual funds, insurance carriers, brokerage firms, credit unions, and other private financial institutions that have provided them for decades. As a fallback, if individuals or employers could not find an acceptable Automatic IRA on the market, they would be able to use ready-made, low-cost automatic IRA accounts provided by a consortium or pool of private-sector financial institutions.

Automatic enrollment is a key part of the Automatic IRA because it especially helps those groups who are most likely to undersave: women, minorities, younger workers, and low- to moderate-income workers. Experience shows that these groups move from very low participation rates that range in percentages from the mid-teens to the mid-twenties to participation rates that reach the mid-eighties. This is equal to those of all workers. Overall, 401(k) participation rates under automatic enrollment increase participation rates from roughly two-thirds of eligible workers to the mid-80 percent level. A key improvement is that individuals start to save earlier than they would have otherwise, which opens the door to their accumulating much higher amounts by the time they are eligible to retire.

While many focus on the value of the Automatic IRA to new savers, it would be equally valuable to older workers who change jobs from a company that offers a 401(k) plan into a smaller company that currently has no type of retirement savings plan. These workers tend to now have savings gaps, which can cripple their ability to build retirement security. However, under the Automatic IRA, those workers could combine his or her old 401(k)-type accounts into an Automatic IRA and to continue saving. Data shows that most workers change jobs as many as 10 times during a career, and without the ability to continuously save throughout their careers using payroll deduction, many Americans will have less than they need for a comfortable retirement.

This is not a partisan or ideological proposal. In 2008, the Automatic IRA won the endorsement of both the Obama and McCain campaigns, and it has continued to enjoy support from all sides of the ideological spectrum. Earlier this year, Rep. Richard Neal of the committee introduced HR 4049, the Automatic IRA Act of 2012. While the Heritage Foundation as a 501(C)3 nonprofit does not and can not endorse any legislation, let me say that the policy contained in his bill would significantly improve our retirement savings system. In the Senate, a similar bill was introduced last September by Sen. Jeff Bingaman as S. 1557. Previous versions were either sponsored or co-sponsored by former Rep. Phil English (R-PA) and former Sen. Gordon Smith (R-OR), and the concept has been endorse by such varied publications as the National Journal and the New York Times. It has also been endorse by significant conservative and liberal officials and former officials.

While my testimony will focus on the Automatic IRA, a second part will discuss simplifying the current confusing series of retirement account types and tax treatments so that both ordinary Americans and employers can better understand their savings options. Rather than the current system of multiple account-types named after sections of the tax code, past legislators and others, there could be a couple of simple savings options available to all, and structured so that they can be combined and rolled over from one employment situation to another as the saver progresses through his or her career.

Finally, I will end with two modest proposals to use tax information to encourage taxpayers to consolidate their retirement accounts if they desire to, and to include Social Security information on an annual 401(k) or IRA statement so that the account owner has information about their expected total retirement income, the need to enable multiple employers to share a retirement savings platform, and a thought about the tax treatment of retirement savings.

The Automatic IRA

The Automatic IRA is intended to help households overcome the barriers to saving by building on the success 401(k) plans with automatic features. Both automatic enrollment and automatic escalation encourage employees toward sensible decisions while still giving them complete control over their retirement savings choices. The Automatic IRA features direct payroll deposits into a low-cost, but simple IRA structure that offers diversified investments. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years but do not sponsor a 401(k) plan or any other retirement plan for their employees would be asked to facilitate their employees saving – without the need to sponsor a formal ERISA-regulated plan, without making employer matching contributions, and without complying with plan qualification or fiduciary standards. They would simply act as a conduit, remitting a portion of their employees' pay to an Automatic IRA, preferably by direct deposit.

The Automatic IRA is also designed to address the concerns of financial providers that have found it less profitable to serve groups of people with a small average account balances. The proposal would provide an optional R-Bond arrangement that uses a Treasury bond account to enable new and small savers to build a nest egg large enough to interest private sector providers, and a private sector backstop arrangement that enables any employer unable to find a local financial institution interested in offering them an Automatic IRA to use one of a series of private sector providers who have agreed to accept any business in any location.

The Automatic IRA Is Simple for Employers

The Automatic IRA would not impose a burden upon employers. They need do little more than they do now with the income and payroll taxes they deduct from an employee's paycheck and send to the IRS. In this case, employers will deduct some of the employees' own money and send it to the private sector funds manager that administers the employer's Automatic IRA. The employer would select that private sector manager from an online list located at a central website, and if the employer does not wish to choose a provider, that company would be assigned at random to a funds manager that is willing to accept all comers.

Because an IRA is personal savings, employers would not be required—or even allowed—to match these savings in any way. Employers would also have no liability for determining if employees are eligible for the program or face the complexity of ERISA and other regulations that govern a 401(k) plan.

Little or No Cost to Employers

Direct deposit to IRAs is not new. In the late 1990s, Congress, the IRS, and the Department of Labor all encouraged employers not ready or willing to sponsor a retirement plan to at least offer their employees the opportunity to contribute to IRAs through payroll deduction.[2] However, employers did not respond to this option. Very few employers have ever adopted direct deposit or payroll-deduction IRAs – at least in a way that actively encourages employees to take advantage of the arrangement.

With this experience in mind, the Automatic IRA is an improved strategy designed to induce employers to offer, and employees to take up, direct deposit or payroll deposit saving. For employers, offering an Automatic IRA would involve little or no cost or regulatory burden. The employer would not be maintaining a retirement plan, and employer contributions would be neither required nor permitted. Firms would ***not*** be required to

(1) comply with plan qualification or ERISA rules,

(2) establish or maintain a trust to hold assets,

(3) determine whether employees are actually eligible to contribute to an IRA or are complying with the limits on contributions,

(4) select investments for employee contributions,

(5) select among IRA providers, or

(6) set up IRAs for employees.

These simplifications eliminate almost all of the costs associated with a 401(k)-type plan. As discussed below, any remaining cost of establishing and operating the Automatic IRA would be reimbursed through a tax credit. Employers would be required simply to allow employees to make a payroll-deduction deposit to IRAs. This dovetails with what employers are already required to do by way of withholding income and payroll taxes from employees' pay and remitting those amounts to the federal tax deposit system. Another factor in avoiding cost is the fact that virtually all employers who would be subject to the Automatic IRA already utilize either an outside payroll processor or use

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[2] In the Conference Report to the Tax Reform Act of 1997, Congress stated that "employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction [IRA] system to help employees save for retirement by making payroll-deduction contributions to their IRAs" and encouraged the Secretary of the Treasury to "continue his efforts to publicize the availability of these payroll deduction IRAs" (H.R. Rep. No. 220, 105th Cong., 1st Sess. 775 [1997]). IRS and Labor guidance was given in IRS Announcement 99-2, "Payroll Deduction IRAs," and Department of Labor Interpretive Bulletin 99-1 (June 18, 1999), 29 C.F.R. 2509.99-1(b).

payroll software. Companies that provide both types of payroll services indicate that the Automatic IRA would simply be another component in services they already offer.

Employer Tax Credit to Cover Automatic IRA Expenses

The Automatic IRA has been designed after lengthy consultations with many small businesses, retirement savings providers, consumer groups, and government agencies to have very low costs for both employers and employees. We recognize that small businesses already have plenty to deal with just to stay in business. As a result, after discussions with many small businesses, designed a tax credit to cover the remaining small costs, if any, of establishing and operating the Automatic IRA.

Unlike some other government-required programs, the Automatic IRA is not an unfunded mandate, and it would be a serious mistake to consider it as such. Unlike health care mandates and similar programs, employers under the Automatic IRA are essentially being hired to provide a service that will benefit them as employers. A detailed survey of employers and employees who would come under the Automatic IRA showed that even if every other firm also offered the Automatic IRA, the fact that their employer does so would increase employees' loyalty to the employer. This can be a great help in attracting qualified employees and retaining them. Further, the same survey showed that the more an employer heard about the Automatic IRA, the more they liked the program and were willing to support it. Many employers want to provide retirement benefits to their employees, but they are simply too busy with keeping the doors open to be able to take any action, are confused by the complexity of 401(k)-type plans, and are worried about the cost. The Automatic IRA deals with all of these concerns.

Businesses and others should also take very seriously the consequences of taking no action. As I mentioned earlier, retirement savings take time to build to an amount that can provide a significant amount of income, and millions of Americans currently have no way to save at work, and don't do so on their own. Failure to improve this situation will lead to demands for additional government-provided benefits either through Social Security or another new program. Those benefits would almost certainly be financed in whole or in part through higher taxes on businesses. Another equally disturbing approach would be a government managed contributory system that would eventually crowd out the private system that provides jobs, tax revenues to all levels of government, and is so innovative that it constantly improves its services at lower costs to employers and employees.

The Automatic IRA would provide a temporary tax credit designed to cover reasonable costs of establishing Automatic IRAs. As described in HR 4049, the tax credit would be in two parts, both of which the firm would receive. The first would be available to a firm for the first two years in which it offered Automatic IRAs and would provide $500 the first year and $250 for the second year to cover any reasonable startup costs. In addition, the firm would receive $25 per employee for up to 10 employees (a maximum of $250) for six years to cover the costs of adding employees to the system or removing them if they leave. After six years experience, Congress could re-examine the tax credit and continue or adjust it as needed. This tax credit structure would be designed to avoid competing with the tax credit available under current law to small businesses that adopt a new employer-sponsored retirement plan. Also, it would be available both to those employers required to offer the accounts and to very small or new firms that are not required to offer the Automatic IRA, but do so voluntarily.

Increase theTax Credit for Employers that Adopt a New Employer-Sponsored Retirement Plan

Under current law, an employer with 100 or fewer employees that starts a new retirement plan for the first time can generally claim a tax credit for startup costs. The credit equals 50 percent of the cost of establishing and administering the plan (including educating employees about the plan) up to $500 per employer per year for three years. To maintain employer incentives to adopt an employer plan, this tax credit should be increased to at least $1,000, and preferably $1,500. Employers could not claim both the new plan startup credit and the proposed Automatic IRA credit.

Simple and Low Cost for Employees

An employee does not need an MBA to understand and participate in an Automatic IRA. As discussed below, most employees will be automatically enrolled into their employer's Automatic IRA, a process that is proven to build participation, which employees like, and under which employees have complete control over their savings decisions. To avoid confusion and to keep costs low, all Automatic IRAs will offer three and only three investment choices.

For most employees, their money would go into a target date fund that provides a diversified mixture of investments that gradually change as the employee get closer to retirement. This is the same default investment choice for 401(k) plans. However, the financial markets are constantly innovating, and when a better or lower cost investment choice comes along, the regulators will have the ability to substitute it for the target date funds.

A second fund choice would be directed at new and small savers. Depending on the wishes of the employer and/or provider, it would be either a stable value fund or an R-Bond account within the Treasury Department. An R-Bond account would be invested in Treasury securities and would be expected to pay about the same rate as a 5-year T-Bond. It would not have any maturity as it would be an account instead of a specific security, and would be a temporary way for small savers to build up a high enough balance to interest many private funds managers. When the account reached $5,000, it would either be automatically rolled over into the employer's choice of private funds manager or rolled over at the request of the account owner.

The third choice could be either a balanced fund or a slightly more aggressive target date fund. It would only be available at the request of the saver. And of course, the employer also has the option to allow their employees to make payroll deductions into an account they already have. Finally, if an employer does not allow this, the employee always has the option to roll his or her Automatic IRA into a private IRA at an institution of their choice invested whatever they choose. However, if the employee chooses an account that is outside the Automatic IRA structure of their employer, he or she would be responsible to make additional contributions on their own.

Direct Deposit and Automatic Fund Transfers

The Automatic IRA would capitalize on automated or electronic fund transfers. Many employers retain an outside service provider to manage payroll, including withholding, federal tax deposits, and direct deposit of paychecks to accounts designated by employees or contractors. For the numerous firms that already offer their workers direct deposit, direct deposit to an Automatic IRA would entail no additional cost, even in the short term. As mentioned earlier, virtually every employer that still processes their payroll by hand would come under the exception for very small employers. As a result, the proposal focuses chiefly on those employers that already use electronic payroll but have not used the same technology to provide employees a convenient retirement saving opportunity. The tax credit should cover the cost of providing this service to their employees.

Employees Covered

Employees eligible for the Automatic IRA would include those who have worked for the employer on a regular basis (including part-time) for a specified period of time and whose employment there is expected to continue. Employers would not be required to offer Automatic IRAs to employees who are already covered by a retirement plan or are excludable from coverage (such as recently-hired employees, those who work less than 1,000 hours a year, union-represented employees or nonresident aliens without US source income) under the qualified plan rules. Accordingly, the proposal is not intended to apply to employers that offer 401(k), SIMPLE, pension or other qualified retirement plans to their employees.[3]

Portability of Savings through Choice of Roth or Traditional IRA

Like a 401(k) contribution, the amount elected by the employee as a salary reduction contribution would go to either a Roth IRA, which receives tax-favored treatment upon distribution, or to a traditional, tax-deductible IRA. To spare households the need to undertake the comparative analysis of Roth versus traditional IRA, after examining the income levels of the target population, Automatic IRAs would be Roth IRAs unless the saver chooses to have a traditional IRA at the time of enrollment, an option that he or she would have. In either case, the use of IRAs as a savings vehicle maximizes the portability of those savings. IRAs generally continue in existence without

[3] The only exception would be an employer that sponsored a retirement plan but excluded a major portion of its workforce – for example, excluding an entire division or subsidiary that is not union-represented or foreign – in which case the employer would be required to offer payroll deposit saving to the rest of the workforce.

regard to changes in the owner's employment status and, in general, are freely transferable by rollover to other IRAs or qualified plans.

Expanding Saving through Automatic Features

Today, individuals who want to save in an IRA must make a variety of decisions that they may not feel they are ready to make in order to open an account. In addition, they must overcome a natural tendency to delay making important decisions until they have "enough information" to make a decision, a time that almost always never arrives. At least five key questions are involved:

- whether to participate at all;
- which financial institution to use to open an IRA (or, if they have an IRA already, whether to use it or open a new one);
- whether the IRA should be a traditional or Roth IRA;
- how much to contribute to the IRA; and
- how to invest the IRA.

These obstacles can be overcome by making participation easier and more automatic. Under automatic enrollment, an employee would be enrolled in an account, contribute a set percentage of income into it, and have that money invested in a safe, diversified investment at a reputable financial services provider. However, the employee would also have the ability to have complete control over all of those decisions.

Further, employees like automatic enrollment. An October 2009 survey by Prudential Insurance found that 74 percent of American workers would rather be automatically enrolled into a 401(k) plan than use the traditional method; while 65 percent support automatic contribution escalation.

Even more telling, a 2007 study by Retirement Made Simpler -- a coalition including AARP, the Financial Industry Regulatory Authority (FINRA), and the Retirement Security Project (RSP) – shows that workers who have been automatically enrolled strongly support the mechanism and start saving before they would have otherwise. According to the study, 97 percent of workers who had been automatically enrolled and remained in the plan were satisfied with the procedure, while 90 percent of those who had been automatically enrolled and then opted out due to individual circumstances felt the same way. Eighty-five percent of those participating in the 401(k) plan said that they had started to save for retirement earlier than they had otherwise planned, while 95 percent felt that automatic enrollment made saving for retirement easy. Finally, 98 percent of those who were automatically enrolled and remained in the plan were glad their company offered automatic enrollment, as were 79 percent of those who had opted out. This last number is key, as it shows that even if workers decided that their specific circumstances did not allow them to remain in the company's 401(k) plan, they still valued automatic enrollment.

This does not mean that automatic features are perfect. A continuing concern that Congress needs to address is whether the current automatic choice for the amount of the initial contribution is too low. Currently, that is set at three percent of income, and while employers have the ability to set a higher rate, most use the three percent level. Unless this low level is paired with automatic escalation, a procedure where the percentage climbs usually when the employee's salary goes up, employees may find that they still have insufficient savings when they retire. Evidence suggests that employees see the initial contribution level as the one recommended by the employer, and many fail to increase it. Further, there are indications that lower income employees are more likely to stick with the initial levels than those with higher incomes. For this reason, Congress should consider increasing the initial contribution level. Several studies suggest that if the three percent is increased to five percent or more, the participation rates will remain nearly the same as they are today.

The Automatic IRA Uses Automatic Enrollment or an Explicit "Up or Down" Employee Election

As shown earlier, automatic enrollment (more often applied to newly hired employees but now increasingly applied to both new hires and other employees) has produced dramatic increases in 401(k) participation among all income and other employee groups. In view of the basic similarities between employee payroll-deduction saving in a 401(k) and under the Automatic IRA, the law should, at a minimum, permit employers to automatically enroll employees into Automatic IRAs.

However, simply allowing employers to use automatic enrollment with Automatic IRAs may not be enough. Requiring employers to use automatic enrollment in conjunction with the Automatic IRA would almost certainly increase participation dramatically while preserving employee choice and control over all saving decisions. However, in some situations, such as small business owners who work with all of their employees closely each day, the employer might regard automatic enrollment as unnecessary or a potential disruption of the existing relationship between employer and employee.

Accordingly, while automatic enrollment would be the presumptive or standard enrollment method, employers could opt out of it in favor of an alternative approach, which is in effect a variation on automatic enrollment. The alternative requires all eligible employees to submit a form where they explicitly either accept or decline participation in an Automatic IRA. Requiring an "up or down" election picks up many who would otherwise fail to participate because they do not complete and return the enrollment form due to procrastination, inertia, inability to decide on investments or level of contribution, and the like.[4] Any employee who fails to comply with the election requirement is automatically enrolled. In either case, to maximize participation,

[4] James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick, "Optimal Defaults and Active Decisions," NBER Working Paper No. 11074 (January 2005).

employers would receive a standard enrollment module reflecting current best practices in enrollment procedures.[5]

Compliance

Whether using automatic enrollment or explicit "up or down" elections from employees, employers would be required to obtain a written (including electronic) election from each nonparticipating employee. That way, no one would be left out by reason of inertia. Employers using automatic enrollment would use a notice that also informs employees of that feature (including the automatic contribution level and investment and the procedure for opting out), and the employer's records would need to show that employees who failed to submit an election were in fact participating. Employers would be required to certify annually to the IRS that they were in compliance with the payroll deposit saving requirements.

The Importance of Protecting Employer Plans

The Automatic IRA is designed carefully to avoid competing with or crowding out employer plans. Probably the most important protection for employer plans is the use of IRAs, which have maximum permitted contribution levels of $5,000 with an additional $1,000 if the contributor is age 50 or older. This is sufficient to meet the demand for saving by millions of households but not high enough to satisfy the appetite for tax-favored saving of business owners or decision-makers, who can contribute up to $17,000 of their own salary to a 401(k) (or $22,500 if age 50 or older) plus matching or non-matching employer contributions that can bring the total annual 401(k) contributions on their behalf to $50,000 a year. In addition, by design, the employer tax credit for providing access to Automatic IRAs is significantly less than the proposed increases to the small employer tax credit for sponsoring a new 401(k), SIMPLE or other retirement plan.

In fact, the Automatic IRA is designed to actually promote more employer plans. First, any employer that wants to match its employees' contributions must adopt a qualified plan or SIMPLE. To preserve that incentive, the Automatic IRA is structured around the IRA, a retirement savings option that does not allow employer contributions. Second, experience with the Automatic IRA will give most employers of all sizes sufficient experience with payroll deduction retirement savings that they will be open to considering moving up to 401(k)s, SIMPLEs and other tax-favored employer plans. Because these plans can now be purchased at very low cost, it would seem natural for many small businesses – especially those whose owner would like to save more or to match employees' saving – to graduate from payroll deduction saving and complete the journey to a qualified plan.

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[5] A national website could provide firms these standard enrollment and election forms, as well as provide an opportunity to promote employee education and best practices as they evolve, such as automatic enrollment and potentially, lifetime guaranteed income.

Encouraging Contributions by the Self-Employed and Independent Contractors

For the self-employed and others who have no employer, regular contributions to Automatic IRAs would be encouraged in three principal ways:

- Expanding access to automatic debit arrangements, including through professional and trade associations that could help arrange for automatic debits into an Automatic IRA. Automatic debit essentially replicates the power of payroll deduction insofar as it continues automatically once the individual has chosen to initiate it.
- Extending the Automatic IRA to many independent contractors through direct deposit with firms from which they receive regular payments (without affecting the individual's status as an independent contractor); and
- Enabling taxpayers to direct the IRS to make direct deposit of a portion of their income tax refunds to an Automatic IRA or other similar savings vehicle. This mechanism has existed for several years, but is under utilized.

Guaranteed Lifetime Income

The Automatic IRA could also serve as a natural platform or proving ground for best practices in retirement savings, possibly including perhaps at some point in the future, an expanded use of lifetime guaranteed income. There is reason to believe that many households with savings but no lifetime income stream to supplement Social Security would be better off if they converted a portion of their savings to appropriately priced guaranteed lifetime income.

Yet most consumers are reluctant to do so. One approach would be to use the same automatic strategy that has so successfully improved enrollment and sensible investment could also encourage more workers to obtain the security of an annuity or other guaranteed lifetime income[6], including perhaps "longevity insurance" that provides a deferred annuity beginning at age 80 or 85, for example. The uniform default investment and the backstop Automatic IRA for any employees who cannot find an appropriate IRA in the market may also lend themselves to exploring means of encouraging greater use of low-cost guaranteed income in IRAs generally as well as in 401(k) and other employer plans.

In the interim, interim steps such as the draft regulations proposed by the Treasury Department and Department of Labor would be a good start at reducing the regulatory impediments that discourage employers from offering annuity-like products as part of their plans. Further incremental steps should follow, and both Congress and the regulators should continue their efforts to completely catalogue the remaining impediments faced by employers and employees and understand their effect. Among

[6] As an example, see "Increasing Annuitization of 401(k) Plans with Automatic Trial Income" by William Gale, Mark Iwry, David John and Lina Walker at: http://www.brookings.edu/papers/2008/06_annuities_gale.aspx

other issues, innovation should be encouraged both in product offerings and pricing with all industry or industry segment being given advantages over another.

Part II: Simplifying Retirement Savings Accounts

About ten years ago, the Bush Administration proposed simplifying the several types of retirement savings accounts into two accounts: the Retirement Savings Account (RSA) and Employer Retirement Savings Accounts (ERSA). In addition, the 2005 Bipartisan Tax Reform Panel[7] proposed a modified version of these ideas. These ideas are worth revisiting although with changes from what they proposed. (The reforms also included the creation of a Lifetime Savings Accounts (LSAs), but those are beyond the scope of this testimony.)

Given the widespread knowledge of the IRA and public support for it, there is no compelling reason to change it into an RSA. In addition, the proposed RSA would have had a higher $7,500 contribution limit, but as Congress has increased the IRA limit since the RSA was proposed and could do so again, that is not really a reason for such a reform.

On the other hand, the ERSA would be a good idea. The original proposal would have consolidated 401(k), thrift, 403(b), and governmental 457 plans as well as SARSEPs and SIMPLE IRAs into one simple account, which could be sponsored by any employer. The existing structure is confusing to employees, most employers, many tax professionals, and many financial services firms that don't specialize in the specific account in question. In addition, because each account type has specific tax incentives and restrictions, it can be difficult to consolidate differing types of accounts.

At the time, three improvements to the retirement savings system were expected from the ERSA. First, the expected coverage and participation to increase because firms that were not currently offering retirement plans because of the complexity and compliance costs were expected to be more likely to offer ERSAs. Second, they expected that more small businesses would offer ERSAs because the reduction in red tape would make it easier and cheaper to do so. Finally, employees were expected to benefit from reduced compliance costs.

To some extent, all three of their expectations remain realistic. After a transition, which could be handled by grandfathering existing accounts with the voluntary option to consolidate existing accounts of differing types into an ERSA, the new system should have much lower administrative costs. As providers focused on the new account type competition should put serious pressure on its administrative costs.

In addition, the simplified structure should encourage more employers to offer an ERSA to their employees or to upgrade their Automatic IRA to an ERSA. This would

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[7] The final report of the President's Advisory Panel on Federal Tax reform is available at: http://govinfo.library.unt.edu/taxreformpanel

almost certainly include greater coverage by small businesses. The ERSA would expand coverage, but would not eliminate the need for an Automatic IRA. In fact, the presence of the Automatic IRA would actually increase the number of smaller businesses that offer an ERSA as they would still have to offer the Automatic IRA, and the difference between an ERSA and an Automatic IRA would be much smaller than under the current account structure.

The simplified account structure would have many benefits, but it would be a mistake to completely eliminate the anti-discrimination tests. An ERSA that resulted in low to moderate income employees receiving a less favorable employer contribution than their better paid co-workers or were not encouraged to participate would be a serious mistake. Unless low to moderate income employees are able to build sufficient retirement savings, they will put increasing pressure on Congress for either higher Social Security benefits or some other form of government paid benefits.

Part III: Use Tax Information to Consolidate Retirement Accounts

Today, millions of Americans have more than one retirement savings account. While some have additional accounts because of a conscious decision, most of them come from past jobs where the account owner failed to take the necessary actions to roll the money into accounts sponsored by their current employers or rolled them into IRAs that the owner has lost. Many of these accounts are "orphaned" because the current account administrator does not have current information about the owner's address, and many of these are consumed by administrative fees, leaving nothing for the saver's retirement.

This is not an inevitable side effect of the existing retirement savings system. Account owners can consolidate most types of retirement savings accounts, but many do not. Few know the procedure, and many lack the needed information, such as the current address or contact information of a former employer. Moreover, employers may go out of business, and former employees may not know who administers them or how to recover their accounts. These "orphaned" accounts hurt both employees and employers. Some employers send the accounts to custodians who try to trace the account owner, but custodians often impose annual fees that can consume the entire balance. Even when employers retain accounts and employees can find them, owners may pay more in fees than if their accounts were consolidated.

One way to deal with this problem would be to use tax information to help the account owner to identify what accounts they own. This change would help to make saving simpler and minimize the losses associated with lost or duplicate accounts. At the same time, some account holders may want more than one account, and this proposal would allow them to continue to do so.

If this reform was adopted, when an individual files a 1040 or other tax form with a current address, the Internal Revenue Service (IRS) would check its records to see whether the individual's SSN is associated with more than one tax-preferred retirement savings account. Information from past employers is already available to the IRS. Rolling 401(k) balances into an IRA after an employee leaves triggers an annual IRA Form 5498 that lists fair market value plus any contributions or withdrawals. For money that remains in 401(k) accounts, the details of former employees are found on Form 8955 SSA in the year they leave the employer. Both forms include information on the accounts owners that could be used to provide the information needed for such a cross-check.

Once individuals with more than one tax-favored account have been indentified, they would receive a letter detailing the number of accounts they own, the value of consolidating accounts, and the process they could use to consolidate. The letter would also include a method that would allow the account owner to access account numbers, names and addresses of custodians, and a copy of the form to use for consolidation. A taxpayer who wishes to retain several accounts could notify the IRS perhaps through a simple check form or online that they do not wish to either consolidate accounts or to be reminded in the future.

This measure would help to reduce the number of "orphaned" accounts and the cost they pose to employees and employers by creating a way to consolidate accounts that is efficient and reliable.

Part IV: Combine Social Security and 401(k) Statements

Individuals must have better information in order to make appropriate decisions about how much to save for retirement and to have realistic expectations as they approach retirement. All too often, retirement savers are blinded by the aggregate amount of their savings, and fail to understand how that figure translates into a monthly income stream. In addition, individuals need to have an accurate idea about what level of Social Security benefits that they will receive and combine the two in order to have an idea of their full retirement resources. They also need this information in time to change their potential future by increasing saving; waiting until retirement is close is too late. Fortunately, there are simple steps that can go a long way to providing this data.

Currently, 401(k) and IRA statements inform accounts owners of their balances at regular intervals. In the near future, the Department of Labor will implement standards that will require 401(k) statements to include the annuitized value of those balances on those statements at least annually. Until recently, the Social Security Administration (SSA) issued annual Social Security statements that showed participants an estimate of their benefit levels. However, the agency has suspended the statements for anyone under age 60 citing its cost. Combining the information on retirement savings accounts – and in particular the annuitized value of those savings – with that formerly provided by SSA would go a long way towards helping individuals to prepare for retirement.

Retirement savings account providers should be encouraged to add estimates of the account owner's future Social Security benefits using information provided by SSA together with the annuitized value of retirement savings balances every year on either an annual statement in the case of IRAs or on one 401(k) quarterly statement. Distribution of the information would be paid for by the 401(k) administrator, just as quarterly statements are now, but SSA could pay the cost of providing the additional benefit information. This would both reduce the cost to SSA, but still ensure that the agency is meeting the requirements of legislation passed by Congress some time ago.

Some 401(k) providers already can and do simulate Social Security benefits and provide this information to account owners, but these providers lack the income and work history data to make a truly accurate projection. Collaboration between the Social Security Administration and 401(k) plan administrators would improve the accuracy of those providers that currently include this information and add the information to the statements of those providers that do not.

Two sets of concerns about using Social Security information would need to be addressed: concerns about privacy and concerns about accuracy. Previous discussions of this proposal have failed because of privacy concerns, as many individuals do not want employers to have access to their Social Security information. The privacy of account holders is a concern for 401(k) providers too, and they already go to great lengths to protect confidential data contained in the quarterly statements. To assuage concerns about the data from SSA, Social Security data could be provided to 401(k) administrators and included on an annual 401(k) statement only if the providers meet certain SSA-developed privacy standards. Plus, individuals could have control over whether their Social Security information is included either through the ability to opt in to the service or the opportunity to opt-out, if the service were automatic. This should preserve individual choice and satisfy those persons especially concerned about privacy.

Of course, the value of a 401(k)-type account can vary over time depending on market results and investment strategy while Social Security benefits are fixed assuming that the program is properly funded. For this reason, account owners should be strongly encouraged to review their statements every year to determine if they need to increase savings rates. In addition, the statements should include a clear and bold disclosure that savings balances can both increase and decline over time depending on market conditions.

To ensure accuracy and consistency annuitized balances in the 401(k) and SSA projections would need to be produced using roughly the same methodology. The utility of these statements would be increased if they included projected Social Security benefits plus both (1) current balances annuitized with payouts beginning at age 65 and (2) projections of annuitized future balances if the account owner continues either to save at their current level or increases the percentage of their salary that they save. The additional information will enable savers to have a better idea of how much they should be saving in order to have a comfortable retirement.

This simple reform would give taxpayers important information about how to plan their futures. Savers desperately need this information, and providing it should be fairly simple and cost effective.

Part V: Multiple Employer Plan

There is no one perfect platform for a 401(k)-type account, and both Congress and the appropriate regulators should encourage companies to develop innovative ways that would make it easier and cheaper for employers to offer these accounts to their employees. One way that definitely deserves consideration is the multiple employer plan that focuses on a modified version of the IRA SIMPLE. This idea originated with Prudential as a variation on a proposal from the Conversation on Coverage.

Like all IRA SIMPLE plans, this of the multiple employer plan would be limited to smaller employers with less than 100 employees. By adding the multiple employer structure, smaller businesses would be able to join together to negotiate the lowest possible administrative fees. Unlike the original IRA SIMPLE, this version does not require an employer contribution, a feature that should make it much more attractive to companies. In return, there is a slightly lower contribution limit.

The multiple employer IRA SIMPLE is not a substitute for the Automatic IRA. If only this idea was adopted, there would still be millions of employees without the ability to save to retirement at work. However, it would expand the options available to employers. Even if Congress does decide to simplify the current confusing system of retirement accounts as I discussed earlier, there would still be different structures under which employers can offer accounts to their employees.

Part VI: A Few Thoughts on Retirement Tax Incentives

The tax incentives that Congress has granted to employees and employers in return for sponsoring or contributing to a retirement savings account is a crucial part of the system, and should not be changed without serious consideration. That does not mean, however, that the current system is perfect and cannot be improved as part of a comprehensive tax reform. For instance, it would be very useful to find a way to enable lower and moderate-income retirement savers to receive higher tax benefits. In addition, it may be that upper income savers would be willing to accept slightly lower tax benefits in return for lower overall tax rates. However, let me reiterate that nothing should be done lightly, without a clear understanding of the complete consequences, or unless it is part of a comprehensive reform.

Conclusion

Thank you for allowing me to present several ideas for improving retirement saving. American households have a compelling need to increase their personal saving, especially for long-term needs such as retirement. This testimony summarizes several strategies for making saving more automatic – hence easier, more convenient, and more likely to occur. In particular, by adapting to the IRA universe practices and arrangements that have proven successful in promoting 401(k) participation, the Automatic IRA holds considerable promise for improving the retirement security of millions of workers.

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Chairman CAMP. Mr. Hardock, you are recognized for 5 minutes.

STATEMENT OF RANDY H. HARDOCK, PARTNER, DAVIS & HARMAN LLP, TESTIFYING ON BEHALF OF THE AMERICAN BENEFITS COUNCIL, WASHINGTON, D.C.

Mr. HARDOCK. Thank you for the opportunity to speak with you today on behalf of the American Benefits Council. I am an attorney with over 30 years experience specializing in retirement plans. I served as Benefits Tax Counsel at the Treasury Department and was the Senate Finance Committee's tax counsel responsible for retirement issues during consideration of the 1986 Tax Reform Act.

This Committee, the Ways and Means Committee, has been responsible for every major improvement in the retirement system. That includes the bipartisan Retirement Security Act passed in 2001, the legislation that established the successful framework for defined contribution plans and IRAs that is still in place today. That 2001 bill was cosponsored by you, Chairman Camp, by you, Ranking Member Levin. We thank you both for that. It was cosponsored by every senior Republican still serving on this Committee and by 10 of the 15 Democrats now serving on this Committee. It was cosponsored by Speaker Boehner, Minority Leader Pelosi, Majority Leader Cantor, and Minority Leader Hoyer. Promoting retirement savings is an area where Republicans and Democrats have long been able to agree, and we urge you to continue your support in the context of tax reform.

The current retirement system is working. It is working for the almost 80 percent of full-time employees with access to retirement plans at work. It works for the almost 100 million Americans who have saved through workplace retirement plans or IRAs. So, the first and most important principle to consider when you discuss tax reform and the retirement system is do no harm.

In 2012, 80 percent of households with defined contribution plans said that tax savings were a big incentive to contribute. Almost half said they would not contribute at all to any retirement savings if it weren't for their defined contribution plan.

Today, coverage and nondiscrimination requirements, the saver's credit, and various other rules ensure that the benefits in defined contribution plans are delivered fairly across all income groups. Current rules also provide balanced incentives that encourage business owners to voluntarily maintain retirement plans and encourage employee participation.

Any major restructuring of the system that reduces or tries to reallocate existing retirement tax incentives is a gamble we cannot afford to take when dealing with the retirement security of working and retired Americans. Reducing retirement savings tax incentives to pay for other initiatives would be counterproductive. Proposals that appear to increase short-term Federal tax revenue from changes in the retirement savings incentives generally get those additional revenues because individuals are saving less for retirement. Making matters worse, as Ms. Miller indicated, short-term revenue gain from changes in the retirement incentives under the current budget rules is an illusion because when a worker saves less money today, it will mean smaller distributions and less tax revenue when the person retires.

Just like the short-term budget scoring conventions, the tax expenditure scorekeeping also does not paint an accurate picture. The bulk of today's estimated retirement tax expenditure comes from savings that are already in retirement plans and IRAs, not from new contributions. So that big tax expenditure number cannot be turned into big new tax revenues without retroactively taxing the existing retirement savings nest eggs of Americans. That action would rightly be seen as a breach of trust by those workers who contributed (and those employers who contributed) on the assumption that this money would grow tax free and be taxed only at distribution.

Still, the retirement system can and should be improved for all Americans, and especially those with lower incomes who find it most difficult to save. Tax reform offers the opportunity to do just that—by building on the existing system, not by tearing it apart. Today, employer-sponsored plans make effective use of payroll deduction, provide fiduciary oversight, and typically include an employer contribution. More Americans need access to those workplace retirement savings plans, and all Americans should be encouraged to save at higher levels.

One area that deserves particular attention is automatic enrollment and automatic increase strategies. Those are plan designs where workers must opt out of plan participation rather than opt in and where the default contribution levels are increased each year. These plan designs increase participation and savings rates significantly, especially for low-income, younger, and minority workers. More employers are adopting these designs each year, but greater incentives should be considered to accelerate that trend.

We also believe much could be done to reduce the costs of plan administration. For example, regulations on delivery of required notices should be brought into the 21st century to better accommodate electronic delivery.

We stand ready to work with the Members of this Committee to assist this Committee in continuing its long history of promoting retirement savings. Thank you.

Chairman CAMP. Well, thank you.

[The prepared statement of Mr. Hardock follows:]

AMERICAN BENEFITS COUNCIL

TESTIMONY OF

RANDOLF H. HARDOCK

ON BEHALF OF

AMERICAN BENEFITS COUNCIL

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON WAYS AND MEANS

HEARING ON

TAX REFORM AND TAX-FAVORED RETIREMENT ACCOUNTS

APRIL 17, 2012

Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to speak with you today on the issues involved in tax reform and tax-favored retirement accounts.

My name is Randy Hardock and I am testifying on behalf of the American Benefits Council (the "Council"). I am a partner in the law firm of Davis & Harman LLP specializing in employee benefit issues and have been a Member of the Council's Board of Directors for the last 15 years. During that time, I have advised the Council and numerous employers that sponsor retirement plans, plan administrators, plan service providers, and individuals with respect to a wide range of retirement plan issues. I also served as Benefits Tax Council in the Department of the Treasury's Office of Tax Policy (from 1993-1995) and as Tax Counsel to the Senate Committee on Finance (from 1986-1993) (including during the Senate's consideration of the Tax Reform Act of 1986).

The Council and I appreciate the opportunity to participate in today's critical and timely hearing on retirement. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The House Ways and Means Committee has been directly responsible for the enactment of every major improvement in the employment-based retirement system over the last two decades. Most notably, it was the tireless work of this Committee in 1999 and 2000 that led to the enactment of the Retirement Security Act early in 2001. That legislation established a sensible and successful framework for defined contribution (DC) plans and IRAs that is still in place today. Significantly, the Retirement Security Act was cosponsored by every senior Republican still serving on this Committee today. It was also cosponsored by Ranking Member Levin, and by 10 of the 15 Democrats now serving on this Committee. Other cosponsors of that bill included Speaker Boehner, Majority Leader Cantor, Minority Leader Pelosi, and Minority Whip Hoyer. In short, the importance of encouraging retirement savings has been one area where Republicans and Democrats have long been able to agree and we urge this Committee to continue to support policies that promote retirement savings.

SUMMARY

Employer-sponsored DC plans and defined benefit (DB) retirement plans are an indispensable building block of our Nation's retirement system. Retirement plans, like those sponsored and administered by the Council's members, successfully assist tens of millions of families in accumulating retirement savings and will provide trillions of dollars in retirement income and a more financially secure retirement. Congress has adopted rules that encourage employers to voluntarily offer these plans, encourage employees' participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. Understandably, individuals have heightened retirement income concerns resulting from the recent economic downturn. But those concerns only serve to reemphasize the vital role workplace-based retirement plans play in ensuring personal financial security and in generating savings to fuel the type of capital investment the economy needs to generate long-term growth.

With about 100 million active and retired workers (and their spouses) accumulating retirement savings under employment-based retirement plans and IRAs, today's retirement policies are working. Those rules enable Americans – with support from their employers – to accumulate savings and generate retirement income. For that reason, the first, and most important, principle we urge this Committee to consider in the context of tax reform is: do no harm. We urge policymakers to avoid any actions that would make it more difficult for individuals to save for retirement or that would discourage employers from starting or continuing to maintain retirement plans. Thus, the wisest course in most instances will be to *not* enact new laws or new regulations that would disrupt the success of the current system.

Dramatic changes in the rules and incentives governing retirement plans are perilous and unintended consequences are likely. Major restructuring of the current system is a gamble we cannot afford to take when we are dealing with the retirement security of working and retired Americans. That is especially true now, with the Baby Boom generation reaching retirement age. In this context, it is important to remember that the employer-sponsored retirement system is premised on its voluntary nature – employers can choose to provide retirement plans to their workers, but they are not required to do so. That voluntary system is built to supplement the safety net provided by Social Security. Changes in the retirement plan tax incentives would require each plan sponsor to reevaluate and completely redesign its retirement plan offerings and could force them to consider eliminating their plans entirely. Even seemingly small changes in laws and regulations often generate confusion and enormous costs for individuals and employers.

As this Committee considers retirement issues (in a tax reform context or otherwise), it is critical to focus on policies that will help individuals and employers generate retirement income sufficient for employees to maintain their standard of living. Too often, retirement policy is driven by extraneous considerations, such as the need to generate revenue for the federal government. When these revenue considerations are at the forefront, the result has often been unnecessary complexity and cost, or worse yet, direct harm to Americans' retirement prospects. Proposals that purport to increase short-term federal tax receipts by redirecting, eliminating, or eroding the existing retirement savings incentives achieve those additional taxes *largely because individuals are saving less for retirement.* Making matters worse, any short-term revenue gain that might be derived from changes in the retirement savings incentives is largely illusory because when a worker saves less money today it will mean smaller distributions (and less tax revenue) when the individual retires. That is a lose/lose situation for the retiree and the government.

Still, the retirement system can and should be improved. Even at current savings levels, too many Americans are at risk of a financially insecure retirement. More must be done to increase retirement security (and overall financial security) for all American families, especially those with lower incomes who find it the most difficult to save. Tax reform offers the opportunity to do just that with relatively modest targeted changes that build upon the existing successful structure to generate greater retirement savings. In particular, in light of the clear evidence of dramatic increases in retirement plan coverage and savings that result when employers implement automatic enrollment and automatic increase designs, we urge the Committee to explore incentives that will accelerate the trend toward utilization of those mechanisms.

THE CURRENT EMPLOYMENT-BASED RETIREMENT SYSTEM IS WORKING FOR MILLIONS OF AMERICAN WORKERS AND RETIREES

Today, the vast majority of large employers offer a DC plan and an increasing number of small employers do as well. According to the Bureau of Labor Statistics, 73% of full-time and 64% of all private industry workers had access to retirement benefits as of May 2011.[1] Over the past three decades, 401(k) and other DC plans have grown dramatically in number, asset value, and employee participation. Private-sector DC plans cover more than 70 million active and retired workers, with millions more participating in 403(b), 457, and the Thrift Savings Plan – types of DC plans maintained in connection with employment by tax-exempt and governmental employers. While not the topic of today's hearing, DB plans also remain vital to the retirement security of many millions of Americans. Ensuring that workable DB plans remain an option for employers must also be a critical priority.

This broad coverage and participation results from the unique advantages employment-based plans bring to bear for employees when it comes to retirement savings and income. These advantages would likely not be available for millions of working Americans if it were not for the existing tax incentives that motivate employee saving and that encourage employers to maintain and contribute to retirement plans.

When discussing retirement plans, media focus is often on employee deferrals into 401(k) plans. Yet, many employers make matching, non-elective, and profit-sharing contributions to complement employee deferrals – thus choosing to share the responsibility for financing employees' retirement. Other employers fund DB plans that

[1] See Bureau of Labor Statistics, Employee Benefits in the United States, March 2011, *available at* http://www.bls.gov/ncs/ebs/sp/ebnr0017.pdf

further add to the retirement security of their employees. Recent surveys of DC plan sponsors found that at least 95% make some form of employer contribution.[2] While certain employers suspended matching and profit sharing contributions due to the recent economic downturn (and, in some cases, because of a dramatic spike in their defined benefit plan funding obligations), the vast majority have not, and in most cases the suspended matches have already been reinstated.[3]

Employees participating in employment-based plans also benefit from enhanced bargaining and purchasing power resulting from economies of scale, fiduciary decision-making and oversight, and access to beneficial products and services. Moreover, Congress has established detailed rules to ensure that benefits in DC plans are delivered across all income groups. For example, extensive coverage, nondiscrimination, and top-heavy rules promote fairness regarding which employees are covered by a DC plan and the contributions made to these plans.

Employers are also in a strong position to know the retirement needs of their employee populations and can tailor retirement programs to these needs. With the growth in DC plan coverage, those plans have continued to evolve and improve, with plan sponsors and service providers developing many features, including automatic contribution escalation, single-fund investment solutions, and investment education programs. Legislative changes and market innovations (often supported by legislative clarifications) have improved both employee participation rates and employee outcomes. For example, the Pension Protection Act of 2006 (PPA) included several landmark changes to the DC system that are already beginning to assist employees. PPA encouraged automatic enrollment (which studies demonstrate significantly increases participation rates, particularly among lower-income, younger, and minority workers) and automatic contribution escalation. With the PPA changes, adoption of these features has increased dramatically. In PPA, Congress also provided new rights to diversify contributions made in company stock, accelerating existing trends toward greater diversification of 401(k) assets.

The evidence is clear: The DC system works and the incremental changes adopted in recent years have made them even more effective. There are still gaps (especially for lower income workers); more can and should be done to expand coverage and to increase contributions. But one of the most important advantages of the current

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[2] Diversified Investment Advisors, Report on Retirement Plans – 2007, (Nov. 2007). Vanguard reports that in 2010, for DC plans it services, 95% of participants were in plans that include an employer contribution. See Vanguard, How America Saves, 2011, figure 5, *available at* https://institutional.vanguard.com/VGApp/iip/site/institutional/clientsolutions/dc/howamericasaves/ See also: Plan Sponsor Council of America, 54th Annual Survey, Reflecting 2010 Experience, p. 23 (reporting 93.4% of surveyed companies make contributions to the plan).

[3] See, e.g., *Vishal Apte and Brendan McFarland, Towers Watson Newsletter (October 2011).* Of 260 companies that discontinued or reduced their 401(k) matching contributions in the downturn, 75% have now restored them.

retirement savings tax incentive structure is that it efficiently produces retirement benefits for millions of American families. Analyses have shown that the tax expenditure more than pays for itself. This multiplier effect produces a remarkable amount of benefits for retirees, with the Department of Commerce reporting that in 2010 employer-sponsored retirement plans paid out $836 billion in benefits,[4] substantially more than the $577 billion in retirement benefits paid by Social Security in the same year.[5]

The importance of the current system is demonstrated by the fact that retirement plans held approximately $17.9 trillion in assets as of December 31, 2011.[6] These trillions of dollars in assets, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American businesses.[7] This capital permits greater production of goods and services and makes possible additional productivity-enhancing investments – investments that help companies grow and add jobs to their payrolls and raise employee wages.

THE CURRENT TAX INCENTIVE STRUCTURE IS THE FOUNDATION OF OUR SUCCESSFUL RETIREMENT SAVINGS SYSTEM

The U.S. retirement savings system successfully encourages individuals to save for retirement by providing tax incentives – including income tax exclusions or deductions – for contributions to employer-sponsored retirement plans and IRAs, up to statutory limits. This tax structure provides a strong and effective incentive for individuals at all income levels to save for retirement and encourages employers to sponsor plans that deliver meaningful benefits to Americans up and down the income scale. The fundamental building blocks of the current tax incentive structure are:

Contributions are Excludible or Deductible From Income: Contributions to qualified workplace retirement plans, both those made by employees and those made by employers, are generally excludable from employees' taxable income, and contributions to traditional Individual Retirement Accounts (IRAs) are tax-deductible in some instances. This pre-tax treatment allows individuals to save more from each paycheck

[4] 91 Bureau of Economic Analysis, U.S. Dep't of Commerce, Survey of Current Business 8, National Income and Product Accounts Table 6.11D (Aug. 2011).

[5] Social Security Trustees Report 2011.

[6] See Investment Company Institute, *Retirement Assets Total $17.9 Trillion in Fourth Quarter 2011*, *available at* http://www.ici.org/research/retirement/retirement/ret_11_q4.

[7] At year-end 2010, 48% of mutual funds' assets were held in a tax-deferred household account. See Investment Company Institute, *2011 Investment Company Fact Book*, Figure A.2, *available at* http://www.ici.org/pdf/2011_factbook.pdf.

than would be the case with after-tax contributions.[8] For a worker in the 25% income tax bracket, for example, a $20 deferral into a 401(k) plan will only reduce take home pay by $15, making saving into the plan an efficient economic proposition.

Employer Contributions are Exempt from Payroll Tax: Because employer contributions to plans are not regarded as "wages," neither employees nor employers owe payroll taxes on these amounts. These payroll tax savings are most significant for modest-income employees earning amounts below the Social Security wage base ($110,100 in 2012) since payments in cash rather than into the plan would be fully subject to payroll taxes.

Taxes on Investment Gains are Deferred: There is no tax on investment gains while funds remain inside the retirement plan. This deferral is critical for incenting savings as workers know they will not have to divert income year-by-year to pay tax on their retirement savings. It is critical to remember that pre-tax contributions made to DC plans and IRAs – and the earnings on these contributions – do not escape taxation but rather are taxed when withdrawn. Thus, the federal tax incentives devoted to spur savings are not lost but are reclaimed as additional tax revenue when individuals make withdrawals.

Saver's Credit Supplements Exclusion/Deduction: The Saver's Credit, which provides a credit of up to $1,000 ($2,000 if married and filing jointly) to low- and middle-income individuals[9] who contribute to DC plans and IRAs, provides a more robust savings tax incentive for eligible individuals than would be provided by the exclusion or deduction alone. Between availability of the underlying income tax exclusion/deduction for contributions, payroll tax savings on employer contributions and the supplemental Saver's Credit, eligible individuals are provided with a very significant tax incentive to contribute to retirement accounts. It is one that far exceeds mere proportionality to their income tax bracket.

Contributions Are Limited and Rules Promote Fairness: Congress has imposed maximum dollar limits on individual contributions to DC plans and IRAs. In 2012, the maximum individual contributions are generally $5,000 to IRAs ($6,000 if 50 or older) and $17,000 to DC plans ($22,500 if 50 or older). Separate limits also apply to total combined employer and employee contributions for any employee and to the maximum benefit a worker can accrue at retirement in a defined benefit plans. These limits act to constrain the tax-preferred savings of upper-income savers while allowing robust tax-preferred savings by low- and middle-income households, and retaining

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[8] Contributions to Roth 401(k) Accounts and Roth IRAs are not deductible or excludable, but they derive a comparable tax benefit when the taxpayer withdraws assets in the form of an exclusion from tax on earnings while the funds were in the account.

[9] In 2012, the Saver's Credit is available to married couples filing jointly with adjusted gross income (AI) of up to $57,500 and single individuals with AGI of up to $28,500.

enough of a personal incentive for business owners and decision-makers to set up and maintain plans for their workforce. In addition, a substantial statutory and regulatory regime requires employer plans to adhere to coverage, nondiscrimination and top-heavy rules, which are designed to ensure that individuals at all income levels receive fair benefits.

THE FIRST PRINCIPLE OF RETIREMENT TAX POLICY: DO NO HARM

Today's retirement laws and policies are working well and are helping many millions of families (supported by their employers) accumulate savings and generate retirement income. For that reason, the first, and most important, principle we urge this Committee to consider in the context of tax reform is to **do no harm**. Policymakers should avoid actions that make it more difficult to accumulate savings and generate sufficient retirement income. Since the employment-based retirement system is the most effective and significant source of retirement saving, any changes in that area should in particular be approached with extreme caution. The wisest course in most instances will be to *not* enact new laws or implement expansive new regulations that would disrupt the successes of the current system.

The American people agree with that assessment. In a study published in 2012, 84% of U.S. households said that continuing to provide incentives to encourage retirement saving should be a national priority. In spite of recent stock market volatility, 89% of households expressing an opinion had favorable impressions of 401(k) plans. Nine out of 10 households with DC accounts agreed that these plans helped them think about the long term and made it easier for them to save. More than 80% of DC-owning households said the immediate tax savings from their retirement plans were a big incentive to contribute. With almost half of DC-owning households stating that they probably would not be saving for retirement at all if it weren't for their DC plans.[10]

Dramatic changes in the rules and incentives governing retirement plans are not warranted and would be perilous. Unintended consequences are likely, and we simply cannot afford to gamble with the retirement security of working and retired Americans; especially when retirement assets are 36% of total household financial assets.[11] In this context, it is important to remember that the employer-sponsored retirement system is premised on its voluntary nature – employers can choose to provide retirement plans to their workers, but they are not required to do so. Changes in the tax incentives would require each employer to reevaluate and potentially redesign retirement plan offerings

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[10] Holden, Sarah, and Bass, Steven, *America's Commitment to Retirement Security: Investor Attitudes and Actions.* Washington, DC: Investment Company Institute (January 2012).

[11] Investment Company Institute. 2012. "The U.S. Retirement Market, Fourth Quarter 2011" (April), Table 3. http://www.ici.org/info/ret_11_q4_data.xls.

and could lead to eliminating the plans entirely. Even seemingly small changes in laws and regulations generate confusion and enormous costs for individuals and employers.

RETIREMENT TAX INCENTIVES LEAD TO LONG-TERM REVENUE GAINS

The retirement savings tax expenditures should not be reduced or tinkered with to pay for other initiatives, whether inside or outside a tax reform process. Significantly, the bulk of the existing "tax expenditure" for retirement plans is attributable to the deferral of tax provided to already saved retirement assets, not to future annual permitted contributions. True, there are trillions of dollars in existing retirement plans and IRAs, but those funds are the primary retirement nest eggs of millions of American families. Those existing savings should not be taxed in order to finance more government spending, deficit reduction, or to offset other tax initiatives (including lower marginal tax rates). Similarly, proposals that purport to increase short-term federal tax receipts by redirecting, eliminating, or eroding the existing retirement savings incentives would realize those additional tax revenues *largely because individuals would be saving less for retirement.* We cannot afford to let Americans save less for retirement; we need to encourage them to save more.

Particularly troublesome is that any short-term revenue gain that might be derived from changes in the retirement tax incentives is largely illusory and cannot responsibly be used to offset costs of reducing tax rates or other long-term government initiatives. The revenue scoring that is performed by the Treasury Department and the Joint Committee on Taxation generally produces estimates in five- and ten-year budget windows, using a cash-flow analysis. Under that methodology, the taxes an employee will pay when he or she retires and starts taking taxable plan distributions generally occur *outside* the budget window. Proposals that reduce retirement savings today will mean the government actually collects less revenue in years outside the budget window because retirees will have less taxable retirement income. As a result, total long-term budgetary savings that might result from scaling back the existing retirement savings tax incentives would be considerably smaller than the short-term revenue estimates might suggest. In fact, a recent study completed by former staff of the Joint Committee on Taxation finds that the present value of tax benefits attributable to current-year retirement savings contributions is as much as *77% less* than estimates of revenue loss under Treasury's methodology.[12] In effect, proposals that reduce retirement savings would actually increase the burden on future generations. That type of shortsighted thinking will not help the Nation address its structural budget deficits, nor would it offset the long-range costs of other changes in the tax law. In that regard, it is important to bear in mind that the assets saved in the employment-based retirement system

[12] Judy Xanthopoulos and Mary M. Schmitt, *Retirement Savings and Tax Expenditure Estimates*, American Society of Pension Professionals & Actuaries, May 2011, *available at* http://www.asppa.org/Document-ault/pdfs/GAC/2011/RetirementSavingsAndTaxExpenditures_ASPPAMay2011.pdf.aspx

supplement and help reduce pressure on other government programs, like Social Security.

RECENT PROPOSALS COULD SERIOUSLY UNDERMINE THE RETIREMENT SAVINGS SYSTEM

Two sweeping proposals that have gained some recent attention illustrate the dangers that could flow from even well intentioned rewriting of the current retirement rules.

One illustrative option for deficit reduction that was explored in the National Commission on Fiscal Responsibility and Reform Report was to lower the cap on annual total employer and employee retirement plan contributions to the *lesser* of 20% of the employee's compensation *or* \$20,000 (the 20/20 proposal). This proposal and any similar proposal to further limit the incentives to save (or discourage business owners from establishing plans) would, over time, do irreparable harm to the retirement security of Americans at all income levels.

Today, total employee and employer contributions to 401(k) and other DC plans cannot exceed the lesser of 100% of compensation or \$50,000 per year (in 2012).[13] Even those contribution levels can only be reached for owners and higher-paid employees if the plan satisfies tough non-discrimination rules that ensure participation and contributions for rank-and-file workers. The existing tax incentives play a critical role in encouraging key decision-makers to sponsor and maintain plans. When a typical small business owner evaluates the significant legal responsibilities, risks, and costs of plan sponsorship, it is often the promise of meaningful tax benefits for key employees that is the deciding factor in choosing to maintain a retirement plan. If tax benefits to decision-makers are substantially diminished, businesses that would have considered plan sponsorship will no longer do so and existing plan sponsors will reduce matching contributions or stop offering retirement plans altogether. All employees will suffer.

The 20/20 proposal would severely depress aggregate retirement savings *for all income levels*. The Employee Benefit Research Institute (EBRI) found that only 5% of workers save for retirement on their own without the benefit of an employer sponsored plan. By contrast, 70% of workers earning between \$30,000 and \$50,000 participate in employer-sponsored retirement plans when they are offered. Preliminary EBRI analysis of the 20/20 proposal projects reductions in 401(k) balances at retirement of between 5% and 14% across *all* income levels. Younger savers with the lowest income would be hit particularly hard, with projected savings at retirement dropping by about 10% for

[13] In many cases, key employees of small businesses do not reach these levels every year. Many contribute more during years their business is doing well and less in other years.

individuals under age 45 in the bottom income quartile.[14] And this EBRI analysis does not take into account the fact that the 20/20 proposal could cause many plans to be terminated and would cause other employers to eliminate or reduce matching and other employer contributions.

Retirement tax incentives are not like other tax incentives, and changes in that structure can very easily harm the very people who are most in need. Today, 79% of the federal tax incentives for DC plans are attributable to taxpayers with less than $150,000 of adjusted gross income.[15] Under current limits, working families with less than $100,000 in income receive 62% of the tax benefits associated with qualified retirement plans – despite paying only 26% of the total personal income taxes received by the federal government.[16] In other words, lower- and middle-income taxpayers receive more than twice as large a share of savings tax breaks as the share of income taxes they actually pay.[17] As a practical matter, those low- and middle-income plan participants would suffer the most under the 20/20 proposal when they lose access to employment-based retirement plans and the employer contributions that go with them.

Another recent proposal, by Brookings Economist William Gale, suggests replacing all exclusions and deductions for retirement savings with a flat 18% tax credit that would be deposited directly into the individual's retirement savings account (the "18% match proposal").[18] This restructuring of the current system (and previous proposals like it) would also be disruptive, counterproductive, and potentially catastrophic. It would cause a steep decline in retirement plan sponsorship and would lead directly to a significant reduction in retirement savings across all income classes.

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[14] *Capping Tax-Preferred Retirement Contributions: Preliminary Evidence of the Impact of the National Commission on Fiscal Responsibility and Reform Recommendations 32 EBRI NOTES No. 7* (July 2011) at 2-6.

[15] American Society of Pension Professionals and Actuaries, Estimated Benefits of Tax Expenditure Estimates for Defined Contribution Plan Participants and Retirees with Account Balances (Aug. 2009) (analyzing IRS data), *available at* http://www.asppa.org/document-vault/pdfs/mediaroom/LTENYT082509.aspx

[16] ASPPA Release May 31, 2011, *available at* http://www.asppanews.org/2011/05/31/asppa-research-shows-savings-from-cutting-retirement-savings-plan-incentives-are-dramatically-exaggerated/

[17] A recent study published by the Center for Retirement Research at Boston College provides further evidence that the DC plan incentives are more progressive than traditional income distribution analysis would predict. The study found "evidence that additional employer contributions to 401(k) plans reduce money wages much less for low-income than for high- income workers" and concluded that: "[b]ecause of non-discrimination rules, employers must induce participation of low-income employees in order to provide qualified benefits to high-income employees. Therefore, employers who wish to contribute to plans in order to attract high-income employees may be unable to reduce money wages to low-income workers in exchange for compensation in the form of retirement plan contributions. See, Eric Toder and Karen E. Smith, *Do Low-Income Workers Benefit from 401(k) Plans? available at* http://www.policyarchive.org/handle/10207/bitstreams/96517.pdf

[18] See, William G. Gale, Testimony to the United States Senate Committee on Finance Sept.15, 2011.

As with the 20/20 proposal, the 18% match would substantially reduce the incentive for key business decision-makers to have a plan. Even where the business did keep a plan in place, it is likely that any employer matching contributions would be curtailed substantially or eliminated. The fact is that the 18% tax credit provides so little benefit to a business owner (especially when compared to other available investment options) that there would often not be sufficient incentive for a business owner to take on the many costs, responsibilities, and risks of maintaining a retirement plan. As indicated above, when plan sponsorship declines, all employees suffer.

A March 2012 study by EBRI confirms that the 18% match proposal will reduce retirement security for workers at all income levels, not just high-income workers. 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% for workers currently age 26-35, with the greatest reductions for those in the lowest income quartile. Lowest-income participants in small business plans would see final retirement savings reductions as high as 40%.[19]

For those employers who might still continue to maintain plans under the 18% match, most other employer contributions to retirement plans, like profit-sharing contributions, could well become a distant memory. The reason is simple. Under the 18% match proposal, if an employer were to contribute $1,000 to each employee's retirement account, the government would then contribute $180 to the individual's account. The $1,180 in the employee's account would be locked in. The employee could not access the $1,000 employer contribution without incurring substantial taxes and penalties, and the $180 government match could not be withdrawn for any reason for some period of time (perhaps not until retirement). The problem is that employees would immediately owe income tax on the $1,000 employer contribution, even though they may not even have the money to pay the tax. Employers will not want to put their employees in a situation where they are forced to pay income tax today on wages they never saw, in order to get a small government match that they may not be able to access until retirement.

Furthermore, the majority of 401(k) plans that include matching contributions provide for a match of at least 50% with respect to employee contributions.[20] This provides a powerful incentive for employees to save. Employers have found that the match must be sufficiently large to get the employees' attention. It is not at all clear that the "government match" under the 18% match proposal would be a sufficient incentive to save. Younger employees, in particular – the very people who should be encouraged

[19] VanDerhei, Jack. "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," March 2012, EBRI Notes

[20] See Plan Sponsor Council of America, 54th Annual Survey, Reflecting 2010 Experience, Table 45.

to save – will be reluctant to set aside money today in order to get a small government match.

Finally, moving to this complex new regime would create great confusion among individuals, thereby deterring savings. This would be extremely counterproductive at a time when all have agreed that the way to foster savings is to keep things simple. Reducing and impeding the incentives to save in plans and IRAs in this way would be particularly detrimental as such savings typically represent a significant share of families' total financial assets.

CHANGES IN RETIREMENT POLICY SHOULD BUILD ON EXISTING SYSTEM, NOT ERODE IT

Promoting retirement savings must remain one of our Nation's top policy priorities. We urge this Committee to continue its leadership in pursuing policies to improve our Nation's retirement system. But any changes that are made should build upon our existing and successful tax incentive structure so that it works even more effectively to facilitate retirement plan coverage and savings by American families.

As this Committee considers these issues in the future, the Council urges you to focus on four objectives when crafting specific retirement policies. These objectives are all designed to advance the goal of retirement income adequacy for American workers.

Accumulating Retirement Savings: The first and most important policy objective in helping Americans generate adequate retirement income is to assist them in accumulating retirement savings during their working lives (which can then be used to generate income in retirement). Current retirement policies and vehicles, particularly employer-sponsored plans, successfully assist American families in doing so. Employer-sponsored retirement plans make effective use of payroll deductions, provide fiduciary oversight and group pricing, typically involve substantial financial contributions by employers to employees' benefits, and facilitate access to investment education and advice. But in order to ensure that as many Americans as possible accumulate the retirement savings they need, policy improvements should be made in the following areas:

- *Coverage* – expanding access to individual and workplace retirement savings plans;
- *Adequacy* – helping individuals (supported by their employers) to save at higher levels;
- *Investing* – encouraging the wise investment of retirement assets; and
- *Preservation* – promoting portability of retirement savings and avoiding spending of savings prior to retirement (leakage).

Unfortunately, given the fiscal condition of the federal government, it will be difficult to remove revenue considerations from policy debates, even in the retirement area. Some good proposals will likely have to be delayed at this time because they are too costly and the required federal resources are simply not available.

Still, incremental improvements in each of these areas can and should be made and even small changes that help create a culture of saving will make a big difference. One area that deserves special attention is promoting the use of default enrollment and increase strategies. Automatic enrollment and automatic escalation strategies hold great promise for increasing DC plan coverage, and also increasing contributions to those plans. Such plan designs, under which workers must opt out of plan participation rather than opt in, have been demonstrated to increase participation rates significantly, helping to move toward the universal employee coverage typically associated with defined benefit plans.[21] More employers are adopting these designs every year, but accelerating those trends is important. Employers are also beginning to increase the default savings rate at which workers are automatically enrolled and designs that automatically increase an employee's rate of savings into the plan over time, typically on a yearly basis. Those changes all will help ensure that workers will have saved enough to generate meaningful income in retirement. In particular, studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income, younger, and minority workers because these groups are typically less likely to participate in a 401(k) plan where affirmative elections are required.[22]

Recent experience shows the power of automatic enrollment and automatic escalation designs to increase participants' annual savings percentages to the higher levels that they will need to achieve a secure retirement. Plan sponsors that establish an initial automatic enrollment default rate of 6% see very little reduction in the participant opt out rate, but experience substantial increases in total employee contributions when compared with employers who establish a more modest 3% default rate. Significantly, even those employees who affirmatively make their own choice on how much to defer, appear to save more when the default level is set higher. Similarly, plan sponsors that

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[21] *See, e.g.*, Vanguard Center for Retirement Research, *Measuring the Effectiveness of Automatic Enrollment*, (Dec. 2007) (stating that "[a]n analysis of about 50 plans adopting automatic enrollment confirms that the feature does improve participation rates, particularly among low-income and younger employees"); *401(k) Benchmarking Survey – 2008 Edition*, Deloitte Consulting LLP (2008) (stating that "[a] full 82% of survey respondents reported that auto-enrollment had increased participation rates").

[22] *See, e.g.*, Copeland (Oct. 2008), *supra* note 27 (noting that Hispanic workers were significantly less likely than both black and white workers to participate in a retirement plan); Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, EMPLOYEE BENEFIT RESEARCH INSTITUTE ISSUE BRIEF No. 318 (June 2008) (noting that industry studies have shown relatively low participation rates among young and low-income workers); Fidelity Investments, *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans* (2007) (stating that, in 2006, among employees earning less than $20,000, the participation boost from automatic enrollment was approximately 50%).

allow participants the choice to opt in to an annual automatic contribution escalation feature find that only 5.8% of participants do so. But if participants default into automatic escalation (with the opportunity to opt out), then 79.6% take advantage of automatic escalation.[23]

We encourage this Committee to find ways to create incentives that will accelerate the trend toward employer adoption of automatic enrollment designs that include higher initial default contribution rates and automatic annual increases. Those changes could include the creation of new and simpler nondiscrimination testing safe harbors, removal of the existing limit on auto escalation levels in existing safe harbors, and tax credits to employers that adopt automatic enrollment and escalation features.

These enhanced automatic enrollment strategies should be accompanied by an extensive effort (1) to educate all Americans on the importance of the level of savings needed to meet anticipated retirement expenses and (2) to inform low- and moderate-income taxpayers on the availability and operation of a simpler and improved Saver's Credit.

Translating Retirement Savings into Retirement Income: A second important policy objective is helping individuals understand how their accumulated retirement savings from all sources (including the savings and benefits of one's spouse, where applicable) may be converted into streams of income in retirement. Recent guidance from the Internal Revenue Service and the Department of the Treasury provides an example of how even modest clarifications can simplify decisions for retirees and provide new ways for them to gain comfort that they will not outlive their retirement savings.

Supporting an Evolving Approach to Retirement: A third important policy objective is to facilitate a flexible and evolving approach to retirement that accommodates those individuals who need or choose to continue paid work into the traditional retirement years. Those individuals should be able to reduce their level of work over time as they transition into full retirement.

Simplification: Tax reform efforts in the retirement area should focus on simplification and reducing the administrative burden on plan sponsors. For example, the number of required notices should be reduced and streamlined and rules should be updated to better accommodate electronic delivery. Those changes could substantially reduce the costs of plan administration. But simplification should not necessarily need to involve consolidation of existing retirement plan options. Different types of employment-based retirement plans provide employers with the flexibility to design plans that meet the unique needs of their particular workforce in the business's specific competitive environment. DC plans, traditional DB plans, hybrid plans, and SIMPLE IRAs all are

[23] Data from the Principal Financial Group® December 2010 and May 2011; Profit Sharing/401k Council of America 2011.

the right fit in different situations. Plan participants are not asked to choose between a 401(k) plan and 403(b) plan, they simply have one or the other (and most are quite happy with the one they have). IRAs have their own unique roles, and are critical for individuals rolling over funds from employment-based plans and provide an opportunity to save when they may not have access to another retirement plan. We also do not believe that existing retirement savings plans should be consolidated or eliminated in favor of other types of non-retirement savings vehicles (e.g., Coverdell Education Savings Accounts, Medical Savings Accounts, or Health Savings Accounts), which have their own purpose and relative merits.

We stand ready to assist the Members of this Committee in continuing its long history of promoting retirement savings. Thank you.

Chairman CAMP. Thank you all for that excellent testimony.

Today is tax filing day, and it is a deadline which Americans have to spend millions of hours preparing their taxes because our system is a complex one, and not only is compliance complicated, but long-term financial planning is complicated as well because of our Code. And I would like to just explore and ask each of you how the Tax Code is performing in the area of retirement security. Employers who want to offer a retirement plan, as many of you—retirement savings option, as you mentioned, they have a choice, as many of you said, of many different proposals out there with different rules. And certainly individuals trying to save for retirement have one set of rules; individuals trying to save for health have another system with another set of rules; and families trying to save for education also have many options available, each with its own set of rules.

But my question is, should the system—and why don't I start with Mr. Hardock and go down the line. But should the system of existing tax-advantaged retirement savings, should those be consolidated to make it easier for individuals to save, if you have an opinion on that?

Mr. HARDOCK. Most Americans that have retirement plans are quite happy with the plans they have. The fact is that plan participants and most employers do not choose between a 401(k) plan or 403(b) plan or 457 plan; they simply have one. Those choices are not particularly difficult, and when they do come into play, they are made by employers.

What you get if you try to consolidate is you make everyone reconsider and everyone amend their plans. That can be very disruptive, disruptive for the individuals involved and expensive for the employers that have to do that. I would add that the members of the American Benefits Council are also very concerned about any proposals that would consolidate retirement savings options with savings vehicles for other purposes like education or health. Most people save for a purpose, and confusing that retirement savings message could be very counterproductive.

Chairman CAMP. All right. Mr. John.

Mr. JOHN. I understand what my colleague just said, but the fact is when we talked to multiple small businesses and the like, the number of different types of savings plans and, frankly, their rather confusing numbers and names cause a fairly great anxiety among small businesses that were considering starting some sort of a plan, especially the ones that were fairly early in that process. So something that would consolidate, something that would simplify, not the least of which—as I say, it is a simple marketing technique—just changing the name of the blasted things—I mean, what is a 401(k) when it comes right down to it—would be exceedingly useful.

There is another aspect to this, though, which is that you referred to savings for different things, and as you pointed out, there are a wide variety of different types of advantages or Tax Code treatments of this. It would actually be much simpler if you just created all real savings the same way and exempted it from income without necessarily having to have one level for a 401(k), one for college savings, one for various and sundry other savings. Savings that is not consumption is actually an exceedingly valuable thing and should be encouraged. So to the point that you look at simplification, it is not just the matter of the accounts, it is the matter of savings itself.

Chairman CAMP. All right. Thank you.

Mr. Sweetnam.

Mr. SWEETNAM. Thank you.

Well, let me first focus in on the individual retirement savings vehicles. First off, I think one of the things that we tried to do in the Administration's proposal was to eliminate the income limits, because when you have those income limits you really weren't quite sure whether you were eligible to make a contribution to an IRA. In fact, if any of you remember prior to the income limits being put on, banks used to stay open on tax day until midnight in order to accept people's IRA contributions. There used to be lines in banks to make IRA contributions on April 15th. Once we put in the income limits, those lines went away. So I think that was one of the things that we tried to do in our proposal.

The second thing that we tried to do, and I think David alluded to this, was with our RSA and LSA proposal. Our LSA proposal was a means for people to save for any reason and to pull money out of those accounts to use for any reason.

I think one of the things that people have to realize is that people's savings needs change over time. Younger people may be thinking about savings, but they may not be thinking about retirement savings. I have a 30-year-old son now, and he is doing saving, but what is he saving for? He is saving to buy that house, which I think would be a really good thing. But when he gets a little bit older, he is going to be saving for retirement. What we tried to do with our LSA proposal was to give lower-income people or people who were at the margins of savings a way to have a tax-favored vehicle in order to have savings.

On the retirement side, I think one of the things that you have seen—I have probably been practicing as long as Randy, and what we have seen over the years is Congress legislating to make the differences between the various types of retirement plans less and less and less, and so that what we were trying to do in our proposal was just take that final step. We had all of the plans have the same contribution amounts. We said, let us just take the final step and eliminate the various Code differences between the two. But Congress has been going that way over the last few years.

Chairman CAMP. Thank you.

Ms. Miller.

Ms. MILLER. Thank you.

I would like to focus on the employer side of this, and I think it actually ties into the individual, too, in that when you are talking to a small employer, it really isn't that confusing. I mean, if you poll somebody that is not thinking about a retirement plan and say, here is this, this, this, but if you are actually talking to an employer saying, do you want to put in a retirement plan, you are really saying, do you want to have an IRA-based plan, or do you want to have one that has a trust that your employees are more likely to leave the money in? You know, if you put your money into a 401(k) for them, they can't pull it out right away. If you put it into a SIMPLE plan, they might run off with it. So you are drawing those distinctions. Then you are really talking about how much can you afford and what would you like to do.

This is where I get concerned about the proposals for individual savings in that right now we have the $5,000 IRA limit, and then you can go up to $10,000 for a SIMPLE plan, and then you can go up to $17,000 for the individual deferral in a qualified retirement plan. So there really are rewards for stepping up and providing better benefits, and I think that is why the system really has been working so well.

If you have—and there is a proposal for, I am sorry, a deferral-only safe harbor of like 8- or $10,000. What happens is if you have somebody that can put $5,000—a small business owner can put $5,000 in an IRA, $5,000 in an LSA. Suddenly there is absolutely no reason in the world in terms of what they can save on a tax-favored basis for them to put in a SIMPLE plan. Right now they have the $5,000 IRA. If they want to put in $10,000, they are going up to a SIMPLE plan. So you have to be careful that what you do on the individual savings side doesn't disrupt the structure that really works pretty well on the individual employer side.

And I think when you look at it from an employer's perspective in selling them a plan, there are options, there are things you can do as opposed to the IRA charts at the beginning of Bill's testimony where it is basically telling you when you can't do something. With the employer side, it is here is what you can do, here are your options. So it is very positive on the employer's side.

Chairman CAMP. All right. Thank you.

Mr. VanDerhei.

Mr. VANDERHEI. Thank you.

While EBRI doesn't take positions on proposals of this sort, I find a lot to agree with in what Randy and Judy just said, and I think from a rather abstract viewpoint, if you look at what is happening with respect to employers, you would introduce a whole new set of nondiscrimination testing if you did something like this.

The other thing you have to keep in mind is many employees are very targeted in what they are saving for, and I think what you would need to keep in mind is if you make it rather amorphous as far as an overall savings target, it is going to be much more difficult for any individual to find out whether or not they are basically on track for a specific retirement income.

Chairman CAMP. All right. Thank you.

Mr. Levin may inquire.

Mr. LEVIN. Well, thank you very, very much for your testimony.

Mr. Chairman, I think this is a hearing that has significance for tax reform for this issue and beyond, because while there are some differences among you, and while I think everyone believes that we can improve the system, I think your testimony issues a warning to those who propose to eliminate all tax expenditures or those who equate tax expenditures loosely with tax loopholes. Because this tax expenditure, I think, is not a loophole. It is a policy. And some have essentially said, let us start by eliminating them all and go on from there, and some propose getting down to a certain point, assuming the elimination of all tax expenditures. And do any of you favor eliminating this tax expenditure? No.

Mr. HARDOCK. That is a big no from this end of the table.

Mr. SWEETNAM. No.

Ms. MILLER. No.

Mr. LEVIN. And I am not sure that this is quite the way to put it, but, Mr. Hardock, you said here after talking about the importance of retirement savings, you say for that reason the first and most important principle you urge this Committee to consider in the context of tax reform is to do no harm. I am not quite sure I would put it that way. But maybe as to this area I think that is true, and the same is true in other areas relating to policies embraced in tax expenditures.

So maybe I will leave it at that except to say, Mr. Sweetnam, I think there is a distinction between what you save for—I am all in favor of supporting, for example, savings for education purposes and for buying a house. I think the proposals to eliminate the present provision for purchasing a house and homeownership, again eliminating that without reference to any income level or anything else, is a mistake.

But I do think you all feel that the retirement structure is more or less working, while we still need to improve it. I think we need to be careful not to lump everything together and lose the emphasis on having a strong Social Security system, which is added to by savings for retirement. I think we need that combination, and I think the point we want to drive home (you mentioned that the percentage now saved for retirement has improved a bit) is that we need to try to build that up not by eliminating Social Security, but by adding on to it.

So I really think your testimony has importance today for this issue and all other issues relating to tax reform. We need to look at it, but with care, and not with such broad strokes that we would sweep away a system like retirement savings that is working, basically working. Thank you.

Mr. SWEETNAM. May I respond?

Chairman CAMP. Thank you. Well, I will do that on somebody else's time. I do want to say, though, that I think we are having a very good discussion today. I do think it is important to point out that I don't think there is anyone who is proposing eliminating this area. The closest thing that came to it was Simpson-Bowles, the President's Commission on Fiscal Responsibility, which capped this, did not eliminate this, and there is no proposal to do such a thing itself.

Mr. LEVIN. Mr. Chairman, let me just say, in the chart that is on page 29 of Simpson-Bowles, it has a number of alternatives——

Chairman CAMP. Yes.

Mr. LEVIN [continuing]. Including eliminating all tax expenditures.

Chairman CAMP. Yes, and that is one reason why I voted against the Simpson-Bowles Commission, as did Mr. Ryan.

So Mr. Herger, you are recognized for 5 minutes.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. John, I want to thank you for your work you put in on an automatic IRA proposal. As someone who comes from a small business background, I know the first question that many small business owners will have about any kind of mandated automatic IRA is what is this going to cost me. Would automatic IRAs create any significant new costs or burdens on employers who offer the IRAs?

Mr. JOHN. No, it actually would not. The way that it is structured, it is simple enough that most employers that are covered with this, roughly 97 percent according to studies by a variety of firms, actually already use some form of payroll-processing software or an outside payroll processor, and for those, having had many discussions with both of those industries, this would just simply be a new module that would be added.

Plus the fact there is a tax credit. The tax credit has two components to it, one part which applies for 2 years which would cover any capital costs of setting up an auto IRA, and the other, which would last for 6 and could be extended if Congress chose to do so during that period of time, would provide a certain amount to cover the costs of actually putting employees on and off the system. It is a very simple, easy-to-understand system, and we found—a major insurance company did some market research with employers for us, and they found that the more they discussed it with the employers, the stronger the employer support for the proposal went up.

Mr. HERGER. Do the rest of you agree with this or have any additional thoughts?

Ms. MILLER. I definitely would agree with that. Even for those that don't use a current payroll provider, we have members who are very interested in providing this. An employer could do it strictly over the phone. The credits should more than cover any cost incurred by the employer.

Mr. HERGER. Thank you.

Mr. John, I understand your proposal would utilize private financial institutions to administer the automatic IRAs. In the past there has been proposals to create personal retirement accounts that would be administered by the Social Security Administration, and some might argue that it would be simpler for small businesses if this could be tied in to the existing payroll tax withholding process. Could you comment on the pros and cons of these different approaches?

Mr. JOHN. Sure. This is a very different—this is completely separate from the proposal in 2005 and before to set up personal retirement accounts in Social Security. There is a private sector funds management industry which works exceedingly well. We don't see any reason to supplant it by government entity for that.

We do have the ability if the private sector provider so chooses to have what is called an R bond, which is a retirement savings account. It is somewhat similar to the I bond, which has been a U.S. Treasury savings account for a number of years now, and that would allow small savers to accumulate roughly $5,000, but at that point then that would be rolled into the private sector. We feel that the private sector is going to be more innovative, it is going to create more jobs, and frankly it will do a better job of keeping costs lower.

Mr. HERGER. Thank you.

Thank you, Mr. Chairman.

Chairman CAMP. Thank you.

Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you for holding this hearing today and for your leadership on these issues as well as overall tax reform. As someone who has been interested in pension and retirement issues since I have been here, I look forward to working with you, Mr. Chairman, and others on this issue.

I think strongly that we need to make sure that Americans have the tools and the education necessary to feel as though they can make the right choices with respect to retirement, and one of our panelists did a study with the Employee Benefits Research Institute, and in that study, Mr. VanDerhei, only 14 percent of Americans are confident they will be able to afford a comfortable retirement, and more than half of all workers reported they have not calculated how much they will need to live during retirement. And you are nodding your head in agreement. Those are pretty unbelievable numbers.

I find out there—anecdotally, I have a friend of mine who is a lawyer who took a 401(k) plan and put it into an IRA, and then ultimately put his IRA into a real estate investment that he has a third party, pretty sophisticated and doing really well according to him, versus others who have not quite an understanding of how much—it has been talked about before—how much they can put in because of the contribution limits or what they can put it in.

My question to all of you, and I will start here on my right, is whether it is simplification, whether it is reform, whatever it is—how do we get more Americans to change that 14 percent number so they have a better understanding, and can make better choices, and can have that—so we can have that 14 percent number be something substantial, like 75 percent of Americans feel they comfortably can live in retirement and understand what they need in retirement? How do we get there as policymakers? Starting here.

Mr. HARDOCK. Well, I like to think of the American people as falling into three buckets. There are the folks who really aren't going to save no matter what you do. If you force them to save, they will borrow more money somewhere else. There are the folks I call the squirrels, who will save no matter what. That is my mother. And then there is almost everyone else, certainly including me, that want to do the right thing, know they need to save, doesn't know quite how to do it, doesn't want the government telling them how to do it, but want to do the right thing. Strategies like auto-enrollment and auto-escalation send a signal to that vast group of people that these are the levels you should be achieving to get to retirement security.

So, earlier Mr. Sweetnam talked about his son who felt that saving for his first home was more important. Well, my son is 25 years old. He asked me, I want to buy a home, but I have this 401(k) plan at work, and there is a match. I said, put the money in the 401(k) plan first. And that goes back to the issue I mentioned earlier, people save for a purpose—for retirement. We need to set up structures and incentives that let people know how much to save, and we will see Mr. VanDerhei's savings numbers for the Gen X-ers and others start to go up even more. We need to start them young, get them involved and get them into the habit of saving, ultimately changing the culture of saving in this country.

Mr. TIBERI. Thanks.

Mr. John.

Mr. JOHN. I actually have four thoughts on this. They will repeat, and I imagine you are going to hear much of the same thing here. Number one is obviously everyone has to have access. If you don't have access, we can talk all we want to about doing it on your own, but 95 percent of people don't.

Second is, of course, start young. That is absolutely crucial with that.

Another thing is the auto structures, auto-enrollment, and particularly auto-escalation. And one of the things that this Committee can do as part of its discussion of tax simplification, tax reform, is to look at the 3 percent default rate for auto-enrollment. There are a number of studies out there that show that people will have precisely the same participation rate if it is 5 percent, 6 percent and the like to start. People think that they are doing the right thing, and that 3 percent, since that is the way it starts, that must be the right amount for them to save, and they find themselves in a trap later on.

Mr. TIBERI. Mr. Sweetnam.

Mr. SWEETNAM. One of the things that we were looking at when we did our retirement simplification proposals is that we thought that we were trying to harness the industry to do a lot more advertising with regard to savings, and one of the things that we looked at was by eliminating the income restrictions for IRAs, that people—that there would be advertisements to get people to come in and do this.

You know, we actually saw this happen when Congress enacted the Roth IRA. I was working on Senator Roth's staff at that time. And when the Roth IRA was enacted, we saw for all different types of IRAs additional savings because everybody was promoting it.

Mr. TIBERI. All right.

Chairman CAMP. Thank you.

I see we are over the time. Mr. McDermott is recognized.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I think this is a very important hearing to have to talk about, and I agree, Mr. Tiberi and I probably come at the same concern over having people's security. But I fly back and forth from Seattle, where United Airlines has its largest base, its oldest base. Most of the flight attendants are about 55 to 60 years old, and one of them told me a story, and I would like you guys to respond, and ladies to respond to this.

Her husband worked for a big bank in Seattle, Washington Mutual, and one day they closed the bank, and he lost his entire 401(k). Boom, gone. All gone because it was invested in the bank. Right? Because he was required to invest it in the bank. Now she flies for United Airlines. They have gone into bankruptcy twice, and each time they go into bankruptcy, the first thing the bankruptcy judge does in response to the company's pleadings is to scrape off the retirement. So this woman who has flown for United Airlines for 29 years now has a guarantee of $231 a month from the PBGC on top of her Social Security.

Now, here are middle-class Americans who did everything right, and they got clobbered by the system, and I want to hear that this automatic system that we are going to enroll everybody in is going to protect those people. This woman said to me, I and my husband are going to work until we die because we have nothing but Social Security.

Ms. MILLER. I would like to take a first stab at that, because the situations you described are just horrible, and Congress has acted to prevent a company forcing an employee to put all their money into employer stock.

That is no longer permissible. And that was—you know, the ability was phased out. And you guys did a great job on that. So hopefully that one won't happen again.

I think the key on automatic enrollment is really all the defaults, and one of those defaults is investment. And in PPA, that was——

Mr. MCDERMOTT. Let me stop you, though. You heard Mr. Tiberi talk about how many people know how to invest or understand, 14 percent.

Ms. MILLER. Right. Uh-huh.

Mr. MCDERMOTT. So how in the world can anybody sit up here and sensibly believe that we can design a system that says we are going to give all of you a choice, but only 14 percent of them understand what in the world they are in?

Ms. MILLER. Most people don't take advantage of that choice; they will stay where you put them. If you automatically enroll them, they will stay in your default investment. So I think the key is having a secure and appropriate default investment. And again, there were changes made in PPA, and I think there has been a recent study——

Mr. MCDERMOTT. Does that mean then, that the company, the small business or whatever, has certain places they could put the money that is safe? They will be restricted as well? Or can they do whatever they want?

Ms. MILLER. They choose the provider, but the type of investment that is the default investment is defined. It is like a target-date fund. Or you could, frankly, that is something that you could be considering, what should that be? But there is ample evidence that whatever you say the default investment can be is where most people are going to end up putting their money.

Mr. MCDERMOTT. So the automatic investment or the automatic enrollment would put it into something that is judged to be—by whom? Who would say that this is a safe investment? Because I would like to know who those people are.

Ms. MILLER. You define the parameters in terms of the individual companies.

Mr. MCDERMOTT. The Treasury will ultimately put the blessing, they will bless the company that is going to make these investments; right?

Ms. MILLER. Right now, it would be the plan sponsor or if you are in—would be the one that is choosing their investment advisor, and the investment advisor, if they hire an investment advisor, would accept fiduciary responsibility—would have fiduciary responsibility for choosing a company that provides——

Mr. MCDERMOTT. Who is on the hook if they made a bad choice?

Ms. MILLER. The fiduciary that is responsible for that decision.

Mr. MCDERMOTT. So any investment counselor would then be responsible for making the patient—the patient, I am a doctor—would be responsible for making the client whole?

Ms. MILLER. Well, in theory. You know, fortunately, there aren't very many situations—now that employer stock is off the table—there aren't many situations where you have a company that the investment has gone down to zero. When you do have responsible people choosing investment providers, it is not—there are—horror stories are more and more rare.

Mr. MCDERMOTT. And the flight attendants, I should just tell them tough luck; $231 is what you are going to get?

Ms. MILLER. The defined benefit system is a whole other——

Mr. MCDERMOTT. It seems to me they ought to be connected somehow. Or we should take away the ability of the companies to take off the pension at bankruptcy.

Chairman CAMP. Thank you. Time has expired.

Dr. Boustany is recognized.

Mr. BOUSTANY. Thank you, Chairman Camp, for holding this very important hearing.

As we look at tax reform and the very equally important area of retirement security, I have taken away a few things just from all of this discussion: Number one being that, obviously, we need to look at how you can promote personal responsibility and savings. Second, whatever we do, I certainly appreciate the adage of, first do no harm how. So how do you avoid major disruptions? And thirdly, can we simplify yet maintain flexibility.

And so, as I am trying to think through this, I remember when I was running a small medical practice and dealing with some of these issues after a full day in the operating room and focusing on the clinical side of my practice, oftentimes individuals come in to work for you, and they have worked somewhere else. They have a retirement account, multiple retirement accounts. And yet—and they may also have an IRA on top of that. And there are a variety of rules that govern this. And I remember having to make phone calls to figure out, how do you incorporate somebody into your business structure when they have had these other outside arrangements in the past.

Talk to me about the rules, the complexity that these rules really present to a business owner trying to work with incoming employees and is this an area that we can really simplify? Any of you, please.

Mr. HARDOCK. I will just start by saying that the problem you describe has been around for a while. The changes made in 2001 on portability of assets allowed individuals to combine, when they switched jobs, assets from one employer plan to the next employer's plan—or an IRA to consolidate those assets in one plan. That was a major improvement and really streamlined the process and made it possible for a business owner to take those assets in for new hires.

It is still complicated because you have items that may have been contributed as pre-tax dollars and others as post-tax. Those are issues we have to deal with no matter what because they exist today and you can't take away someone's pretax treatment or post-tax treatment. But we have made enormous strides since 2001 in improving those rules.

Ms. MILLER. Yes, I think there has been an awful lot of progress made. And I also think that if you look at the options that are available, these days you are more likely to have somebody that comes into your practice that also had a 401(k) plan at their other arrangement. And so there is a little more simplicity because I think sometimes when we talk about consolidation, then you are talking about a 403(b), 457, 401(k); in the medical practice, maybe there was a 403(b), but as Randy said, the rules have been simplified to make that an easier process.

But in most instances, you now will have somebody coming from a similar type plan to your current arrangement. And I think that really smoothes it. I do think—in our written testimony, there are some comments on rules that can be changed that make it a little easier for small business to not get themselves in trouble. And I think we should get rid of those rules that trip people up. Frankly, they are rules that apply whether it was an ERSA or 401(k). Just plain commonsense stuff.

Mr. JOHN. And if I may add, the real serious problem is the fact that people forget to combine. I have actually an IRA that was rolled over from TSP 20-plus years ago, and I keep meaning to roll it into Heritage's plan, but I have yet to do that. What we see is we have a significant number of people who lose their accounts, especially over the years, whether employers go out of business, the providers change and the like. And there is some suggestion in my written testimony about a way to use tax information to enable people to find their lost accounts and to encourage them to combine them.

Mr. BOUSTANY. Thank you.

One last question. Are there incremental steps that would make it easier for employers to offer annuity options as part of a defined contribution plan?

Mr. SWEETNAM. Well, I think that this is something that the IRS and the Treasury Department are currently looking at. And I think that it has been something that the policymakers are really looking to give people that ability to address, to use an annuity.

Now I am not speaking for the current Treasury Department or the IRS, but I think what they have been trying to do is to eliminate some of the difficulties under the current law to go and to move into an annuity product. And that is something that I think policymakers have been looking at over a number of years.

Mr. BOUSTANY. Thank you.

Chairman CAMP. Thank you very much.

Ms. Jenkins is recognized.

Ms. JENKINS. Thank you, Mr. Chairman.

Thank you for holding this hearing, and thank you to all the panel for participating. I have a question for you, Ms. Miller. The President's 2013 budget proposal includes a proposal capping certain individuals' itemized deductions to 28 percent.

Ms. MILLER. Right.

Ms. JENKINS. And the limitation on deductions under the proposal include the exclusion or above-the-line deduction for pretax employee contributions to defined contribution plans and contributions to traditional IRAs. Given that the tax break for retirement savings is a deferral, not a permanent write-off, wouldn't limiting deduction on the front end but not when the amount is distributed result in double taxation? And what are your thoughts on how the President's proposal would affect retirement savings rates and also on small business owners' decision to set up or maintain retirement plans for their employees?

Ms. MILLER. I appreciate that question.

I was very disappointed to see retirement savings included in that proposal because you are right, it would be double taxation if you have someone who—because this is a deferral. So if you have someone who is at a 31 percent marginal rate and you are giving them 28 percent cap on that, then they are paying that 3 percent now. But when they pull it out, there is no special accounting. I am not saying there should be because that would be a wreck. But when you pull it out, they are paying taxes on it again. So it really literally is double taxation.

And if you are being honest when you are talking to an employer, why would they want to put themselves in that position? So I do think it would be harmful and anything that reduces the tax incentive for a small business owner, to me, I think will discourage coverage.

Ms. JENKINS. Okay. Thank you.

Mr. Sweetnam, your testimony mentioned that following the Bush administration's proposal simplifying this area, many interested parties were concerned about the proposal resulting in fewer savings opportunities being available to small businesses, causing them to opt out of offering an employer-based savings vehicle. You also mentioned that the 2005 budget proposal addressed some of those concerns. Can you just elaborate for us on what you heard during your proposal and what changes you made to the 2005 budget? And if Congress were to move forward to meaningful reforms, what are some of the transition rules that you might advise us to keep in mind?

Mr. SWEETNAM. Well, the two big things that were problems, one, in 2004, we had the LSA and the RSA contribution amount at $7,500, and we reduced it to $5,000. And what we heard from some of the policy folks, particularly ASPPA being one, was that by having that high of a tax-favored savings amount, some smaller businesspeople might say, well, you know what, I can put in $7,500 in my LSA, $7,500 in my RSA. I have sheltered everything; I don't need any further savings through an employer-provided plan.

The other thing that we did was in our ERSA proposal, we tried to simplify some of the nondiscrimination rules. And one of the things that we did was we eliminated all the various testing methodologies that are currently available, thinking that that was simplification. Well, as I think Judy has said before, one person's simplification is another person's opportunity to make various changes. And so we listened to them and what we did was we just reduced the general complexity of the test. We didn't reduce some of the opportunities that small businesses would have in order to create more flexible types of plans.

Ms. JENKINS. Thank you.

I yield back.

Chairman CAMP. Thank you. Mr. Neal is recognized.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Chairman, I have had a long-standing issue and I think pretty strong credentials in this area. Just to recount quickly, I worked with Bill Thomas before he was Chairman of this Committee on raising IRS rates. As you recall, that was not a favorite of Mr. Rostenkowski at the time. And I carried the RSA proposal for the Clinton administration with Bob Rubin, recalling that the Clinton proposal in terms of differentiating itself from the Bush proposal was, the Clinton RSA proposal was as an addition to Social Security; the Bush RSA proposal was as a substitute for Social Security.

And I have carried this auto IRA proposal for a long period of time. Now, I introduced this bill 5 years ago, and at least three of the panelists I know have already endorsed it, and I suspect the other two have some sympathy for it. Now this proposal would raise the national savings rate by nearly $8 billion a year. Endorsed by Brookings and now with hard work from David John and The Heritage Foundation, we have developed this proposal. I have kidded David many times; it is not every day that a Massachusetts Democrat's legislation is endorsed by The Heritage Foundation. We have done just that.

Let me tell you who else supports this legislation: The AARP, Latinos for a Secure Retirement, the Black U.S. Chamber of Commerce, Putnam Prudential, Natixis. And I must say with some grave disappointment, since Phil English left, I can't get one Republican to sign on to this legislation.

Mr. Herger I thought was headed in the right direction. He was headed in the right direction as he began to question Mr. John. He couldn't bring himself to say it was the Neal proposal, but came very close to going to the altar without saying "I do."

Now, David, why does Heritage support this proposal?

Mr. JOHN. Heritage supports this for two reasons. And we have enjoyed working with you over the years. Although, for some of my colleagues, it has been a little—I tell some of them I just went to a bar.

I have also enjoyed working with your staff, both Melissa initially and Kara Getz now.

Conservatives support the auto IRA for two very good reasons. Number one is that savings changes behavior. It takes people and it brings them closer to the community. It makes them more future-oriented and makes a variety of cultural changes that are very important.

A second one which is equally important, crucial that every American has the opportunity to save, is the alternative: If we don't have a retirement savings system that applies to all and allows people to start at one company and move to another and continuously save, inevitably, we are going to see the data that Jack had initially, where people do not have sufficient retirement savings, and they are going to come to Congress, and they are going to say: Please, sir, we need more taxpayer benefits. We don't have the money for that right now.

Mr. NEAL. Also endorsed by The Brookings Institution, that is important.

Ms. Miller, could you tell me why you have endorsed the IRA proposal that I have offered?

Ms. MILLER. Yes, we are very supportive because it really does build on the current employer structure. And we think once employers—first of all, people need to have an opportunity to save at work and you just can't do that without having the employer involved. When you get over that hurdle, then we feel that once employers are used to doing payroll deductions and feel comfortable with that, it will be easier to approach them and say, listen, you have been doing this; can you afford to do a little more? Maybe a simple plan would work for you or a 401(k). And once they are in the system, they will more comfortable moving up and providing some employer contributions as well.

Mr. NEAL. It would require no matching contributions from the employer.

Ms. MILLER. It would require no matching contributions from the employer. And just the way—you know, 30 years ago, it was a different story, but right now with the development of electronic systems, it would be so easy and so little trouble for the employer to make this work.

Mr. NEAL. Particularly good for the small employer.

Mr. Hardock, why do you like the proposal?

Mr. HARDOCK. The good thing about the proposal is that it sends a signal that we need to get more employers into auto-enrollment and auto-escalation. The proposal is one way to move in that direction.

As Dr. John indicated, providing incentives to employers to do that—making it attractive to employers to go in that direction—is something that I think is well worth exploring. Providing those incentives, getting more employers to do it, and giving employees that option of the auto IRA if they don't have a plan of their own, is valuable. So it expands the reach.

I think there is a question of how quickly you can get there.

Chairman CAMP. Thank you.

Mr. Buchanan is recognized.

Mr. BUCHANAN. Thank you, Mr. Chairman.

And I also want to thank our witnesses today.

As you know, we have 10,000 Baby Boomers retiring every day, they claim, for the next 30 years, 20 years. But a lot of them are very uptight, frankly, about planning on retiring with all of these concepts that they had, and now they are getting to the point where they can retire, 60, 65; they don't know if they are going to have enough money, if they are going to get the return on their assets because they like to put them in more conservative assets going forward. And then the other thing is they are not sure, maybe at one point, they thought they were going to live to 75; now my mother-in-law is 92. They are all concerned about it.

What can Congress do, do you think, if anything, to help bring a little bit more security and dignity? What incentives or what would be one thing that we could do that we are not doing to make a difference? I can tell you I am slowly getting to that age, and a lot of our friends who thought they were fine 10 years ago in terms of retirement are very, very concerned today. They are working longer; they are not sure. Any thoughts on that.

I will start with you, Ms. Miller.

Ms. MILLER. Yes, thank you. When we are talking Baby Boomers with such a short timeframe, I think one thing that you should do is, when you are looking at tax reform, keep those catch-up contributions in. Because as a Baby Boomer, I can say that I am a lot more conscious of how much I need to save now that it is too late. And it would be very good to keep those options there.

I think looking further down the road, it is really important to engage younger people. And automatic enrollment and auto-escalation are critical.

But I also think we need to look more at e-delivery of things. We are all very supportive of all sorts of disclosures, but when people get a stack of paper, they don't necessarily look. And if we could approach people more with something that is interactive, it could be easier for them to plan, easier for them to get engaged, and they really would like you to enable more electronic delivery.

Mr. BUCHANAN. Mr. John, would you comment?

But let me just mention, I was reading in *USA Today*, they were talking about where they are at in terms of retirement. I think it was 60 percent, an enormous number, that was just relying on Social Security, and they don't have much beyond that. It is pretty scary to think you worked 40 years of your life, and there is not something in place. Do you have anything you want to add to that?

Mr. JOHN. Let me add two things if I may. First, of course, is to take this as an object lesson. The fact is if you reach 55 or 60, you don't have nearly the flexibility that you used to have. And we need to make sure through the auto IRA and a wide variety of other things to make sure that this doesn't happen to the next generation.

But we have a second crisis that is coming with the Baby Boomers. The first one is going to be not having enough money, and the second is not managing it properly so that they run out of money at the time when they are 80 or 85. We need to very carefully examine the question of guaranteed lifetime income, annuity type products, whether they are ones that kick in at the age of 80, whether they are ones that are purchased at the time of retirement, to make sure that we don't have the same individuals who are worried now even more worried when they are 85 and their bank account is empty.

Mr. BUCHANAN. Let me ask one more quick question just in terms of Congress helping small business. I am concerned there are a lot of small employers out there where employees would like to have some kind of retirement; they don't offer it. What—you know, that is tax deductible—what incentive can we help with small businesses in terms of making sure that as many of them as possible would provide some kind of retirement package, 401(k) or whatever else that is available out there?

Mr. Hardock, do you have any comments on that?

Mr. HARDOCK. I think many Members of this Committee, both Republicans and Democrats, have supported incentives, for example start-up credits for small business to send the signal that if you set up this kind of plan the government will help you with that initial administrative expense. I think doing more on that front would be helpful.

I think Mr. Neal now has a bill in. But others on this Committee have in the past supported that concept, and it could easily be expanded on because that is where our problem is. Small businesses that are not covering their employees partly because of the costs. Electronic delivery would help there, too. It is amazing how expensive it is to send out all of this paper.

Mr. BUCHANAN. Thank you.

Mr. Chairman, I yield back.

Chairman CAMP. Thank you.

Mr. Marchant is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. VanDerhei and Ms. Miller, you both state in your testimony that despite what some may claim, studies show that current tax incentives for savings for retirement are quite progressive. What would be the effect on progressivity if you lowered the top marginal rate to 25 percent?

Ms. MILLER. That is a very complicated question and depends in part on what else you have done when you have lowered that marginal rate to 25 percent. I mean, it is a fact that as the top rate declines, there is less incentive for tax deferral because you are saving less money when you contribute. But there are other competing ways to save. It depends in part on what is happening with capital gains and dividends. If you have no tax to be paid on an investment, as David would like to see generally, then it becomes very difficult to incentivize an employer to put in a plan unless you specifically have a targeted tax credit or some other specific benefit to encourage that employer to put in a plan.

So I think that this is something that is particularly sensitive to what else is happening. But it is true that as the rate declines, the incentive, cash that is freed up by putting it in this plan, also declines. So you have to be careful not to give it a double hit certainly by also—maybe you need to increase the contribution limits in order to maintain an incentive there for employers to put in plans.

Mr. MARCHANT. Thank you.

Mr. VANDERHEI. I agree with what Judy said and would like to amplify it a bit. We had done some work last summer looking more at the Simpson-Bowles type proposal, but a lot of that could be expanded to this type of proposal. If you are reducing the marginal tax rates, especially for the small business owners, you are changing the calculus of what their cost-benefit analysis is of providing that to the employees. And Judy has in her written testimony a graph that we worked on last year that actually shows—I believe we had as much as an 11 percent decrease in the number of small plans, defined as plans with less than 100 employees, because of the 20–20 limits. If that is something you would be interested in, we could very easily modify that to look at what the impact of decreasing marginal tax rate would be apart from the 20–20 limits. I could get back to you on that if you are interested.

Mr. MARCHANT. I think we would be interested in that in all our proposals, that that tax rate be capped at 25 percent. And for Mr. John, what would be the overall effect on retirement savings of adopting the 20–20 proposal as was proposed by the Bowles commission?

Mr. JOHN. I am not a micro or macro economist, so I have not really modeled it. I usually tend to defer to Jack on issues along that line.

Mr. MARCHANT. Okay. Well, Jack.

Mr. VANDERHEI. The 20–20? Actually, we have a figure in the written testimony that takes a look at what would happen. I don't think, surprisingly, the biggest hit would be on the highest income quartile. We found, for example, that people currently 36 to 45 if it were applied today would have a 15 percent reduction on average in their retirement balances. What I think comes as a surprise to many, though, is that the second biggest hit actually comes on the lowest-income quartile and that is because of the 20 percent, not the 20,000. And one thing that many people ignore is that oftentimes, people will come back into the workforce later on in their age. They may be a spouse, and they may find that because of catch-up or whatever, they have the ability to put much more of their income in. We find that they are the ones who typically end up triggering the 20 percent as opposed to the high income, who trigger the 20,000. But even for what we found for 36 to 45, almost 10 percent for the lowest-income quartile, 10 percent reduction in average account balances because of 20–20.

Ms. MILLER. I think that is actually understated for the lower paid, because small business owners, they would have about zero incentive for putting a plan in, and the safe harbor contributions they make for rank and file workers would be gone. And so I think that really understates the negative impact.

Mr. MARCHANT. Thank you, Mr. Chairman.

Chairman CAMP. Thank you.

Mr. Thompson is recognized.

Mr. THOMPSON. Thank you, Mr. Chairman.

And thank you for holding this hearing. I think it is extremely important, and it is an area where we ought to have a lot of common agreement. This is something we can actually do to help people. A lot of young folks out there who could really benefit from good work that this Committee could do.

I want to follow up on a couple of questions that were asked by other Members. Mr. Buchanan asked about what to do to encourage small business folks to participate.

Ms. Miller, in your written testimony, you mentioned that employers who don't offer any sort of retirement plan for their employees cite business concerns. Could you elaborate on what those business concerns are? And did your research show any downturn or any of the folks who were offering it, did they jettison those programs during this recession?

Ms. MILLER. Sure, I don't have any data on that last piece, although our members certainly anecdotally if a business goes out of business, obviously, the plan is gone. And certainly as a small business, when your resources are drained, you will cut back on contributions if nothing else.

But when employers say they are not putting a plan in for business reasons, there are a few that are top line reasons. One is that they don't think the employees care. And if the employees say, give me cash, then the employer would rather just give them cash if they have it.

The second is that small businesses are notorious for not lasting very long. And if you aren't sure you are going to survive, then you are hesitant to do something that really says, hey, I have arrived, I can plan long term, too.

And the third is the cost. I think there is—some employers don't understand how inexpensive it is to actually set up a plan. But most commonly the issue is that they don't feel they can afford to make a contribution or to promise to make a contribution. And that is why really we are supportive of the auto IRA proposal, because it could get employers in without out-of-pocket costs themselves. And we think that they will find that employees do actually appreciate it, and we can get over a couple of hurdles at the same time.

Mr. THOMPSON. I think Mr. Neal's bill would speak to that issue.

Ms. MILLER. Absolutely. Yes. Yes.

Mr. THOMPSON. For public record, I told him a minute ago that I would coauthor the bill. I think it is a good one.

Mr. John, you have done some research on retirement savings plans in other countries. Was there anything there that really knocked your socks off?

Mr. JOHN. There were actually a couple both good and bad. If we look, for instance, at New Zealand, New Zealand has a form of the auto IRA, but given the fact that they only have 3 million people, it is a much more centralized form. But it works exceedingly well early on.

The one that is a huge mistake is the United Kingdom. The United Kingdom went through and back in 1997, then Chancellor of the Exchequer, Gordon Brown, increased the taxes of retirement plans by about 5 billion pounds a year. The net result obviously was a collapse. The second thing they did was the U.K. continuously tinkers. They come up, they set up a program, they actually have a brilliant program called NEST, National Employment Savings Trust, that starts to go into effect this fall, except that the government just announced within the last week or so that now they are looking at a completely different approach. And what that does is to breed confusion and distress.

Mr. THOMPSON. Is there anything that we should take from the different foreign programs that you evaluated and look at putting in place here?

Mr. JOHN. The ones that work the best are the ones that have the broadest coverage and start people young and keep them saving throughout. Australia has a mandatory system which works exceedingly well. I am not suggesting that the United States move to something along that line, but the broader the coverage, the better it is. And it is possible to do a very simple system, like the auto IRA, and keep it cheap. Frankly, we studied overseas systems very extensively in developing it.

Mr. THOMPSON. Thank you all very much for being here.

Thank you, Mr. Chairman.

Chairman CAMP. Mr. Berg is recognized.

Mr. BERG. Thank you, Mr. Chairman.

You know, obviously, the goal in this whole thing is, how do you make it simple and easy to pick the right plan for each individual? And you know, obviously someone's understanding of financial markets and what is best for them and trying to make a lifelong decision rather than a short-term decision, so I was intrigued by the automatic IRAs.

And in part of your testimony, Mr. John, you talked about simplifying things but also having an automatic IRA. So kind of my question to you, does the simplification come first, or do you do the automatic IRAs and then simplification after that?

Mr. JOHN. I anticipate that, given the direction of things, that the auto IRA comes first. The auto IRA is crucial, because if people don't save, if they do not get started early on, it doesn't matter if you simplify or not.

Mr. BERG. Thank you.

I just had one kind of out-of-the-box question. And it seems like so many people are going through a lot of different jobs today and sort of the new normal is several different careers, several different jobs. And a lot of younger people that I know have been to two or three different employers in a short period of time. So each time you are trying to analyze what is the best retirement program? Here is what the employer is offering. Has there been anything done like out of the box and looking at a plan that would just be an individual's plan, and this plan would follow the individual, even though they are an employee but, again, they would make the decisions on what is the right package for them for their working career? And as they went in and out of different careers and different jobs, those employers might pay into their individual plan rather than the employer sponsoring a separate plan?

Mr. JOHN. There have been some examinations of that sort of thing, but the key factor is that most people, especially when they are starting out, don't have the expertise to make that kind of choice. And the natural human reaction when you are faced with a choice that you don't understand is that you do nothing. So people stop. That is the value of both an employer-sponsored plan, where you have the payroll deduction and the auto-enrollment and the auto-escalation. And what we find as time goes on that a certain proportion of people who started out in auto-enrollment later learn and take more control over their activities.

Mr. BERG. Any other comments on more of an individual plan that follows an individual?

Ms. MILLER. I think it is very hard to motivate an employer to participate in that kind of an arrangement, because the employer, once they feel financially secure enough to put in a plan, they are looking at the tax benefits. They are also looking at what works for their company. And what sometimes, I think, gets forgotten in talk about a single, simple plan is that employers will use—they still use vesting schedules. If they are putting in a contribution for workers, it might be fully vested because it is a safe harbor, but if there is something more than that, they don't like the idea of giving money to somebody that is coming and going right away. And so the money won't necessarily all be vested right away. And it will vest after a few years, or maybe a graduated schedule, it is 5 years.

So that really doesn't work when you have an individual account. And so there are things that employer—flexibility that the employer has under an employer-based arrangement that would disappear and I think make them less engaged.

Mr. BERG. Thank you.

I yield back.

Chairman CAMP. Mr. Reed is recognized.

Mr. REED. Thank you, Mr. Chairman. To follow up on Mr. Berg's sentiment, one of the issues I see is the need—we talk a lot about employers and the government here in Washington being the ones to choose best what individuals should do with their futures, especially when it comes to retirement. And we kind of have this attitude up here sometimes that I try to fight every day that Washington knows best; just trust us, we will take care of it. And I want to get to ways to try to enhance individual accountability and responsibility for people, allowing them to control their own destiny.

So are there things that we could be doing to encourage literacy when it comes to financial planning? Any ideas, thoughts from the panel as to where we could really change the mindset of individuals as they go into the workplace of actually being aware that 20, 30 years will come, and we need to have something in the bank to take care of us? Are there any proposals that anyone could share with us that they would say we should be taking a real close look at and advancing?

Ms. MILLER. I have to get back to electronic delivery and really getting people engaged. There are some amazing things going on out there in terms of enrolling people and having their own individual information set up on their iPad or handing them out when people come in to get enrolled and letting them work through and see what it is really going to be like.

And yet there are constraints on how everything has to be handled right now that minimizes what you can do. And so it almost ties—you know, this market is incredibly competitive and creative and can't always get to do everything it could do because——

Mr. REED. Could you give me some examples of those constraints? When you say there are constraints, are they regulatory constraints?

Ms. MILLER. Yes, regulatory constraints. For example, right now, we have all of this paper that is due out for disclosure on investments, and it is going to be—we support the disclosure, but people are going to be getting a stack of paper, and I don't think they are going to read it.

And if you were able to—if you had their email address, I mean, we give people at work an email address. You can't necessarily use that if they aren't—you know, that is not a routine part of their job and all of this other stuff and even though they may have used our Web site. So if somebody uses the Web site, you should be able to drive them to that Web site to get this information. Once they are there, there are fun things you can do. There are people working on games to encourage people to save. We need to really be able to get them involved.

But right now, you have to send them that stack of paper unless they went through certain steps. And it is just really a major expense, and it really discourages creativity and truly engaging people, especially younger people that are so much into electronics. If we can't deliver this information on their iPhone, they are not reading it. And right now, we can't.

Mr. REED. Mr. John, I see you nodding over there.

Mr. JOHN. I agree with everything that Judy has said, as I usually do.

But there are other areas—for instance, the U.K. has something called the Platform Account, which combines the retirement savings account with a variety of other types of savings and investment vehicles. And one of the things that they have found that works exceptionally well over there is that because the employer knows how old this employee is and in what stage of life they are, they can shoot them little target videos. So if the individual has just got a child, they can shoot them a video talking in 2 minutes about, here is what you can do to start saving for your child's future. Or if you just married, here is what you can do to start saving for a house. And we found in studies that these work exceptionally well, and they work even better if the person who is being recorded is someone that is someone like a coworker or someone who has some sort of a connection to that individual.

Mr. REED. How about in the educational, like our high schools, elementary school? Any thoughts on that type of forum?

Mr. JOHN. Yes, my older daughter, who is 25, went through one of the finest high schools in the United States up in Montgomery County. And she took a variety of courses in photography, cooking with amazing results, and I think she didn't have to take a single financial literacy course.

Mr. REED. That is a great point.

With that, I yield back, Mr. Chairman.

Chairman CAMP. Thank you.

Mr. Lewis is recognized.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Mr. Chairman, I want to apologize to members of the panel. I had to run out and speak to a group of eighth grade students. So they kept me for a while.

I heard your testimony, and I want to thank you all for being here. And thank you for your service.

Ms. Miller, it is good to see you again. Thank you also for all that you do.

Ms. Miller, many of the people who criticize or question our tax incentives for retirement savings argue that they are for the wealthy. They say that these laws favor high-income people. In your experience and research, do you find this to be true? Do you have any ideas as to how we can further increase participation among lower- and middle-income workers? How can we make it easier for people to save for retirement?

Ms. MILLER. That is a very good question. I think if you look at the retirement savings incentives, first of all there is a cap on compensation that can be considered. It is at $250,000. So when we hear a lot of talk about let's cut incentives for people who make over $250,000, I cannot help but think, we already cap it. We can't include compensation over $250,000.

That applies also when you are testing for nondiscrimination. So somebody might make a million dollars, but when you are comparing their percentage of pay in this plan to the lower-income person's percentage of pay, you use the $250,000. So we already have something that is built in to limit that.

The nondiscrimination rules generally will say that if the business owner wants to put in the maximum of $50,000, those workers are going to be getting a contribution; 3 percent, 5 percent, you know, depending on the arrangement. They are going to be getting the employer money. And it really is additional money.

There have been some people who will say, oh, they would have been getting that as pay anyway, but there was a really good recent look at this by Eric Toder and somebody else, I forget, showing that for lower-income groups, if there is a 401(k) plan, it is new money. It is largely new money. They have like 89 percent, but for small business, it is more like 100. It really is additional money.

So I think these nondiscrimination rules do that. It is a matter of getting access to more people, and that is why we are strongly supportive of something like the auto IRA program, that would make these arrangements available to more workers and just grow what we have here.

Mr. LEWIS. Mr. Sweetnam, you mentioned that in another time in another period, that the banks would stay open. And I remember rushing down to the bank when I was much younger, had all my hair, with my wife before the banks closed to get a $2,000 IRA. What happened to that spirit? What happened? Should we bring it back?

Mr. SWEETNAM. That was one of the things that we proposed doing in the Bush administration simplification proposals.

What happened was that we put income limits on who could make contributions to IRAs. So when you and I were seeing the lines going in and the banks staying open, it meant that everyone could make a $2,000 IRA contribution. Now, everyone cannot make a $2,000 or—can't make a deductible IRA contribution. It depends on what their adjusted modified adjusted gross income is and whether they are an active participant in an employer plan.

You will see in my testimony, I have two pages worth of charts that talk about who can and can't make contributions. Before, you didn't have that, and everyone could go in, and the banks could say, come on in, and we will set up your IRA. That is the difference. That is the difference now.

Mr. LEWIS. Thank you.

Mr. Chairman, could I yield the balance of my time to the gentleman from Oregon?

Chairman CAMP. There is only 30 seconds left, but you will get your own time in a few minutes.

Mr. BLUMENAUER. Then I will wait.

Chairman CAMP. Mr. Paulsen is recognized.

Mr. PAULSEN. Thank you, Mr. Chairman. We have had a lot of good discussion. I appreciate the testimony in the hearing. One thing that we haven't talked about is ESOPs, Employer Stock Ownership programs that enable workers to accumulate substantial amounts of retirement savings, as compared to some of these other defined-contribution retirement plans. And there are studies that even show that the value of the retirement accounts of an employee that works for, say, an S ESOP, as an example, for that firm, would average $100,000 in 2008, and you compare that to only about a $45,000 average of an employee with an average 401(k) account. So I think these statistics definitely show that ESOPs have been tremendously successful when it comes to helping workers save for retirement.

Mr. Sweetnam, if I can just ask you, should Congress make sure that we protect ESOPs in the context of successful retirement savings vehicles as we tackle tax reform and also attempt to simplify the defined-contribution retirement system as well?

Mr. SWEETNAM. When we looked at the retirement simplification when I was part of the Treasury Department, we thought that the ESOPs worked perfectly fine, and we didn't try to modify them at all. I have dealt with ESOPs and S ESOPs over my career, and they have provided very good benefits for people. So I think that one of the things you are hearing from everyone here is that we shouldn't be cutting back on retirement benefits and ESOPs and S corporation ESOPs are an important benefit, and I think that everybody is fine with continuing on.

Mr. PAULSEN. Ms. Miller, you are nodding your head a little bit, too. But should ESOPs or S ESOPs be used, that structure serve a little bit as a model for tax reform or just having that encompass?

Ms. MILLER. I think that it is important to maintain them. I am not sure that I could say they are a model because when you are dealing with an employer and what they should be doing, when it fits a situation, it is a wonderful thing, but it doesn't always fit a situation. I think it sits alongside other retirement programs.

Mr. PAULSEN. Let me ask a question for some of the other panelists, too. There has been a lot of mention of some of the current—or some mention, I should say, of some of the current law, the nondiscrimination rules that apply to 401(k) plans that make sure that lower-income workers also can benefit from these plans. Can you talk a little bit about how these rules work from the perspective of how a tax incentive could help the owner of a small business afford the contributions that would be required for those type of rules? Anyone?

Ms. MILLER. I can speak to that. I think, most commonly, if you are dealing with a small business who has—probably their accountant has said, go see so-and-so about putting in this retirement plan, and they have gotten to the point where they are finally making some money, and they are coming to the end of the year, and they are going, wow, I have this $30,000 sitting there. I am going to take it out as a bonus, and I am going to pay all sorts of income tax on that money.

You can show them if they put in a qualified retirement plan and make a contribution for themselves and save on that for income tax purposes, they can use some or close to all of that tax savings to make the required contributions for other people. And that way, then you say to them, okay, you can take this bonus home and you can write out a check to Uncle Sam for 28 or 31 percent of it or 36. Or you can put in this plan and give that money—you find out the receptionist's name when you go in, of course, you can give that money to your employees. And most times, they are very eager to have retirement savings themselves and help their employees save as well. So that tax incentive, though, is a key part of it. You have to show them how it can be better used than to just take it home.

Mr. PAULSEN. Anyone else?

Thank you, Mr. Chairman.

Chairman CAMP. Mr. Blumenauer is recognized.

Mr. BLUMENAUER. Thank you very much, Mr. Chairman.

I apologize, I have been in the Budget Committee defending the interests of the Ways and Means Committee.

Chairman CAMP. Thank you for that service.

Mr. BLUMENAUER. It is a pleasure.

And I am sorry that I was not able to be more of a part of this. I had a chance to review some of the material. It strikes me as something that would be—our time is well spent. With all of the vagaries that are surrounding tax changes, some of the budget pressures, retirement security seems to me to loom very large.

And I appreciate advice and admonition from the panel members about looking at the big picture, about things that encourage employers to provide a range of choices. I know at times, it may be bewildering, which is why I have supported the automatic IRA enrollment. It is why I am a lead cosponsor on the ESOP; where it is appropriate, it is very powerful.

But I was struck by something Mr. John said about the experience in Great Britain. Be careful about tinkering—about taking an already confused and confusing system and, with all the best of intentions, changing it again.

It seems to me that with your help and advice, and Mr. Chairman and the Committee, zeroing in on things that truly are refinements, not sea change, I am willing to explore all sorts of modifications in the Tax Code, including in some cases, raising taxes on myself and others. But I think that the investments that have been made in the Tax Code to incent retirement savings, insurance, these are things that a lot of people are relying on. These are things that it takes a while for the consumer to be educated. And there are opportunities for a whole host of unintended consequences if we are not careful.

So I just wanted to express my strong support for the Committee working on this for the advice and counsel about refinement at a time when Americans have hit choppy water economically; where millions of people have lost what they thought was the value of their home, maybe it was artificially inflated, but they borrowed against it, and they were counting on it; where retirement savings and college education accounts have been diminished.

I think the advice that we are getting here about refinement, not tinkering, moving forward is well taken. And I hope it is something that we can work on together to strengthen these retirement opportunities, send clear signals, automatically enroll, incent innovative approaches but have continuity and follow through. It seems very, very important to me.

And I appreciate the courtesy. I am sorry I wasn't with you more, but I think your contribution is very important, and this hearing I think is very important.

Thank you very much, Mr. Chairman.

Chairman CAMP. Thank you very much. And to another Ways and Means Member who also serves on Budget Committee, Dr. Price.

Mr. PRICE. Thank you, Mr. Chairman, and I, too, apologize for not being here for the entire hearing.

I want to thank you for your testimony on what is, I think, an incredibly important issue. And I want to hone in, and it may have already been discussed, but ask Mr. VanDerhei and Ms. Miller, if you would, my sense, the small business folks at home, people that I talk to tell me that there are impediments and obstructions into both the employer and the employee being able to contribute to what might be a more open, flexible, and I think you called it creative plan. Ms. Miller, if you had to identify the greatest impediment that the government puts in place to either the employer or the employee for setting up a flexible, responsive retirement plan, what would that be? Mr. VanDerhei.

Mr. VANDERHEI. Well, I will focus on the responsive part of that. One of the major improvements we have had in the retirement system in this country, certainly since 2006, is the increased adoption of automatic enrollment and automatic escalation of contributions. For a variety of reasons, a number of employers have adopted a safe harbor approach, this automatic escalation, which unfortunately currently has a maximum cap of 10 percent.

I think if you talk to most financial planners, they would say that in addition to what the employer is probably matching, perhaps 3 percent, you need, especially for employees who are starting this process late in their careers, something more than just a 10 percent contribution per year, and I think if there were ways to not only, first of all, have employers increase the default contribution rate, as David had already mentioned, from perhaps 3 percent to 6 percent or more, but to allow those employees who want to automatically allow their contributions to escalate over time, to go beyond the 10 percent.

Mr. PRICE. You would increase the cap?

Mr. VANDERHEI. Yes.

Mr. PRICE. Increase the cap.

Mr. HARDOCK. Mr. Price, on that same issue there is some data in our testimony that shows that when you do that, it is like telling your kid a C is a good enough grade, you will get a C. If you tell him an A is the grade you want, you are going to get closer to an A. And then the data we have seen shows that if you set that bar higher, even the people who don't do the automatic escalation do more because they see the bar, and they say, oh, that is what I am supposed to do.

Mr. PRICE. Ms. Miller.

Ms. MILLER. Yeah. I think one important point to make here is that auto-enrollment isn't as popular with smaller employers as it is with larger ones, and the reason is that it is too easy—practitioners don't recommend it to them because it is too easy to trip up, and then you get hit with penalties on it.

And I think we need to take a look at some issues that would make it easier for small employers to do this kind of thing without incurring additional expense. And, you know, an example is if you are automatically enrolling, then when someone completes their year of service, you sign them up. With a small business, sometimes you forget that, that date passes, and you didn't do it, and you get to the end of the year, and whoever is doing your retirement plan work says, oh, so-and-so should have been enrolled. Well, if they happen to only have missed a few months, that is okay, you can get them signed up, but if they were out for close to a year, the small business owner, to do this automatic—this safe harbor correction not only has to put in whatever match they would have made, but they have to put in the automatic enrollment contribution, too, so the employee got their salary, but they also get the employer money. And it just is so much hassle that they just don't want to bother, and that makes no sense. If they have to make the match, yes, but not to have to put the contribution in.

Also, small business deals with top-heavy rules where if over 60 percent of benefits are for key people, then there is a minimum contribution of 3 percent of pay, which is fine, but if the owner wants to be nice and let everybody contribute to the plan, even if they haven't had a year of service in, suddenly they have to make the contribution for everybody, which, as I mentioned, if they are going to be short term, they really don't want to. So they really are constrained by some of these things that are particularly difficult for small business and really would be pretty easy to clean up.

Mr. PRICE. Thank you.

My sense is that there has to be a right balance between this competitive and creative market that we want out there and regulation.

Ms. Miller, would you say that that balance has been struck right now, or are we out of balance?

Ms. MILLER. There is room for improvement, let me—definitely room for improvement.

Mr. PRICE. Great.

I thank you. I would appreciate each of the panelists, if you desire, to follow up on that score, identifying those areas where the regulatory environment is actually less helpful to employers and employees.

Thank you, Mr. Chairman.

Chairman CAMP. Thank you, Dr. Price.

Again, I want to thank our panelists for excellent testimony today. Some good information was transmitted to us as many good points were made. And with that, this hearing is now adjourned.

[Whereupon, at 12:06 p.m., the Committee was adjourned.]

[Submissions for the Record follow:]

Financial Security. For Life.

The American Council of Life Insurers

Written Statement for the Record

for

"Tax Reform and Tax-Favored Retirement Accounts"

Committee on Ways and Means

United States House of Representatives

April 17, 2012

American Council of Life Insurers (ACLI) Statement for the Record
"Tax Reform and Tax-Favored Retirement Accounts"
Committee on Ways and Means
United States House of Representatives
April 17, 2012

The American Council of Life Insurers (ACLI) commends the Committee for holding this hearing on the important tools Americans use to save for their retirement. We applaud Chairman Camp (R-MI) and Ranking Member Levin (D-MI) for holding this particular hearing to consider the current menu of options Americans rely on to save for retirement and to examine how they increase retirement and financial security for American families. ACLI urges the Committee, first and foremost, to do no harm to the existing retirement system as it is considered in the context of tax reform. Policymakers should avoid disrupting a retirement system that works well for most Americans and instead focus on enhancing the system so that it works well for more Americans.

THE AMERICAN COUNCIL OF LIFE INSURERS

The American Council of Life Insurers is a national trade organization with over 300 members that represent more than 90% of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member companies offer insurance contracts and investment products and services to qualified retirement plans, including defined benefit pension, 401(k), 403(b) and 457 arrangements and to individuals through individual retirement arrangements (IRAs) and on a non-qualified basis in an annuity. ACLI member companies also are employer sponsors of retirement plans for their employees. As service and product providers, as well as employers, we believe that saving for retirement, managing assets throughout retirement, and utilizing financial protection products are critical to Americans retirement and financial security.

Seventy-five million – or two out of three – American families count on life insurers' products for protection, long-term savings, and a guarantee of lifetime income when it's time to retire. Given today's economic uncertainties, the financial and retirement security these products provide has never been more important. To provide context on the extent to which the life insurance industry protects American families, in 2010 alone, American families received $58 billion in life insurance death benefits, $70 billion in annuity payments, $16 billion in disability income insurance benefits, and $7 billion in long-term care insurance benefits. Through these products, and other qualified offerings, Americans are able to plan, and save, for a secure retirement.

AMERICA'S PORTFOLIO OF RETIREMENT SOLUTIONS

Recognizing the need for Americans to have a private sector means by which to save for their retirement, Congress has worked over several decades to create retirement solutions that meet the needs of varied employers who want to offer their employees a plan and individuals who want to save on their own. In this way, Congress acknowledged that "one size does not fit all."

In fact, ACLI and other financial services providers have worked to provide educational resources to make sure these plans are well understood by the employers that offer them and by the individuals that choose to save on their own. Workers that are covered by an employer-sponsored retirement savings plan understand their plan offerings through educational efforts by their employer. Similarly, individuals and employers have access to advisors, internet education sites, and governmental resources that can help guide them to the best suited retirement solution.

ACLI supports simplification of the retirement system to the extent that changes improve retirement outcomes for American families. In the past, piecemeal changes in the name of simplicity have actually resulted in more complexity – both for employers who are required to implement these changes and for individuals who had become accustomed to the previous rules. As policymakers consider ways to improve the current retirement system, it is important that we build on its successes, not reduce the available solutions.

AMERICA'S EFFICIENT SYSTEM OF RETIREMENT SAVINGS

ACLI thanks the Members of this Committee for their support of the H.Con.Res. 101 and its statement of support for the current structure of retirement savings tax rules. To date, more than half of this Committee – led by Reps. Gerlach and Neal – support this resolution recognizing the important role that 401(k), 403(b), 457, IRAs, and other current law retirement savings tax rules play in helping Americans build retirement savings.

As noted in the resolution, a critical component of the current system is the tax rules designed to encourage Americans to save for their retirement. While enhancements can and should be made, in general the current system, and in particular the tax rules designed to encourage savings, have worked extremely well and are highly valued by American savers.

A recent survey found that "a vast majority of households agree that preserving the current retirement savings incentives should be a national priority. Eighty-eight percent of households owning DC accounts or IRAs agree with this policy priority, while 76 percent of households without DC accounts or IRAs agree."[1] Further, another survey by the National Association of Home Builders found that retirement savings programs like an IRA or a 401(k) are rated by American voters as the most important investment that will pay off for one's family. 41% of respondents cited "retirement savings programs" as their number one priority (the second place choice of "a home" was the top priority of 28% of respondents).[2]

Additional savings incentives have also been put into place to further encourage low-income Americans to save for their retirement. There is a supplemental retirement saving incentive of up to $2,000 *exclusively* for lower- and middle-income individuals. This Saver's Credit is only available to: an individual earning less than $27,750, or a married couple earning less than $55,500. The ACLI would support enhancing this credit by permitting the credit to be deposited directly as additional savings to an employee's retirement plan. More generally, when considering the distribution of public retirement benefits, we would note that low-income Americans enjoy significantly greater public retirement subsidies in the form of Social Security benefits than do upper and middle-income Americans. "Measured against wage-indexed average earnings, the lowest [income] quintile receives a median replacement rate of 244 percent versus 47 percent for the middle quintile and 34 percent for the highest quintile."[3]

POLICYMAKERS SHOULD NOT LIMIT SAVINGS OPPORTUNITIES

Unfortunately, short-sighted proposals that would dramatically change the current tax rules for retirement savings have been put forward and analyzed by members of Congress.

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[1] Holden, Sarah, and Steven Bass. 2012. America's Commitment to Retirement Security: Investor Attitudes and Actions. Washington, DC: Investment Company Institute (January).

[2] Neil Newhouse, Alex Bratty, Public Opinion Strategies, NAHB National Survey of Likely Voters, January 2012

[3] Andrew G. Biggs and Glenn R. Springstead, "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income," Social Security Bulletin, Vol. 68, No. 2, 2008.

Independent analyses have generally found that these proposals would be detrimental to retirement savings and would disproportionately -- and negatively -- impact younger and lower income workers.

In his testimony before the Senate Finance Committee in 2011, Dr. Jack VanDerhei, Research Director at EBRI, discussed EBRI's analysis of a proposal to fundamentally change the retirement savings system put forward by Dr. Bill Gale, Senior Fellow, Brookings Institution. His proposal envisions transitioning the current deduction-based retirement system into a system incentivized by refundable tax credits for retirement savings. EBRI's analysis of this proposal found that the lowest income workers would be most likely to react to such a change by reducing their retirement savings (56.7% of respondents to their survey would reduce savings). Additionally, EBRI found that a proposal of this sort would significantly reduce Americans' total retirement savings. This is especially true for younger Americans who, under EBRI's most generous assumptions, could see a reduction in their 401(k) account balances of at least 11% -- however this reduction could be as high as 30 or 40% under more realistic assumptions.

Another analysis by EBRI revealed that the recommendation by The National Commission on Fiscal Responsibility to limit contributions to defined contribution retirement plans to the lesser of $20,000 or 20 percent of compensation will reduce retirement security for workers at all income levels, not just high income workers. According to the study, those in the lowest income quartile will have the second highest average percentage reductions and small business owners may be less likely to offer a plan to their employees if contribution limits are lowered. Proposals to reform retirement savings incentives must focus on crafting policy that will result in better long-term retirement outcomes for Americans, rather than on short-term deficit reduction.

Separately, some states are considering legislation to create government-sponsored retirement plans for private sector workers. These proposals raise many questions and concerns, including application of ERISA to state-run plans, increased taxpayer liabilities, and direct state competition with the private sector. Instead, states should focus their efforts on state-wide education programs that raise awareness of retirement security issues, promote retirement savings, and encourage the adoption of new plans.

INCREASING RETIREMENT AND FINANCIAL SECURITY

ACLI urges this Committee to look at proposals that would enhance retirement and financial security.

The ACLI supports reforms to and expansion of the private multiple employer plan (MEP) system to further encourage and facilitate participation by employers that are not prepared to sponsor a stand-alone retirement plan.

MEPs can be an important tool to reduce costs and administrative burdens. Under a MEP, businesses join together to achieve economies of scale and advantages with respect to plan administration, and advisory services. MEPs may be a good option for employers that are not confident they can or should sponsor their own retirement plan. Participation in a MEP may facilitate a smooth transition to a stand-alone employer-sponsored retirement plan. ACLI would like to thank Reps. Kind and Neal for introducing legislation that would expand the private MEP system (H.R. 1534 and H.R. 4050, respectively).

ACLI also supports expanding participation by encouraging employers to enroll workers automatically in defined contribution plans and IRAs, and to increase contributions through auto-escalation.

Rep. Kind has introduced automatic IRA legislation that encourages employers to enroll workers automatically in an IRA, H.R. 1534, the SAVE Act. On the other hand, the Administration has put forward the Automatic IRA (AutoIRA) proposal in its budget proposals. Rep. Neal has also introduced legislation to this effect, H.R. 4049. These later proposals would require any employer in business for at least two years and having ten or more employees to automatically enroll eligible employees into a Roth IRA. If the employer offers a qualified plan, SEP or SIMPLE retirement plan for its employees, it is not required to participate. However, if the employer's qualified plan otherwise excludes a portion of its workforce (i.e., a subsidiary, or division of the company) from participation in its qualified plan, the employer must provide an AutoIRA for those excluded employees.

Other initiatives that would increase American's retirement and financial security include:

- Efficiently distributing disclosures to individuals through the electronic delivery of notices. Rep. Neal's legislation, H.R. 4050 also includes a provision to this end.

- Facilitate the use of longevity insurance. The Department of the Treasury has taken important steps to allow the use of longevity insurance, however Congress should consider doing more to modernize and reform minimum required distribution (MRD) rules.

- Facilitate the use of lifetime income options in retirement plans. Rep. Neal's Legislation, H.R. 4050, also includes provisions to provide lifetime income portability and ease plan administration.

PRESERVE ACCESS TO INVESTMENT ADVICE

Access to affordable investment advice is key to helping individuals and employers select and utilize the most appropriate retirement savings solution. ACLI thanks Chairman Camp and many other members of this Committee for sharing their concerns over the Department of Labor's ("Department") initial proposed rule on the definition of fiduciary for purposes of giving investment advice. In response to these concerns, in September, the Department announced that it would re-propose the rule. ACLI appreciates the Department's concern that under some circumstances the current rule impinges the Department's ability to bring enforcement actions in situations that are clearly abusive. We share the Department's interest in seeing that plans and participants who seek out and are promised advice, receive advice that adheres to the standards imposed by ERISA. At the same time, we are concerned that the initial proposed rule's pursuit of this objective would have disrupted investment sales and distribution practices that are customary in the marketplace, well understood, and commonly relied upon by financial service providers, plans and participants alike. We are also concerned that these changes would have resulted in plans, plan participants, and IRA owners having less access to investment information.

The SEC soon will issue a Request for Information in pursuit of its rulemaking. This is in response to Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that a uniform fiduciary standard be implemented for all broker-dealers, their registered representatives and investment advisors. This initiative directly impacts many of the same individuals that would be affected by the fiduciary rule being promulgated by the

Department. ACLI has requested that these two agencies coordinate and issue their proposed regulations simultaneously. We hope that any re-proposed rule will advance the Department's and the SEC's enforcement objective while avoiding unnecessary disruption and negative impacts to plans, participants and individuals.

IMPORTANCE OF LIFETIME INCOME

As the first wave of the baby boom generation reaches retirement age, it is important to educate American workers about the need to consider the need to have guaranteed lifetime income in retirement. Many current retirees are fortunate in that they are receiving lifetime monthly income from both Social Security and an employer-provided defined benefit (DB) pension. That situation is rapidly changing. Today, more workers have retirement savings in defined contribution (DC) plans, which largely do not offer the option to elect a stream of guaranteed lifetime income. This change leads to questions of how individuals will manage their savings to last throughout their lifetimes. Workers need to understand the value of their retirement savings as a source of guaranteed lifetime income. With this information, workers would be in a better position to consider augmenting their Social Security benefit with additional amounts of guaranteed lifetime income. This income may be used to meet anticipated monthly expenses and it shifts the risk of outliving one's savings to a life insurer.

ACLI thanks Reps. Kind and Reichert for their continued support of the bipartisan "Lifetime Income Disclosure Act," a provision that is part of their legislation, H.R. 1534. This is the first step in helping individuals think of defined contribution plan savings as not only a lump sum balance, but also as a source of guaranteed lifetime income. With this additional income information on a benefit statement, coupled with the Social Security income statement, workers can see how much monthly income they could potentially receive in retirement. Workers can better decide whether to increase their savings, adjust their 401(k) investments or reconsider their retirement date, if necessary, to assure the quality of life they expect in retirement.

Over the long-term, the nation will benefit when individuals address their long-term financial security needs today, and will be less likely to rely on public assistance tomorrow. Government policies that encourage prudent behavior, such as long-term savings for retirement, should not only be maintained, they should be enhanced. Therefore, ACLI continues to urge policymakers to support and build on the current retirement savings system and reject any proposals that would limit Americans' opportunity to save and prepare for their future.

Comments for the Record

U.S. House of Representatives

Committee on Ways and Means

Hearing on Tax Reform and Tax-Favored Retirement Accounts

Wednesday, April 17, 2012, 10:00 AM

By Michael G. Bindner

Center for Fiscal Equity

Chairman Camp and Ranking Member Levin, thank you for the opportunity to submit these comments for the record to the House Ways and Means Committee. Our comments are an expansion of last month's comments and are, as always, in the context of our tax reform plan, which has the following four elements:

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure every American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25% in either 5% or 10% increments. Heirs would also pay taxes on distributions from estates, but not the assets themselves.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, personal retirement accounts, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

Under our proposal, tax deferred accounts will no longer be needed. Returns on investment and savings will be tax free until spent for the vast majority of households. Households who do pay the income and inheritance surtax will need no incentive to save (they already do) and none should be granted to them in the tax code. More importantly for reform is the question of the transition from the current patchwork system of tax deferred and pre-taxed retirement accounts to a system without them.

Some VAT proponents take the position that if the tax replaces taxes paid by employees and shareholders, introduction of a VAT will be price neutral while others contend that it will result in an increase to price levels whenever the rate in increased and upon introduction. As many VAT adoptions occurred in Europe during times of high inflation, the matter is eminently debatable.

Our detailed proposal to the Fiscal Commission in 2010 assumed that there would be a one-time price increase of some level and that during the transition, net pay would be allowed to rise for most wage earners by the same rate as the VAT by adjusting tax withholding tables by that amount. If prices did not increase by the same percentage, this would be a one-time bonus for most workers and an inducement to either save or to increase consumption. Other analysts are also of the view that the perception that VAT introduction will raise prices in the future will result in immediate spending in the period just before introduction. In either scenario, VAT introduction may just kick-start the economy.

An argument against VAT introduction is that it would impose additional taxes on Social Security recipients and individuals who have already invested in Roth Individual Retirement Accounts with funds that have already been taxed.

In order to hold Social Security beneficiaries harmless, there should be a one-time Cost of Living Allowance increase by the same percentage as the tax, as well as an additional increase whenever the VAT rate increases. Additional increases to the base benefit would result to offset any increases to Medicare Part B and Part D premiums. Both of these would be paid for by our proposal to shift the employer contribution from an income capped payroll tax to an uncapped Net Business Receipts Tax.

Roth holders would get a one-time tax rebate on their income taxes equal to the VAT rate based on their account size. Assuming a 10% VAT and a Roth IRA of $100,000, the rebate would be $10,000. This rebate could be paid out over a period of years, as most accounts have been accumulated in that fashion. Holders of tax deferred accounts would obviously need no rebate and would simply pay consumption and income taxes upon withdrawal, with income taxes due only if the additional income pushes total income above the income tax floor.

No adjustment to incomes for workers or retirees will be made to offset the NBRT, as this tax is replacing a variety of taxes including payroll taxes for disability insurance, unemployment insurance, hospital insurance, survivors insurance for non-retirees, the employer contribution to old age and older survivors insurance, the corporate income tax, business taxes collected through the personal income tax system and a portion of personal income taxes. Transition to this tax will reduce gross income, but not necessarily net income. Additionally, some families will receive an increase of income due to the introduction of an expanded refundable child tax credit, while others may experience a salary decrease if they have a smaller family size as base wages are reduced within companies to account for the expansion of this credit.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

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Committee on Ways and Means
Hearing on Tax Reform and Tax-Favored Retirement Accounts
Wednesday, April 17, 2012, 10:00 AM

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

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May 10, 2012

The Honorable Dave Camp
The Honorable Sander Levin
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Corporation for Enterprise Development, Letter of Record for the April 16, 2012 hearing on "Tax Reform and Tax-Favored Retirement Accounts"

Dear Chairman Camp and Ranking Member Levin,

The Corporation for Enterprise Development (CFED) would like to thank the House Committee on Ways and Means for holding its hearing on retirement savings and tax reform. The retirement security of American households is imperative to the long-term stability of the American middle class. We appreciate that the Committee is exploring options within comprehensive tax reform for improving retirement savings options for Americans.

CFED advocates for tax policies that encourage and enable all Americans, regardless of income, to save for retirement. It is a well-known fact that most Americans put aside too few resources for their retirement, despite the importance of retirement savings for financial security during their senior years. According to the Employee Benefit Research Institute (EBRI), just 14 percent of Americans are very confident that they will have enough money to live comfortably in retirement[1]. Those without savings set aside for retirement tend to be the most vulnerable populations: poor health, lower educational attainment, Latino and African-American workers and part-time employees. EBRI reports that 60 percent of workers report that the total value of their household's savings and investments is less than $25,000, excluding the value of their primary home and any defined benefit plans.

These figures are dismal and discouraging; however, there are plans in place designed to help Americans save for their retirement. Employer-sponsored retirement plans are often the easiest way for workers to save, with pre-tax contributions and employer payroll-deductions. These policies have greatly contributed to families increasing their retirement plan participation and savings rates. CFED would like these accounts to be maintained; the ability for Americans to save for retirement is imperative. Unfortunately, these policies

[1] Ruth Helman, Mathew Greenwald and Associates, Craig Copeland and Jack VanDerhei, *The 2012 Retirement Confidence Survey: Job Insecurity, Debt Weigh on Retirement Confidence, Savings,* EBRI Issue Brief #369, March 2012 (Employee Benefit Research Institute, 2012).

could use reform; in their current design they disproportionately go to the top percent of earners and largely miss middle and lower-income families.

In fact, the overwhelming majority of tax payers who benefit from federal incentives for retirement fall disproportionately in the higher tax brackets. Roughly 70 percent of workers who earn $50,000 or more participate in an employer-retirement plan while only one-quarter of workers who earn between $15,000 and $19,999 participate. Those who earn less are even less likely to participate[2]. This is critical because every dollar not saved for retirement reduces post-retirement income or extends the number of years that must be worked. A median worker who is 35 years from retirement will have to work an additional year for every $2,350 not saved for retirement. Insufficient retirement savings increases the likelihood of income poverty and a dependence on public assistance during an individual's senior years. The retirement tax policies that are in place that benefit the wealthy and skip the middle class and working poor are not only unfair but unproductive. They miss the savings capability and needs of low- and moderate-income individuals and hurt the economic security and mobility of American households and the American Economy.

The discussion around how to improve the participation and savings rates for all Americans through comprehensive tax reform is incomplete without a fair and honest discussion on installing a truly universal savings and investment infrastructure and incentive for low-income families. The best way to effectively incent retirement savings for working class Americans is to create a refundable tax credit for those who set aside money in tax-preferred retirement plans.

As you know, there is already a tax credit that is designed to incent retirement savings, called the Saver's Credit, which was designed to provide a modest retirement saving incentive for low- and moderate-income households. However, the current Saver's Credit is highly underutilized. This is because the credit is only available to offset a taxpayer's income tax liability, thus making credit unavailable to the 50 million working households who pay payroll taxes but have no income tax liability[3]. In a universe of more than 50 million eligible tax filers, only 6 million Americans claimed the credit in 2009. More could be done to expand the Saver's Credit and tax credits similar to it in order to reach the majority of low- and moderate-income households.

[2] Beadsie Woo, Ida Rademacher and Jillien Meier, *Upside Down: The $400 Billion Federal Asset Budget* (CFED and Annie E. Casey Foundation, 2010).
[3] *Split Refund and Saver's Credit: Two Better Ways to Save for Retirement*, The Retirement Security Project, February 2008.

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CFED supports the concept of a refundable tax credit designed for savings, whether that tax credit is an expanded Saver's Credit or proposals like the Freedom Savings Credit[4], designed by the Aspen Institute Initiative on Financial Security. There are multiple benefits of installing a refundable credit for savings into the U.S. Tax Code:

- Asset-building subsidies are primarily embedding in the U.S. Tax Code. The President's Fiscal Year 2013 Budget proposed a total amount of $548 billion in resources to promote federal asset-building opportunities, including $165 billion for retirement security; of the $548 billion, fully $508 billion will consist of tax subsidies[5].

- The tax filing process is an amazing opportunity for the majority of low-income households. Many households do not have a complete review of their finances until this critical time of year. Through payroll withholding and refundable tax credits, families receive an average refund of approximately $3,000, according to 2008 tax data. Some portion of this lump sum of money, sometimes the largest sum of funds that American families will receive all year, could be saved and used for asset-development, like funding a ROTH IRA or another retirement savings vehicle.

Creating a refundable tax credit for savings that reaches the bottom 60 percent of households that are asset-poor (e.g. households without sufficient savings to survive at the federal poverty level without income), would allow families to slowly improve their financial security through our already established federal tax code, build savings and invest in assets, which would help households become more financially resilient and successful.

CFED also supports policies, like the Automatic IRA Act of 2012 (H.R. 4049) introduced by Congressman Richard Neal (D-MA), that support automatic enrollment as a method of increasing retirement participation. Automatic enrollment is a simple, cost-effective way to help Americans save for retirement through payroll deductions for most workers who currently do not have an employer-provided retirement plan. According to the Retirement Security Project (RSP), automatic enrollment dramatically boosts 401(k) participation rates from a national average of about 75 percent of eligible employees to between 85 and 95 percent[6]. In addition, RSP estimates that automatic IRA initiatives could increase net national savings by nearly $8 billion annually. Automatic enrollment would provide a

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[4] Lisa Mensah, Raymond O'Mara III, Colby Farber, Robert Weinberger, *The Freedom Savings Credit: A Practical Step to Build Americans' Household Balance Sheets*, The Aspen Institute, Initiative on Financial Security (February 2012).
[5] Reid Cramer, Rachel Black and Justin King. *The Assets Report of 2012, An Assessment of the Federal "Asset-Building" Budget,* April 2012 (New America Foundation, 2012).
[6] *Automatic IRAs: Extending Retirement Saving Opportunities to 78 Million More American Workers*. The Retirement Security Project (August 2009).

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secure retirement option for workers, lessen dependence on Social Security and present an opportunity to lift low-income working families out of poverty during retirement.

We would like to thank the Committee again for bringing to the table the important issue of retirement savings and participation for American families during this important discussion of comprehensive tax reform. We ask the Committee to consider proposals to establish refundable tax credits designed for savings for low-income households as well as policies that would simplify the process of saving for retirement.

Sincerely,

Ida Rademacher
Chief Program Officer

STATEMENT FOR THE RECORD

OF

TOD A. RUBLE

**CHIEF EXECUTIVE OFFICER,
CUSTODIA FINANCIAL**

FOR THE HEARING ON

"TAX REFORM AND TAX-FAVORED RETIREMENT ACCOUNTS"

BEFORE

**THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS & MEANS**

APRIL 17, 2012

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Thank you for the opportunity to submit this statement for the record. We applaud the Committee for its leadership on tax reform and retirement security issues.

Retirement security is an important policy objective. Done properly, comprehensive tax reform offers the opportunity to achieve the goals of simplification, efficiency, and strengthening retirement and financial security for American families.

In the interim, we want to ensure the Committee is aware of an issue that requires more immediate attention. As other sources of credit have become scarce for American families, more and more are turning to their defined contribution plans and accessing their retirement savings to meet emergency cash needs. American families lose billions of retirement savings annually due to defaults on these loans as a result of death or disability. This easily avoidable loss of retirement savings is growing rapidly and is the result of the current policy framework that does not ensure access to insurance or debt protection options to plan participants.

THE PROBLEM

Approximately 90 million Americans participate in defined contributions plans, including 401(k) plans.[1] More than 85 percent of these plans allow participants to borrow from plans.[2] Plan loans are preferential to an early withdrawal and allowing participants to borrow from such plans has had a positive effect in increasing participation levels and contribution amounts.

However, due in large measure to recent economic events, the incidence of participants borrowing from their accounts has dramatically increased.[3] The borrowed funds are largely being used by plan participants to assist in meeting emergency financial obligations, such as to mitigate the impact of unemployment, to make mortgage payments and prevent foreclosure, or to pay medical expenses. 28 percent of all allowed participants have elected to take loans.[4] However, the borrowing rate is higher for those of more modest incomes and among minority groups.[5] Additionally over a quarter of borrowers have multiple loans outstanding.[6]

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[1] U.S. DEPARTMENT OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, ABSTRACT OF 2009 FORM 5500 ANNUAL REPORTS (Dec. 2011).

[2] CONGRESSIONAL RESEARCH SERVICE, AN ANALYSIS OF BORROWING FROM DEFINED CONTRIBUTION RETIREMENT PLANS, R40828 (Sept. 22, 2009).

[3] ARIEL/AON HEWITT, LEAKAGE OF PARTICIPANTS' DC ASSETS: HOW LOANS, WITHDRAWALS, AND CASHOUTS ARE ERODING RETIREMENT INCOME (2011).

[4] *Id.*

[5] Loan frequency peaks among those with incomes between $30,000 and $89,999. Nearly 50 percent of all African-Americans and 40 percent of Hispanics, compared to about a quarter of whites and Asian-Americans, carried a plan loan balance in 2010. ARIEL/AON HEWITT, 401(K) PLANS IN LIVING COLOR: 401(K) PLANS IN LIVING COLOR: A STUDY OF 401(K) SAVINGS DISPARITIES ACROSS RACIAL AND ETHNIC GROUPS (2012).

[6] ARIEL/AON HEWITT, LEAKAGE OF PARTICIPANTS' DC ASSETS, *supra* note 3.

Outstanding loans present a considerable risk to retirement security, as the consequences for an unprotected borrower are significant. The unfortunate reality is that, from time to time, participants with outstanding plan loans die and become disabled. If a borrower does die or become disabled without this type of protection, the borrower would be required, within 60 days, to pay back the outstanding balance or have the entire amount treated as an "early withdrawal" from the plan. This forced early withdrawal immediately becomes a liability for the borrower at the state and federal income tax levels. Regrettably, in most instances, borrowers or their beneficiaries are left with no alternative other than using their remaining account balances to cover the resulting tax liability, thus eliminating the pre-tax accumulation of the plan for retirement.

Exacerbating this problem, defined contribution plans are tax-advantaged and are governed by the Employee Retirement Security Act ("ERISA") which, under present law, effectively dissuades plan sponsors from embracing private market solutions for fear of litigation. Providing legal certainty would ameliorate this issue.

THE SOLUTION

Insurance or debt protection could mitigate the leakage of retirement savings that occurs as a result of borrowers' death or disability. Unfortunately, the current policy framework does not ensure access to such coverage.

However, H.R. 3656 presents a solution to this problem. Mirroring the auto-save features of the highly successful and bipartisan Pension Protection Act,[7] this legislation would amend the Internal Revenue Code ("Code") so that defined contribution plans may elect to provide automatic enrollment for plan participants into loan life and disability insurance or similar protection. The bill also provides plan sponsors with an incentive to incorporate auto-enrollment options by affording greater legal certainty as a safer risk path than what currently exists. If enacted, this modification to the Code would create a mechanism to assist millions of plan participants by providing the option to protect their retirement savings from the adverse consequences of loan defaults.

Under the proposal, if a plan chooses to automatically enroll participants into coverage, a borrower may elect to decline ("opt-out of") this protection. This protocol ensures guaranteed coverage at the most affordable cost available and is issued at the time the emergency loan is initiated. With coverage in place, in the unfortunate event of death or disability of the borrower with an outstanding loan, the insurance provider would repay the full amount of the loan balance as well as an amount sufficient for the borrower or beneficiary to pay any accompanying Federal tax liability as a result of the deemed distribution or early withdrawal. Upon a participant's affirmative decision to borrow and

[7] Research has widely demonstrated that plan participation rates have increased significantly as a result of the auto-enrollment provision contained in the Pension Protection Act. Enrollment in plans has increased significantly among younger and lower-paid employees and the participation gap has decreased among racial groups among employees subject to auto-enrollment. For these reasons, some commenters have recommended building on this success and expanding auto-enrollment into other areas. *See, e.g.*, ARIEL/AON HEWITT, 401(K) PLANS IN LIVING COLOR, *supra* note 5.

access coverage, the protection afforded would provide repayment and avoid loss of retirement savings. This repayment would avoid loss of retirement savings by effectively replenishing the borrower's account balance. Thereafter the borrower or his or her beneficiary would have the same options currently available to them under current law (*e.g.*, a rollover of the plan balance to an Individual Retirement Account ("IRA")). This legislative solution is budget neutral in that it does not require new federal spending to implement. Moreover, it provides a private market "backstop" provided by an efficient market with various providers that would ensure taxes are paid on the loan proceeds deemed to be a distribution.

The proposal would also encourage plan fiduciaries to take the costs of protection into consideration when determining the interest rate to be charged on loans. Allowing plans to offset the cost of the optional coverage to borrowers would still deliver a healthy rate of return on a protected loan. This solution does not create any undue imposition on plan sponsors and actually maintains current operational and distribution protocols. In addition, this broadly supported solution would create thousands of new jobs and provide an estimated $5 billion plus of new overall economic impact.

CONCLUSION

Current policy fails to include a provision for loan insurance or debt protection options, exposing plan participants to significant risk of loss of retirement security. As recommended in the 2012 Ariel/Aon Hewitt Study, in recognition of the stress faced during difficult economic times, public policy should "allow retirement plan participants to weather short-term economic hardship without compromising their financial future."[8] We strongly urge Congress to consider H.R. 3656, which would provide a solution to this problem and strengthen retirement security.

We greatly appreciate the opportunity to submit this statement. We are pleased to be a resource to the Congress, the Committee, and the Subcommittee on these and related matters. We look forward to our continued work together on these important issues.

[8] *Id.*

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Serving the entire ESOP community

April 20, 2012

House Ways and Means Committee
1102 Longworth House Office Building
Washington DC 20515

Following is a statement from The ESOP Association for the Ways and Means Committee's April 17, 2012 hearing: Hearing on Tax Reform and Tax-Favored Retirement Accounts.

The statement is being submitted by

The ESOP Association
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The author of the statement is J. Michael Keeling, president of The ESOP Association. He can be reached at the address and phone number provided above or by email at Michael@esopassociation.org.

The ESOP Association is the national trade association for companies with employee stock ownership plans (ESOPs). The Association's primary members are U.S. corporations that sponsor ESOPs. The mission of The ESOP Association is simple: To advocate for, and educate about, employee ownership through the ESOP model.

Statement follows:

Chair Camp, Ranking Member Levin, and distinguished members of the House Committee on Ways and Means, I am J. Michael Keeling, President of The ESOP Association, the national 501(c)(6) trade association for U.S. corporations that sponsor employee stock ownership plans, or ESOPs, with nearly 1,500 U.S. corporations that sponsors ESOPs as our primary members, and just under 1,000 persons who provide specialized services to ESOP sponsors as secondary members.

Today's hearings are part and parcel of the Committee's commitment to study our entire Federal income tax laws, in a systematic process, before launching a detailed re-write of those laws. Clearly, the tax code's provisions that encourage private sector employers to fund, wholly or partially a "savings" vehicle to provide income for employees when they retire from work, or become disabled, are major provisions of current tax law. Not to review these laws, in terms of impact on Federal revenue compared to why prior Congresses put these laws into place would be a huge dereliction of duty; it is pleasing to see that this Committee continues to meet its obligations as it has since the income tax laws were first enacted in the second decade of the 20th century.

Today, I do not dwell on the reasons why Federal tax law encourages both retirement savings growth and more widespread ownership of productive assets through the ESOP model of ownership, as I know the ESOP community will have ample opportunity to present to the Committee members, and their staffs reasons that the ESOP model has created in the vast majority of instances more retirement savings for ESOP participants in companies that are more productive, more profitable, and more sustainable, while providing locally controlled U.S. jobs. We have the macro data to back up these statements, such as the recent General Social Survey 2010 that evidences that during the Great Recession of 2008/09, employees of employees stock owned companies were four times **less** likely to be laid off than employees of conventionally owned companies. The percentage to be specific were employees of employee stock owned companies were laid off during the Great Recession at rate of less than 3% whereas employees of conventionally owned companies were laid off at a rate of just over 12%.

Again, we will dig into the track record of ESOP companies when the Committee begins to dig into the details of what to do, if anything, about current ESOP laws in the tax code.

What I want to share with the Committee today is history of how ESOP laws developed, and how they were supported by leading political figures of both those holding so-called conservative views of government, and those holding so-called liberal views.

Clearly, the Ways and Means Committee of the 21st Century does not have to do what the Ways and Means Committee of the 20th Century did with regard to ESOPs and employee ownership. But knowing what your colleagues of this oldest Committee in Congress did over nearly 100 years will assist your review.

Interestingly, the first time the Ways and Means Committee undertook a major review of Federal tax law, in the 1920 and 1921 period, in reaction to the first tax laws after the ratification of the 16th Amendment of the Constitution, a major point of debate and discussion was how to treat company stock that U.S. corporations were putting aside for their employees.

Yes, using company stock to help employees meet their retirement income needs pre-date the Federal income tax law, and Social Security law.

For you see, back in the last half of the 19th Century, as the Industrial Revolution took hold in our nation, corporations grew and their work forces grew. Leaders of these corporations, such as Railway Express, Montgomery Ward, Sears and Roebuck, Procter and Gamble, to name a few, came to see that loyal employees were reaching ages when their active working days were coming to a close; but these employees had nothing to support them once their jobs terminated. So, the leaders of these "new" national corporations begin to set aside company stock for the employees to have when they retired.

The basic premise of the first income tax law was, and it still is the basic rule, that all income of whatever nature and from whatever source is subject to the Federal income tax.

So the debate in 1921 was the value of the stock these corporations were setting aside for employee's taxable income to the employees the year it was set aside, and was the value of the stock a compensation cost that was a deductable cost of business for the corporation?

After much back and forth, it was decided that the stock value was not current income to the employees, and was a cost of compensation. The law arising in 1921 labeled the scheme as tax qualified deferred compensation, and it was what is now labeled a "stock bonus plan".

Frankly, the stock bonus plan is an ESOP that has not financed its acquisition of employee stock for the employee's retirement savings.

So, literally, the first retirement savings plan recognized in the Federal tax code was a stock bonus plan.

While the Ways and Means Committee added many rules about how a tax qualified deferred compensation plan should be managed in the 30s, 40s, 50s and 60s, really today what is considered the defining law for tax qualified deferred compensation plans are the tax laws in what is known as the Employee Retirement Income Security Act, or ERISA, passed in the mid-70s.

But important to note is that in the late 40s, and here details are a little fuzzy as private letter rulings were not public until a tax law enacted in 1977, an Alaskan company asked the IRS if it could borrow money to obtain the assets for its stock bonus plan, which was holding employer securities. The IRS said yes, and the "leveraged" employee stock ownership plan was born, though not labeled an ESOP.

From the late 40s until the early 70s, a small number of these leveraged stock bonus plans were established, as it was easy to see how it presented an excellent way for an owner to exit his or her business without abandoning loyal employees, while enabling the exiting shareholder to cash our her or his "chits", without selling to competition, or liquidating his/her assets.

I know other witnesses will go over the general history of ERISA, and how ERISA had roots in concerns over investments by certain large defined benefit pensions seemed to be helping organized crime, and how the collapse of several large defined benefit plans heavily invested in company stock left unionized work forces without any retirement income.

The Congressional and White House push to address these concerns of the 1950s and 1960s led to the creation of ERISA, which of course began in the House.

The first version of ERISA was drafted by your House Committee, Education and Labor in the early 70s, and bluntly was focused almost entirely on defined benefit plans. A key rule adopted by the Committee was any retirement savings plan, or tax qualified deferred compensation plan, could not hold more than 10% of its assets in company stock.

When the Ed and Labor version was sent over to the House Ways and Means Committee, American businesses, many of whom had sponsored stock bonus plans since the 19th century, woke up, and persuaded Ways and Means to a make distinction between a plan that promised a benefit, or a defined benefit, and a plan that made no specific promise to the employee as to the level for the benefit, but did promise to make a certain contribution each year, if certain business results were reached—in other words, profit sharing plans, of which stock bonus plans were one.

So the defined contribution plan was born, and it was permitted to hold company stock beyond the 10% limit on company stock imposed on defined benefit plans.

The legislation moved on, and reached a Conference between the House and Senate, and there decisions were made to permit, under certain very regulated circumstances, a stock bonus plan to borrow money to acquire company stock for the plan. And the name "employee stock ownership plan", or ESOP was codified into the tax code's ERISA section, as well as the labor section of ERISA.

This is just a brief history of how ESOPs were created formally under ERISA that lays out that the idea of rewarding employees with company stock did not just fall from the sky in the mid-70s, but was actually a most time honored method of providing retirement income for employees.

Let us fast forward to the last quarter of the 20th Century, when the work of the Ways and Means Committee on ESOP issues became quite intense, especially in the period from 1987 through 2001.

While many of the early laws in the 1976 through 1986 period promoting retirement savings and ownership through ESOPs were driven by the leadership of the late Senator Russell B. Long, the legendary top Democrat of the Senate Committee on Finance, the truth is that he did not have an unfettered pathway, as Ways and Means members in Conference often altered and even pushed back on some of his ESOP proposals adopted by the Senate. But today, the focus is on what Ways and Means has done over the years with regard to ESOPs, not what the Senate Finance Committee did.

Before looking at the 1987 through 2001 period, a short detour is in order with regard to the last time Ways and Means reformed the tax laws in a major tax reform effort—the 1985 and 1986 time frame.

While the Democrats of 1985 and the Republicans of 1985 could hold differing views on details of what should be in the tax laws, in 1985 there was a major, obvious coming together of President Ronald Reagan and the Democrats who controlled the House, to rewrite Federal tax laws, to make them more simple, and to lower tax rates.

After this general agreement, the Reagan Administration developed a comprehensive tax reform proposal, labeled by the pundits, members of Congress, and lobbyists as "Reagan I".

Reagan I was a trial balloon, and the Administration welcomed the private sector, or better put, private sector interest groups also known as lobbyists, to interact with the Treasury Department where the heavy lifting was done to draft Reagan I.

Interestingly, Reagan I did not have any provision about ESOPs. The tax experts at Treasury knew that President Reagan, dating back to his days as a radio commentator, was a huge fan of ESOPs, as was the important Louisiana Senator Russell Long. So frankly they punted on ESOPs, waiting to hear from the White House and Senator Long on what was an acceptable way to handle ESOPs.

Now, keep in mind, after just nine years of ESOPs as a formal tax qualified deferred compensation plan, there had been some controversy among retirement income gurus in both the public and private sector, as the data showing the strength of ESOP companies as providers of jobs and retirement income was not as obvious in 1986 as it is today. The strongest voices were candidly among Department of Labor ERISA experts; in a rather odd twist, the Treasury officials asked the Department of Labor people to come up with a recommendation about ESOPs in what was released in 1985 as Reagan II.

Here is what Reagan II said about ESOPs: It proposed that all the tax benefits that were added for ESOPs in the 1984 tax law known as DEFRA be retained, not reduced or eliminated, but that ESOPs no longer be an ERISA plan. While purely speculation on my part, I assume the DOL thinking was the strength of ESOPs in the tax committees was too strong to unravel tax preferences for ESOPs, but since ESOPs were concentrated in company stock, ESOPs should not be retirement savings plans.

Next, Ways and Means had long and lengthy hearings on Reagan II, that some called Treasury II.

What did the ESOP community say, or more specifically, what did The ESOP Association say about the ESOP provisions of Treasury/Reagan II?

Interestingly, the ESOP witness before Ways and Means said that the Association had no underlying problem with ESOPs not being ERISA plans, but that if the Committee agreed with Reagan II, the Committee should include in the ESOP laws of the tax code provisions related to vesting, discrimination, fiduciary obligations of the trust, limits on contributions for highly paid, distributions rules etc that were all part of existing laws in ERISA, as these were provisions that protected employees.

In no surprise, the staff of Ways and Means, and the Joint Committee on Taxation, said to themselves—"what the heck, why move ESOPs out of ERISA legal and regulatory schemes, but then impose on ESOPs the very same legal and regulatory schemes?"

So, when the chair of Ways and Means made his proposal to the Committee, the late Dan Rostenkowski, he left ESOPs in ERISA, but eliminated most of their tax preferences in what was known as Rostenkowski I, or "Rosty I".

The Ways and Means Committee then sat down for days marking up what was known as "Rosty I". Chair Rostenkowski had a rule, primarily driven by the then Budget Act, that any change in Rosty I offered by a member had to be revenue neutral. In the many hours of mark up, recall is that only three amendments were adopted by the full Committee amending Rosty I that were not offset with increasing taxes elsewhere to pay for the amendment.

One of the three revenue losing amendments was an amendment restoring the ESOP tax preferences adopted in 1984, offered by former Congressman Beryl Anthony; it was adopted on a voice vote, with no public declaration of opposition.

(Note, to fit into the revenue matrix, Congressman Anthony's amendment sunsetted the ESOP tax preferences after five years; but still, other similar proposals, except for two, were defeated by voice or roll call vote during the mark up of Rosty I.)

(Also note, while tweaking some of the 1984 and earlier tax preferences for ESOPs in Conference, the majority of the 1984 preferences for ESOPs were made permanent in the Conference Committee work on the 1986 Tax Reform Act, with little or no debate.)

Senator Long retired at the end of 1986, and in the period from 1987 through 1994, the Ways and Means Committee, both the full committee, but primarily its Oversight Subcommittee, held at least six hearings on ESOPs. Nearly all were in the context of reviewing ESOPs as takeover defense tactics during the hey day of hostile corporate takeovers in the late 80s. Two hearings did review an idea that an employer could not sponsor a defined contribution plan such as an ESOP as a primary retirement savings plan, but only as a second plan, so to speak, to a defined benefit plan.

In 1995, the Senate Finance Committee repealed a ESOP tax benefit related to lenders getting a break for loans to ESOPs, and that provision was adopted by the House Ways and Means Committee in a 1996 bill, which was included in then Chair Archer's mark in a last minute effort to have a revenue neutral reduction in small business taxes to offset the costs of an increase in the minimum wage.

Now we come closer to current history, as since 1986, when the individual tax rate became lower than the C corporation tax rate, there has been a push to open up more rules permitting S corporations, or pass through entities. Part of the agitation was to have S corporations for the first time to sponsor an ERISA plan, such as an ESOP, that could hold employer stock.

In 1998, it was the Ways and Means Committee that adopted a workable provision of tax law that permitted an S corporation to sponsor a leveraged ESOP. The amendment was offered by former Congresswoman Nancy Johnson, and was adopted by the Ways and Means Committee with no opposition.

Since 1998, approximately 5,000 U.S. corporations that are S corporations sponsor an ESOP. Approximately 1,000 belong to The ESOP Association.

As it is not unusual with tax law provisions that are unique, the first S ESOP law was abused by flim flamers. In the ESOP case it was primarily actors and athletes setting up one person or two persons ESOPs.

In its 2000 budget proposal for FY 2001, the Clinton Administration proposed a major reduction in the benefit for being an S ESOP corporation.

The ESOP community came to the Ways and Means Committee with a proposal to stop the flim flamers that was not as drastic as what the Clinton Administration had proposed, and the Ways and Means Committee, adopted as set fourth in Chair Thomas's mark, a proposal put forward by former Congressman Jim Ramstad. The Ramstad amendment, a very tight anti-discriminatory rule related to how much key people could have in their ESOP accounts, ended the flim flannery.

So, what is my point Mr. Chairman and Ranking Member Levin, and others distinguished members of the Committee?

The point is that the Ways and Means Committee has a long, and complete record of reviewing ESOP law, and has always come down in support of ESOPs as a retirement savings plan, and as the Federal courts have said over and over, as an ownership plan.

The ESOP community only asks that you do the same kind of serious review of ESOP companies and their providing of retirement savings benefits, and their contribution to sustainable jobs, and higher performing companies that your predecessors did in putting together primarily the 1986 Tax Reform Act, an other tax laws after 1986.

We look forward to your questions, your review and the dialogue that will take place during your work on tax reform over the next 18 months or so.

Thank you for permitting the submission of this statement.

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Statement of the Investment Company Institute
Hearing on "Tax Reform and Tax-favored Retirement Accounts"
Committee on Ways and Means
United States House of Representatives

April 17, 2012

The Investment Company Institute[1] is pleased to provide this written statement in connection with the hearing on April 17, 2012, in the U.S. House of Representatives Committee on Ways and Means titled "Tax Reform and Tax-Favored Retirement Accounts." The Institute strongly supports efforts to promote retirement security for American workers. We thank Chairman Camp and Ranking Member Levin for their past support of retirement savings plan improvements, including provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Pension Protection Act of 2006 (PPA). Reflecting these improvements, Americans currently have about $18 trillion saved for retirement, with more than half of that amount in defined contribution (DC) plans and individual retirement accounts (IRAs).[2] About half of DC plan and IRA assets are invested in mutual funds, which makes the mutual fund community especially attuned to the needs of retirement savers.

As noted by this Committee, "the major components of retirement security are Social Security, employer-sponsored plans, and personal savings."[3] While Social Security is outside the scope of this hearing, no assessment of employer-sponsored plans and IRAs can avoid a discussion of the significance of Social Security in ensuring retirement security—or retirement income adequacy—for American workers. In this respect, Social Security is the primary element for the majority of American retirees[4] and replaces significant portions of income for lower-income retirees. Social Security replaces 71 percent of average annual lifetime household earnings for the lowest lifetime household earnings quintile; 43 percent for the middle lifetime household earnings quintile; and 30

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.4 trillion and serve over 90 million shareholders.

[2] *See* Tables 1, 6, and 12 in Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2011" (April 2012); available at www.ici.org/info/ret_11_q4_data.xls.

[3] *See* Committee Hearing Announcement released April 10, 2012.

[4] Since 1975, there has been little change in the importance of Social Security benefits in providing retiree income. Social Security benefits continue to serve as the foundation for retirement security in the United States and represent the largest component of retiree income and the predominant income source for lower-income retirees. In 2010, Social Security benefits were 57 percent of total retiree income and 87 percent of income for retirees in the lowest 40 percent of the income distribution. Even for retirees in the highest income quintile, Social Security benefits represented one-third of income in 2010. *See* Figure 3 in Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010," *ICI Research Perspective* 17, no. 9 (December 2011); available at www.ici.org/pdf/per17-09.pdf.

percent for the highest lifetime household earnings quintile.[5] Since the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), increasing numbers of retirees also receive benefits from private-sector pension plans (defined benefit (DB) and DC) and receive more in benefits from these plans.[6] Moreover, it is projected that more than 60 percent of 401(k) participants in their late 30s to mid-40s, who will turn 65 between 2030 and 2039, will accumulate enough in their 401(k) accounts to replace more than half their salary.[7] These statistics speak to the success of the changes implemented over the past 35 years. A crucial component of this success is the current retirement savings tax incentives, including the contribution rates, that motivate saving and encourage employers to maintain and contribute to employer-sponsored plans. While it is important to consider how the retirement system can be improved, Congress should not throw out decades of progress by taking away the ability of American workers to make full use of the retirement vehicles they value so strongly in supplementing their Social Security benefits. Consistent with the views of the overwhelming majority of Americans,[8] we urge Congress to maintain the current retirement savings tax incentives, including the contribution rates, and allow our successful employer-provided retirement system to flourish.[9]

CONTRARY TO CONVENTIONAL WISDOM, INCOME FROM EMPLOYER-SPONSORED PLANS IS INCREASING

Retirement policy discussions often start from the premise that retirees' pension income has fallen over time. Looking at the entire period from 1975 to 2010, the data show that, contrary to conventional wisdom, private-sector pension income has become more, not less, prevalent over time. Across all income groups, retirement income from employer-sponsored retirement plans is more prevalent among retirees today than in the mid-1970s, when sweeping new retirement plan regulations were enacted under ERISA.[10] In 2010, 31.5 percent of retirees received income—either directly or through a spouse—from private-sector retirement plans, compared with 21.3 percent in 1975 (see figure below).[11] The median income received by those with private-sector pension income

[5] Figures represent the median initial replacement rates for retired workers in the 1940s birth cohort. *See* Exhibit 10 in Congressional Budget Office, *CBO's 2011 Long-Term Projections for Social Security: Additional Information* (August 2011); available at www.cbo.gov/sites/default/files/cbofiles/ftpdocs/123xx/doc12375/08-05-long-termsocialsecurityprojections.pdf.

[6] *See* Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010," *ICI Research Perspective* 17, no. 9 (December 2011); available at www.ici.org/pdf/per17-09.pdf.

[7] Americans in their late 30s to mid-40s represent the first segment of the population that could potentially participate in a 401(k) plan during their entire working careers. Today's Baby Boom Generation typically entered the workforce in the early 1970s—a decade before the introduction of 401(k) plans. *See* Holden and VanDerhei, "Can 401(k) Accumulations Generate Significant Income for Future Retirees?" *ICI Perspective* 8, no. 3, and *EBRI Issue Brief* (November 2002); available at www.ici.org/pdf/per08-03.pdf. The EBRI/ICI 401(k) Projection Model also explored the potential impact of automatic enrollment on 401(k) accumulations. *See* Holden and VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *ICI Research Perspective* 11, no. 2, and *EBRI Issue Brief* (July 2005); available at www.ici.org/pdf/per11-02.pdf.

[8] *See* Figures 6 and 7 in Holden and Bass, *America's Commitment to Retirement Security: Investor Attitudes and Actions*, Investment Company Institute (January 2012); available at *www.ici.org/pdf/ppr_12_retir_sec_update.pdf* and discussed later in this statement.

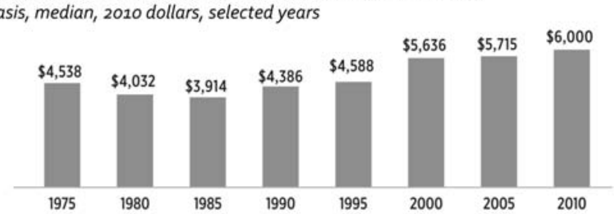
[9] In this respect, the increases in retirement plan participation rates resulting from the implementation of automatic enrollment and automatic increase provisions attest to the dramatic impact that even small changes building upon the existing system can have on improving retirement savings for American workers. *See* note 24, infra.

[10] *See* Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010," *ICI Research Perspective* 17, no. 9 (December 2011); available at www.ici.org/pdf/per17-09.pdf.

[11] Overall, in 2010, 46 percent of retirees had income from private-sector pensions, government pensions, or both. In 1975, 34 percent of retirees had income from private-sector pensions, government pensions, or both. Data are ICI tabulations of the Current Population Survey (CPS). *See* Figure 4 in Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010," *ICI Research*

increased to $6,000 per person in 2010 from $4,538 in 1975 (in 2010 dollars). Further, because the survey data used to analyze retiree income do not fully capture payments from DC plans and IRAs, the increase in pension income since ERISA is likely understated.[12]

Retirees Receive More Income from Private-Sector Pensions (DB and DC)
On a per capita basis, median, 2010 dollars, selected years



	1975	1980	1985	1990	1995	2000	2005	2010
Share of retirees with private-sector pension income	21.3%	24.7%	28.1%	34.0%	34.2%	32.7%	34.3%	31.5%

Source: ICI tabulations of the March Current Population Survey; see Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010" *ICI Research Perspective* (December 2011)

This rise in private-sector pension income likely reflects changes in the pensions offered. Since ERISA, an increasing share of private-sector workers has worked for employers that sponsor DC plans, offsetting a decreasing share that has worked for employers that sponsor DB plans.[13] This rise in DC plan coverage has resulted in a rising number of households with retirement assets. In addition, accelerated vesting requirements and other rule changes have led to more DB plan participants receiving benefits.[14]

Perspective 17, no. 9 (December 2011); available at www.ici.org/pdf/per17-09.pdf; and Table 19 in Brady and Bogdan, "Supplemental Tables for A Look at Private-Sector Retirement Plan Income After ERISA, 2010;" available at www.ici.org/info/per17-09_data.xls.

[12] The CPS understates DC plan distributions and IRA withdrawals. *Ibid* and *see* discussion and Figure 20 in Sabelhaus and Schrass, "The Evolving Role of IRAs in U.S. Retirement Planning," *Investment Company Institute Fundamentals* 15, no. 3 (November 2009); available at www.ici.org/pdf/per15-03.pdf.

[13] By 1998, 56 percent of active participants in private-sector retirement plans were covered by a primary DC plan, and 36 percent had a supplemental DC plan. In contrast, in 1975, 87 percent of active participants in private-sector retirement plans had primary coverage through DB plans, dropping steadily over time to below 50 percent by the mid-1990s. Data reported are from reports published by the U.S. Department of Labor. Primary plan status and secondary plan status are not reported on Form 5500. For firms with multiple pension plans, the status was inferred by DOL analysts. Data are available through 1998; after 1998, DOL no longer inferred primary and secondary status for plans. For the 1975 data, *see* U.S. Department of Labor, Pension and Welfare Benefits Administration (now Employee Benefits Security Administration), *Private Pension Plan Bulletin, Abstract of 1992 Form 5500 Annual Reports*, no. 5 (Winter 1996). *See* also U.S. Department of Labor, Pension and Welfare Benefits Administration (now Employee Benefits Security Administration), *Private Pension Plan Bulletin, Abstract of 1998 Form 5500 Annual Reports*, no. 11 (Winter 2001–2002); available at www.dol.gov/ebsa/pdf/1998pensionplanbulletin.pdf. These data are summarized in Figure 2 in Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA," *ICI Research Perspective* 16, no. 2 (November 2010); available at www.ici.org/pdf/per16-02.pdf.

[14] *See* discussion on page 4 of Brady and Bogdan, "A Look at Private-Sector Retirement Plan Income After ERISA, 2010," *ICI Research Perspective* 17, no. 9 (December 2011); available at www.ici.org/pdf/per17-09.pdf.

DB plan coverage does not always translate into receipt of pension income. Many retirees may have worked for companies that offered DB plans, but, because private-sector workers change jobs often, the combination of long vesting periods and back-loaded benefit accrual resulted in many retirees receiving little or no retirement income from the plans. The belief in a golden age of pensions—a time in our history when most private-sector workers retired with a monthly pension check that replaced a significant amount of their salary—is not supported by the facts. Furthermore, the typical amount of private-sector pension income observed in the historical data can be generated by relatively modest accumulations in DC plans or IRAs. Indeed, Congressional Research Service (CRS) analysis of pre-retiree households' balance sheets finds that the median accumulation in DC plans and IRAs is $100,000, which is estimated to generate $8,400 per household per year in retirement income.[15]

THE DEFINED CONTRIBUTION SYSTEM IS WORKING FOR MILLIONS OF AMERICAN WORKERS

With most households having accrued DB promises, retirement assets, or both by retirement age,[16] and with the overall pension income of retirees rising, the data suggest the shift to DC plans has been beneficial to American workers.[17] Nevertheless, DC plans continue to attract criticism and unfavorable comparisons to DB plans. As noted earlier, the reality is that workers never were universally covered by the DB system, and even those who were covered did not accrue significant benefits unless they stayed at one employer for an entire career. In contrast, because of their portability, DC plans are well-suited to a mobile workforce.[18] DC plans also serve households across all ages and incomes. There are a number of other indicators of the success of the DC plan system.

- 401(k) plan design provides discipline to save for retirement paycheck-by-paycheck and a range of investment options. On average, research conducted in a collaborative effort with EBRI finds that 401(k) plan participants have age-appropriate asset allocations.[19] ICI research finds that 401(k) investors have concentrated their mutual fund investments in lower-cost funds.[20] In recent years, the availability and use of target date funds have expanded.[21]

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[15] CRS analysis of Survey of Consumer Finances data: "For example, if the median retirement account balance of $100,000 among households headed by persons 55 to 64 years old in 2007 were converted to an annuity, it would provide a monthly income of $700 per month ($8,400 annually) to a man retiring at age 65 in 2009." *See* Purcell, "Retirement Savings and Household Wealth in 2007," *CRS Report for Congress*, RL30922 (April 8, 2009).

[16] *See* discussion in text on p.10 of this statement.

[17] It is too soon to evaluate fully the impact of 401(k) plans because today's retirees have not had full careers with such plans. However, research finds that full careers with DC plans generate significant nest eggs and replacement rates. *See* discussion later in this statement and notes 22–25, *infra*.

[18] As an indicator of workforce mobility, consider average job tenure among American wage and salary workers. In January 2010, the median tenure that wage and salary workers age 25 or older had at their current employers was 5.2 years and ranged from 3.1 years among those age 25 to 34, to 7.8 years among those age 45 to 54, to about 10 years among those age 55 or older. *See* U.S. Department of Labor, Bureau of Labor Statistics, "Employee Tenure in 2010," News Release USDL-10-1278 (September 14, 2010); available at www.bls.gov/news.release/pdf/tenure.pdf.

[19] *See* Figures 21 and 30 in Holden, VanDerhei, Alonso, and Bass, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2010," *ICI Research Perspective* 17, no. 10, and *EBRI Issue Brief* (December 2010); available at www.ici.org/pdf/per17-10.pdf.

[20] *See* Holden, Hadley, and Lutz, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2010," *ICI Research Perspective* 17, no. 4 (June 2011); available at www.ici.org/pdf/per17-04.pdf.

- Even though 401(k) plans have been around for about 30 years—not even a full working career—Americans have accumulated more than $3 trillion in these plans.[22] This figure does not include hundreds of billions of dollars saved in 401(k) plans and rolled over into IRAs.[23] Median 401(k) account balance statistics are often cited as evidence of inadequacy, but these statistics are misleading because they tend to ignore other accounts that an individual might have, including other 401(k) plan accounts and IRAs. It is important to judge the retirement system as a whole. Not all workers have the same need to save in DC plans, as some will receive higher replacement rates from Social Security and some will have DB plan benefits.

- DC plans have the potential to replace a significant share of income in retirement. In 2002, EBRI and ICI projected what 401(k) plans could accumulate across a full career.[24] The EBRI/ICI 401(k) Accumulation Projection Model moves 401(k) participants through their careers, with decisions as they age that reflect actual participant behavior on contributions, asset allocations, job changes, rollovers, withdrawals, and loans. The study focuses on 401(k) participants who will turn 65 between 2030 and 2039 (now aged 38 to 47). For more than 60 percent of this cohort, their 401(k) accumulations are projected to replace more than half their salaries. Accounting for Social Security, the majority of the lowest income quartile of this cohort is projected to fully replace their salaries.

- Other studies have come to similar conclusions. In a recently published article, economist Peter Brady of ICI illustrates that most workers can achieve adequacy by supplementing Social Security benefits with income from a 401(k) plan funded with moderate contributions and invested conservatively.[25] Economists Andrew Samwick and Jonathan Skinner of Dartmouth compared typical DB plans and typical 401(k) plans under a variety of possible labor market and investment return scenarios and concluded that "generally, 401(k) plans ... are as good or better than DB plans in providing for retirement."[26] Economists James Poterba of MIT, Steven Venti of Dartmouth, and David Wise of Harvard examined current and projected 401(k) accumulations and concluded, "Our projections suggest that the advent of

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[21] *See* Holden, VanDerhei, Alonso, and Bass, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2010," *ICI Research Perspective* 17, no. 10, and *EBRI Issue Brief* (December 2010); available at www.ici.org/pdf/per17-10.pdf. A target date fund pursues a long-term investment strategy, using a mix of asset classes, or asset allocation, that the fund provider adjusts to become less focused on growth and more focused on income over time as the fund approaches and passes the target date, usually mentioned in the fund's name.

[22] At year-end 2011, 401(k) plans had $3.1 trillion in assets. *See* Table 4 in Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2011" (April 2012); available at www.ici.org/info/ret_11_q4_data.xls.

[23] *See* Figure 8 in Brady, Short, Lutz, and Holden, *The U.S. Retirement Market: Third Quarter 2010*, Washington, DC: Investment Company Institute (January 2011); available at www.ici.org/pdf/ppr_11_retire_q3_10.pdf.

[24] *See* Holden and VanDerhei, "Can 401(k) Accumulations Generate Significant Income for Future Retirees?" *ICI Perspective* 8, no. 3, and *EBRI Issue Brief* (November 2002); available at www.ici.org/pdf/per08-03.pdf. The EBRI/ICI 401(k) Projection Model also explored the potential impact of automatic enrollment on 401(k) accumulations. *See* Holden and VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *ICI Research Perspective* 11, no. 2, and *EBRI Issue Brief* (July 2005); available at www.ici.org/pdf/per11-02.pdf.

[25] *See* Brady, "Can 401(k) Plans Provide Adequate Retirement Resources?" *Public Finance Review*, vol. 40, no.2: 177-206 (March 2012).

[26] *See* Samwick and Skinner, "How Will 401(k) Pension Plans Affect Retirement Income?" *American Economic Review*, vol. 94, no. 1: 329-43 (March 2004).

personal account saving will increase wealth at retirement for future retirees across the lifetime earnings spectrum."[27]

- DC plan participants and traditional IRA-owning households are responsible stewards of their retirement nest eggs. A common criticism of DC plans is that retirees relying on this type of plan could run out of money before death.[28] Anecdotally, many believe most distributions from DC plans are lump sums that are spent, which contributes to this popular belief that people will run out of money. Research shows that a majority of individuals do not spend their lump-sum payments upon distribution, but rather roll over these funds to IRAs or other tax-deferred plans.[29] At the juncture of retirement with a DC plan balance, households indicate that they consult multiple sources of advice and information when making the distribution decision.[30] Traditional IRA-owning households typically postpone withdrawals, take withdrawals based on life expectancy, and use withdrawals to pay for living expenses.[31]

AMERICAN WORKERS SHOW STRONG SUPPORT FOR THE DEFINED CONTRIBUTION SYSTEM AND ITS ASSOCIATED TAX INCENTIVES

Americans highly value their DC plans and the features typically associated with them. A 2011 household survey demonstrated American households' strong support for key features of DC plans, including their tax benefit, and their appreciation for the investment opportunity these plans provide.[32]

- **Overwhelming support for preserving the tax incentives for retirement saving:** Eighty-five percent of all U.S. households disagreed when asked whether the tax advantages of DC accounts should be eliminated. Eighty-three percent opposed any reduction in employee contribution limits.[33]

- **Many oppose altering key features of DC plans:** Nearly 90 percent of all U.S. households disagreed with the idea that individuals should not be permitted to make investment decisions in their DC accounts. Nearly eight in 10 disagreed with the idea of replacing all retirement accounts with a government bond.[34]

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[27] *See* Poterba, Venti, and Wise, "The Changing Landscape of Pensions in the United States," *NBER Working Paper*, No. 13381 (September 2007); available at www.nber.org/papers/w13381.

[28] The danger of running out of money is not unique to DC plans. For example, just because a benefit plan payment may be regular or guaranteed for the life of the participant does not mean that the payment is sufficient to support the participant's retirement income needs.

[29] In addition, individuals also may leave the balance in the DC plan until a later date. For example, see the experience of The Vanguard Group in the DC plans that they recordkeep (Figures 90–95 in *How America Saves, 2011;* available at https://institutional.vanguard.com/iam/pdf/HAS11.pdf).

[30] *See* Sabelhaus, Bogdan, and Holden, "Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring between 2002 and 2007," *Investment Company Institute Research Series* (Fall 2008); available at www.ici.org/pdf/rpt_08_dcdd.pdf.

[31] *See* Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2011," *ICI Research Perspective* 17, no. 8 (November 2011); available at www.ici.org/pdf/per17-08.pdf.

[32] *See* Holden and Bass, *America's Commitment to Retirement Security: Investor Attitudes and Actions*, Investment Company Institute (January 2012); available at www.ici.org/pdf/ppr_12_retir_sec_update.pdf.

[33] *Ibid* (Figure 7).

[34] *Ibid* (Figure 7).

- **Investors like choice and control of investments:** Ninety-seven percent of all DC account–owning households agreed that it was important to have choice in, and control of, the investment options in their DC plans. Seventy-nine percent said their plan offers a good lineup of investment options.[35]

- **Most households continue to have positive attitudes toward the 401(k) system:** Sixty-five percent of all U.S. households in 2011 had favorable impressions of 401(k) and similar plan accounts, similar to 2010.[36] Nearly three-quarters of households expressed confidence DC plan accounts that could help participants reach their retirement goals.[37]

ICI's household surveys during the past three years find that even in the depths of a bear market and despite a broad economic downturn, Americans continue to be committed to saving for retirement and value the characteristics, such as the tax benefits and individual choice and control, that come with DC plans.

EFFECTIVE POLICYMAKING REQUIRES A BETTER UNDERSTANDING OF THE "COVERAGE GAP"

While the current retirement laws and policies are working well and are helping tens of millions of American workers accumulate savings and generate retirement income, some argue that the system is a failure in that not all Americans have access to an employer-sponsored plan. This perceived failure is referred to as the so-called "coverage gap." The fact is that the majority of private-sector workers needing and demanding access to pensions as part of their compensation have pension plan coverage.[38] Discussions about coverage, however, often rely on misleading or incomplete coverage statistics. Household surveys, such as the Current Population Survey (CPS), typically show lower rates of pension coverage than surveys of business establishments, such as the National Compensation Survey (NCS). For example, the CPS data show that more than half (or 77.7 million) of all workers were without pension coverage in 2010.[39] The March 2011 NCS, on the other hand, shows that 64 percent of all private-industry workers and 73 percent of all full-time private-industry workers have access to a pension.[40]

However, even if one uses the CPS data for analysis, looking below the aggregate statistics paints a significantly different picture. Of the 77.7 million workers who report that their employer does not sponsor a pension plan, 17.9 million are either federal workers, state and local workers, self-employed, or work without pay.[41] This leaves 59.8 million workers who are private-sector wage and

[35] *Ibid* (Figure 6).

[36] *Ibid* (Figure 4).

[37] *Ibid* (Figure 8).

[38] *See* Brady and Bogdan, "Who Gets Retirement Plans and Why, 2010," *ICI Research Perspective* 17, no. 7 (October 2011); available at www.ici.org/pdf/per17-07.pdf.

[39] *Ibid* (Figure 4). Pension coverage includes DB and/or DC plans.

[40] *See* Table 1 in U.S. Department of Labor, Bureau of Labor Statistics, "Employee Benefits in the United States – March 2011," News Release USDL-11-1112 (July 26, 2011); available at www.bls.gov/ncs/ebs/sp/ebnr0017.pdf. Pension coverage includes DB and/or DC plans.

[41] Federal, state, and local government employees are excluded from the analysis because the focus of public policy typically has been to increase access to pensions among private-sector workers. Self-employed workers are excluded because, being their own employer, they can access an employer-provided plan by exercising their option to establish a plan. *See* Figure 4 in Brady and Bogdan,

salary employees. Yet this still overstates the number on which to focus. Of these, 5.9 million are under age 21 and 2.8 million are age 65 or older. This leaves 51.0 million private-sector wage and salary employees age 21 to 64 who report that their employer does not sponsor a pension plan (*see* figure below).[42] Of these, 21.6 million are part-time, part-year workers[43] and 7.0 million are full-time, full-year workers age 21 to 29.[44] This leaves 22.4 million full-time, full-year private-sector wage and salary workers age 30 to 64 who report that their employer does not sponsor a pension plan. Of these, 6.5 million earn less than $25,000 a year[45] and 4.1 million earn $25,000 to $44,999 a year and are age 30 to 44.[46] The result is 11.8 million private-sector wage and salary employees who are likely to desire to save in the current year and who do not have access to an employer plan. But 2.2 million of these have a spouse whose employer sponsors a plan. The final result is 9.6 million private-sector wage and salary employees who are likely to desire to save in the current year and who do not have access to an employer plan through their own employer or a spouse.

"Who Gets Retirement Plans and Why, 2010," *ICI Research Perspective* 17, no. 7 (October 2011); available at www.ici.org/pdf/per17-07.pdf. Pension plans include DB and/or DC plans.

[42] *Ibid* (Figure 5).

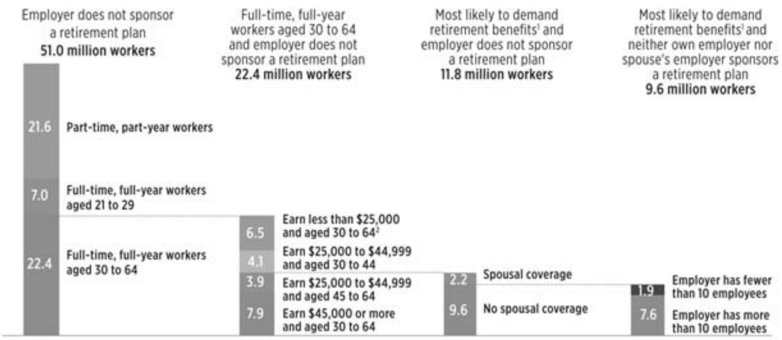
[43] Most part-time, part-year workers have low income and high replacement rates from Social Security. They are unlikely to save for retirement in the current year if they work full-time or year-round in other years. *Ibid* (Figure 5).

[44] Few in this age group save primarily for retirement. Workers age 21 to 29 save primarily for education, the purchase of a home, or for precautionary reasons. *Ibid* (see ICI tabulations from the 2007 Survey of Consumer Finances , Figures 1 and A1, in Brady and Bogdan, "Who Gets Retirement Plans and Why: An Update," *ICI Research Perspective* 17, no.3 (March 2011); available at www.ici.org/pdf/per17-03.pdf.).

[45] The primary concern for workers earning less than $25,000 per year is they do not have enough to spend on food, clothing and shelter. In fact, many are eligible for government income assistance so that they will be able to spend more than what they earn on these items. Social Security replaces a high percentage of their lifetime earnings. In retirement, they may be considered well-off relative to their standard of living when they were working. *Ibid* (*see* Tables 41 and 42 in Brady and Bogdan "Supplemental Tables for Who Gets Retirement Plans and Why, 2010;" available at www.ici.org/info/per17-07_data.xls).

[46] Workers age 30 to 44 who earn between $25,000 and $44,999 a year may have the ability to save, but have other saving priorities, such as starting a household and having children. Given that they get a substantial replacement rate from Social Security, they are likely to delay saving for retirement until later in life–perhaps after age 44. *Ibid* (Tables 41 and 42).

A Closer Look at Workers Whose Employer Does Not Sponsor a Retirement Plan
Millions of private-sector wage and salary workers age 21 to 64, 2010

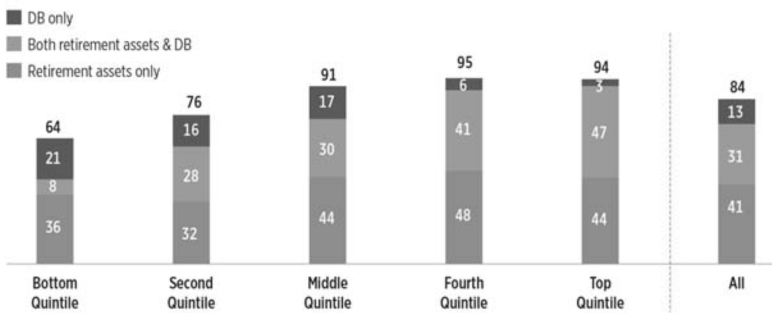


[1] Full-time, full-year workers who earn $45,000 or more and are aged 30 to 64 or earn $25,000 to $44,999 and are aged 45 to 64.
[2] Among full-time, full-year workers aged 35 to 44, $25,000 represents the top earnings of the 20th percentile of annual earnings and $45,000 represents the top earnings for the 50th percentile of annual earnings.
Note: Components may not add to the total because of rounding.
Source: Investment Company Institute tabulations of March 2011 Current Population Survey; see Brady and Bogdan, "Who Gets Retirement Plans and Why, 2010," *ICI Research Perspective* (October 2011)

Many more workers have access to an employer plan at some point during their working careers than is implied by looking at a snapshot of coverage at any point in time. This can be seen by examining data on households approaching retirement age. The figure below shows tabulations from the Federal Reserve Board's 2007 Survey of Consumer Finances (SCF) for households approaching retirement (i.e., households with a working head age 55 to 64), including both private- and public-sector employees.[47] Eighty-four percent of these pre-retiree households had DB benefits and/or retirement account assets, and such retirement resources are spread across the income distribution. More than 90 percent of pre-retiree households in the top three income quintiles (with total household income over $55,500) had such retirement resources; three-quarters of pre-retiree households in the second income quintile (with income of $32,900 to $55,500) had such retirement resources; and almost two-thirds of pre-retiree households in the lowest income quintile (with household income of $7,200 to $32,900) had such retirement resources. Although lower-income households are less likely to have both DB plan promises and retirement account assets, this group also has less of a need to supplement Social Security with workplace or private savings to maintain their pre-retirement standard of living.

[47] Figures are ICI tabulations of the 2007 Survey of Consumer Finances. Retirement assets include DC plan accounts (e.g., 401(k), 403(b), 457, thrift plans) and IRAs.

Percentage of Pre-Retiree Households with Retirement Assets and/or DB Pension, 2007
Households with working head age 55 to 64, by income quintile, excludes top and bottom one percent of the income distribution



Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances

It is also important to remember that households with earned income have access to IRAs to save for retirement on a tax-advantaged basis. For example, Congress designed the traditional IRA with two goals in mind: (1) to create a contributory retirement account for workers without access to plans at work, and (2) to provide a rollover vehicle to preserve assets accumulated in employer-sponsored retirement plans (both DB and DC). Although a small share of individuals contributes to traditional IRAs in any given year,[48] the majority of those that contribute make repeat contributions in succeeding years.[49] In addition, many of those IRA investors contributing to traditional IRAs contribute at the limit.[50]

* * *

The promotion of retirement savings—whether through employer-sponsored plans or IRAs—has long been one of Congress' top priorities and legacies. More recently, Congress strengthened the private-sector retirement system by raising contribution limits in 2001 (EGTRRA) and making those provisions permanent in 2006 (PPA). We welcome this Committees' continued leadership in

[48] A number of factors may account for this relatively low contribution rate. Two of the major determinants of individuals' decisions to contribute to traditional IRAs are their assessment of their need for additional retirement savings and their ability to deduct contributions from their taxable income. Individuals who are covered by retirement plans at work may find that they can meet their saving needs through those plans. In addition, coverage by such plans may curtail their eligibility to make tax-deductible contributions. For lower-income households, Social Security replaces a much higher fraction of pre-retirement earnings, which may reduce their need for additional retirement savings. Furthermore, there is some evidence that confusion about IRA rules may prevent some individuals from contributing.

[49] *See* Holden, Sabelhaus, and Bass, *The IRA Investor Profile: Traditional IRA Investors' Contribution Activity, 2007 and 2008*, Washington, DC: Investment Company Institute (2010); available at www.ici.org/pdf/rpt_10_ira_contributions.pdf.

[50] *Ibid.*

pursuing policies to improve our Nation's retirement system. But any changes should only build upon our existing system that, through tax incentives and other features, successfully encourages millions of Americans to accumulate savings during their working lives and therefore generate adequate income in retirement.

Written Comments of
Kevin A. Wiggins

to the

U.S. House of Representatives Committee on Ways and Means

Hearing on

Tax Reform and Tax-Favored Retirement Accounts

Hearing Held on April 17, 2012

Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to submit these written comments on Tax Reform and Tax-Favored Retirement Accounts. I am an ERISA attorney and a former member of the ERISA Advisory Council, appointed to that position by the U.S. Secretary of Labor. This statement should be attributed to me alone.

For the sake of brevity, I will limit my comments and submit them in a bullet point format.

- Most Americans need to save more for retirement.

- At least two persons who testified at the hearing may have suggested that deferrals under a retirement plan qualified under I.R.C. § 401(a) *et. seq.* are tax-deferred only, and that such deferrals do not escape or evade taxation because all benefits are taxed upon distribution from the trust. At least two well-respected law review articles indicate, however, that trust earnings in a qualified plan can be considered permanently exempt from tax. *See* Daniel I. Halperin, *Interest in Disguise: Taxing the "Time Value of Money,"* 95 Yale L.J. 506, 520 - 24 (1986); *William D. Andrews*, A Consumption-Type or Cash Flow Personal Income Tax, 87 Harv. L. Rev. 1113, 1126 (1974).

- As the ERISA Advisory Council concluded in 2010, there appears to be a great need to bring more members of traditionally under-served segments of the population, such as women and minorities, into the private retirement system. *See* 2010 ERISA Advisory Council Report, *Disparities for Women and Minorities in Retirement Savings*, available at http://www.dol.gov/ebsa/publications/2010ACreport3.html. To address this and similar issues, the Office of the President has proposed auto-IRAs. A far more efficient, and far less costly, approach would be auto-supplemental wage withholding.

Sincerely,

Kevin A. Wiggins

NAGDCA National Association of Government Defined Contribution Administrators, Inc.

TESTIMONY SUBMITTED TO THE

HOUSE COMMITTEE ON WAYS & MEANS

ON

TAX REFORM AND TAX FAVORED RETIREMENT ACCOUNTS

April 17, 2012

WASHINGTON, D.C.

JULIA DURAND
PRESIDENT
NATIONAL ASSOCIATION OF GOVERNMENT DEFINED
CONTRIBUTION ADMINISTRATORS, INC.

The National Association of Government Defined Contribution Administrators (NAGDCA) appreciates this opportunity to submit its comments for the record on this most important issue that touches so many Americans who may or may not have adequate income for their retirement needs.

Chairman Camp has indicated that the hearing is to explore whether, as part of comprehensive tax reform, various reform options could achieve the three goals of simplification, efficiency, and increasing retirement and financial security for American families.

He said in announcing the hearing,

> "Retirement security is one of the most important long-term policy priorities we face as a Nation. While many argue that the existing menu of tax-favored retirement plans provides choice and flexibility for families and employers alike, others have questioned whether the ad hoc development of retirement savings incentives has led to undue complexity and inefficiency that reduce the effectiveness of these incentives. The general principles of tax reform apply to retirement security as well: American families trying to save should have options that are simple, fair, and economically efficient."

NAGDCA was founded in 1980 and is the leading professional association representing public employer sponsored deferred compensation and defined contribution plan administrators. NAGDCA represents administrators from all 50 states and over 150 local governmental entities, as well as private industry plan providers. These states have, under their auspices, over 5,000 local government deferred compensation plans. NAGDCA also represents nearly 100 industrial members that provide services to public plan sponsors.

NAGDCA is an organization in which its members work together to improve state and local government defined contribution plans including §457(b), §401(k), §401(a), and §403(b) plans through a sharing of information on investments, marketing, administration and laws relating to public sector defined contribution plans.

Our members administer state and local government defined contribution plans that are regulated under the Internal Revenue Code (IRC) and available to public employers. These plans, which supplement state and local defined benefit plans, provide a convenient vehicle for public employees across the country to save for retirement. In all cases, full time employees of the entity offering the plan are eligible to participate (and, in many cases, part time employees are also eligible to participate). Altogether state and local defined contribution plans administer approximately three trillion dollars in assets across the country.

Since the inception of public employer defined contribution arrangements as supplemental retirement savings plans, there has been tremendous growth in access to these plans, employer sponsorship, employee participation and assets at every level of government throughout the United States.

The data collected by NAGDCA from our membership demonstrates that, over the years, there has been:

- increased participation in the plans, which demonstrates that more individuals are taking personal financial responsibility for preparing for their retirement,
- increased deferrals made by state and local

government employees,

- greatly improved satisfaction with the benefit payment process, and
- increased consolidation of retirement assets.

The numerous changes that have been made to the laws and regulations that govern public-employer defined contribution plans have been essential to these increased participation rates. We appreciate your continued support of these improvements.

NAGDCA believes that to achieve retirement security—and to ensure that millions of public employees will be self-supporting during their retirement years—it is imperative to maintain a shared responsibility between employers and employees. Thus, defined contribution plans should not be viewed merely as supplemental savings plans but as a critical component of an individual's overall retirement security.

It is in this spirit that NAGDCA advocates for policies that enhance defined contribution plans. State and local governments are proud of the supplemental retirement savings plans that have been created by working jointly with the federal government. The existence of these plans has resulted in higher savings rates and increased retirement preparedness. The goal of any proposal to alter or significantly change employer-sponsored retirement savings plans should be to enhance or simplify the current procedures, and to ensure that the administrative costs to employers and participants are reasonable.

We at NAGDCA applaud Chairman Camp for initiating an educational process to establish a basis for tax reform. We appreciate that the review of tax favored retirement accounts should be part of the process. We agree with the Chair's stated goals: simplicity, fairness, efficiency and increased retirement and financial security.

NAGDCA believes that the defined contribution plans, including §457(b), §401(k), §401(a), and §403(b), that its members administer across the nation meet these goals. While there is always room for improvement, the record of these state and local government sponsored plans is extraordinary.

The plans are operated with extreme efficiency in costs to both the state and local governments and the participants.

Even without the application of non-discrimination rules there is little or no indication of inequities between employees.

In most cases where a state or local government offers a 457 or 401(k) plan there is little complexity. The complexity, if any, that lies in all defined contribution plans is in the investment decisions that must be navigated by each participant. Here NAGDCA would urge Congress to address how participants can access fair, honest and effective advice in retirement planning and investments.

As our statement indicates, defined contribution plans administered by NAGDCA members have an excellent and documented record of administrative transparency, increased participation rates, increased deferrals, greatly improved satisfaction with the benefit payment process, and increased consolidation of retirement assets.

Of particular importance to the participants in the plans administered by NAGDCA members is the continued availability of section 457(b) plans. These plans have been available to government employees for some time preceding the broad availability of section 401(k) plans. A unique feature of the 457(b) plan is the lack of a penalty for withdrawal at employment termination when it occurs before the departing employee has reached 59 and one half years of age. Should there be a consolidation of defined compensation plans, NAGDCA strongly believes, without question, that this feature should be preserved for state and local government employees, current and future, as an incentive to save and adequately prepare for their retirement.

It is well known that many state and local government employees retire before they are 60. Many state pension plans allow for and encourage early retirement. The features of 457(b) plans are an important incentive to encourage savings.

We thank you for the opportunity to comment and look forward to working with you as the Committee reviews these issues. If we can ever be of assistance or serve as a resource, please do not hesitate to contact us.

Statement for the Record
To The House of Representatives Committee on Ways and Means
Hearing on Tax Reform and Tax-Favored Retirement Accounts
Held on April 17, 2012

Submitted by:
Robert L. Reynolds
President and Chief Executive Officer, Putnam Investments, and President of the Putnam Funds

I would like to thank Chairman Camp, Members of the Committee on Ways and Means and Congressional staff for allowing us to submit this statement about an issue that has been elevated by the ongoing debate about our federal deficits and national debt: the need to preserve and enhance incentives for retirement savings in America.

Surging federal deficits and a national debt growing faster than our economy truly do pose a national security issue. To ensure the stability of our financial system and maintain global competitiveness, it is vital that we get our national debt on a sustainable track. America needs to get our economy growing faster than our public debt or risk a slide towards insolvency and debt-driven financial crisis such as we see playing out in Europe today.

As we struggle to bring federal deficits down and get our national debt back onto a sustainable path to solvency, savings, and retirement savings in particular, have a vital role to play in a transition that America absolutely has to make. Simply put, our nation needs to move away from rising public spending, surging debt, and excessive, debt-driven consumption to a new economic model, grounded on higher savings, and greater incentives for investment, business formation, and job creation. Ultimately, the best way to deal with our deficits and debt will be to outgrow them. And a robust retirement savings structure will be key to spurring such growth.

Regrettably though, there is now a real risk that tax incentives for companies to offer workplace savings plans and for individuals to participate in them could be undermined by ill-considered policy changes aimed at reducing the budget deficit. Proposals to cap or roll back tax deferrals for retirement savings, which have emerged from ongoing deficit debates, are particularly dangerous.

If adopted, such proposals could have the effect of reversing a generation's worth of congressionally driven progress on retirement savings. They would undercut incentives for thousands of small and emerging companies to offer their workers retirement plans and could thus deprive millions of future workers access to workplace savings plans.

Moreover, potential cuts to current retirement savings initiatives would likely return far less revenue to Treasury than their proponents estimate — even over the short-term – while placing millions of future retirees at risk.

National solvency and personal solvency, we believe, are mutually reinforcing. Our tax and economic policies should never pit one against the other. Strong personal and workplace savings are essential to restoring America's long-term solvency because true solvency includes strong household balance sheets as well as a sustainable federal budget. After all, every dollar that retirement savers set aside is one less dollar that will be asked from the government in the future.

The benefits of savings – and the negative impact of excessive household debt on national economies are both highlighted in a recent International Monetary Fund study, "Dealing with Household Debt." In it, the IMF found that, "Housing busts and recessions preceded by larger run-ups in household debt tend to be more severe and protracted." [1]

This suggests that personal solvency, which is grounded primarily, though not exclusively on retirement savings, is a key part of the solution to our national debt concerns -- not part of the problem. Whatever actions we take to curb federal deficits, we should preserve and indeed enhance incentives for the personal and workplace savings that enable millions of working Americans to secure their own retirement futures.

Savings Incentives Meet A Clear National Need

The need for enhanced savings in our country is clear and indisputable. Americans today live longer, more active lives. The cost of health care, especially in later life, is increasing steadily. Traditional defined benefit pension plans have declined in number and scope, and only a declining minority of today's workers, primarily in the public sector, have access to them. Meanwhile, Social Security's projected ability to replace pre-retirement income is declining, even under current law, as a result of rising eligibility age and the costs of Medicare deductions. This "perfect storm" in the retirement income arena makes incentives for saving even more essential.

To supplement dwindling sources of assured retirement income, working Americans have come to rely on a broad spectrum of voluntary, private retirement savings programs that Congress has created over the past several decades. These include individual retirement accounts (IRAs), defined contribution savings vehicles including 401(k), 403(b) and 457 plans, and tax-advantaged variable annuities.

[1] International Monetary Fund, "Dealing with Household Debt," April 2012, p.3

These programs have enabled millions of workers and their families to save for more secure, dignified retirements. While they can -- and should -- be improved, these programs represent a major, made-in-America success story.

Defined contribution workplace savings plans, and the incentives and programs that support them, have proven successful, enabling over 80 million Americans to accumulate more than $4 trillion. And with the passage of the Pension Protection Act of 2006, Congress significantly improved these plans by endorsing several key plan design elements which already show signs of enabling millions more participants to replace a greater share of their pre-retirement incomes for life.

These key elements include automatic enrollment of participants (who remain free to "opt out"), automatic escalation of participants' deferral rates and legal safe harbor for plan sponsors to default participants to qualified default investments (QDIAs) that include balanced funds and target-date "lifecycle" funds (strategies that systematically reduce investment risk as retirement dates approach). Numerous studies have illustrated the success of such automatic features in lifting workers' capacity to replace worklife incomes when they do retire.

Putnam's own research suggests that there is – already – a significant success story underway for millions of workers within the existing 401(k) structure. A survey of the retirement readiness of nearly 3,300 working Americans sponsored by Putnam Investments and Brightwork Partners last year found that working Americans overall were on track in calendar 2010 to replace 64 % of their current income in retirement. This is somewhat short of what they are likely to need, but close enough so that most people, though not all, can still achieve secure retirements if they act now to raise savings rates.

The details of these survey findings have major policy implications – and disclose "best practices" -- that policy-makers should seek to spread across the whole workplace savings system. For example, when you include future Social Security benefits, the best-prepared quartile of working Americans are on track to replace 100% of current income in retirement. The least-prepared quartile are on track to replace just 46% of pre-retirement income even with their Social Security benefits. Yet the mean household income of both groups in our 2010 survey was identical: $93,000.

Several factors account for this vast difference in retirement readiness, but one in particular appears crucial: The very best-prepared Americans – roughly 19 million workers according to Brightwork estimates – both enjoyed access to a 401(k) or other defined-contribution plan at work and contributed 10% or more of their income to their plan.

In short, today's existing 401(k) plan structure can deliver solid retirement security for those workers who make the decision to take part and who also defer 10% or more of their salaries. In effect, we have discovered an antidote to the risk of elderly poverty – and it has three simple ingredients: access to a workplace savings plan, the decision to save, and willingness to defer at rates of 10% or more.

Today's retirement savings programs were given the advantage of deferring federal income taxes precisely because they could deliver results that are clearly in the public interest. Tax deferrals offer a powerful incentive for workers to maximize their savings and have contributed greatly to the success of these plans. Today, roughly 70% of American families have tax-advantaged retirement savings[2] and assets held in employer-sponsored retirement plans, IRAs and annuities totaled $17.9 trillion at year end 2011.[3]

Tax incentives are important to workers saving for retirement. A recent survey by the Investment Company Institute found that 85% of households supported maintaining tax incentives for retirement savings. The survey also found that 45% of respondents reported they probably would not be saving for retirement if they didn't have access to a defined contribution plan.[4]

Limiting or eliminating these incentives could have a detrimental affect on workers' ability to save sufficiently for retirement and the propensity of employers to offer workplace plans. Recent analysis by the Employee Benefit Research Institute (EBRI) demonstrated that "modifying the federal tax treatment for 401 (k) contributions would result in an average percentage reduction in 401(k) balances of between 6% and 22%, at Social Security normal retirement age for workers currently ages 26-35." The study also found that "smaller employers were more likely to respond negatively to the proposed changes than larger employers." EBRI cited other recent surveys which reported that small companies may "have less desire" to offer a 401 (k) plan to their employees if the tax incentive structure changed.[5]

Indeed, some smaller business owners and companies are motivated to offer workplace savings plans to their employees because of the $50,000 pear year maximum that these owners can set aside for themselves under current law. If that amount is capped at a lower level, some business owners may become more selective about offering workplace savings programs or simply decide to save only for themselves and key employees.

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[2] Investment Company Institute, 2011 Investment Company Fact Book, p. 102

[3] ICI, 2012

[4] ICI, "America's Commitment to Retirement Security: Investor Attitudes and Actions," 2012, p. 14, 17

[5] EBRI, "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," 2012

Changes to savings tax incentives would impact workers of all income levels. But the worst impact would likely be on low- and moderate -income workers. In a study published in July 2011, EBRI found that proposals to cap tax deferrals would "most affect the highest-income workers, but it also would cause a very big reduction in projected retirement accumulations for the lowest-income workers."[6]

Without incentives, workers reported they would probably save less. In its 2011 Retirement Confidence Survey, EBRI found that lower income workers – even those earning between $15,000 and $25,000 -- would be negatively impacted if tax deferrals were eliminated. A full 76.2% of workers in this household income category cited the tax deductibility of contributions as "very important." Also in that same cohort, 56.7% said they would reduce the amount they would save if the tax deferral were eliminated.[7]

One frequently-cited argument in favor of limiting these tax incentives is the contention that the deferrals benefit the wealthy more than average workers. But, workplace-based retirement programs are particularly beneficial for lower- and middle-income workers. Research by the American Society of Pension Professionals & Actuaries found that households with annual incomes below $100,000 pay 26% of income taxes but receive 62% of the benefit from the tax advantages of 401(k) plans. In contrast, families earning more than $200,000 per year pay more than half (52%) of income taxes, but receive just 11% of the tax advantage benefits from these plans.[8]

Indeed, savings deferrals for the establishment of workplace plans are uniquely "progressive" because under the provisions of ERISA law, business owners and plan sponsors must meet non-discrimination rules that ensure that the benefits of savings deferrals are widely shared among all employees of a firm – not limited to top executives.

If similar rules were applied to, say, mortgage or charitable deductions, then affluent taxpayers could be required somehow to assure that lower income employees also had access to homeownership or were somehow subsidized in giving the charities of their choice. Seen in that light, retirement savings deferrals under ERISA represent a major policy success: effectively harnessing business owners' legitimate self-interest to the public good of retirement security for all.

[6] EBRI, "Capping Tax-Preferred Retirement Contributions: Preliminary Evidence of the Impact of the National Commission on Fiscal Responsibility and Reform Recommendations," July 2011.
[7] EBRI, "The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results from the 2011 Retirement Confidence Survey," March 2011, pp. 3, 5
[8] ASSPA, "ASPPA Testifies in Defense of 401(k) System," September 15, 2011

Savings Deferrals are not true "tax expenditures"

The core rationale behind proposals to cut or curb retirement savings incentives is that the tax deferrals at the heart of 401(k) plans and similar savings vehicles represent tax "expenditures" that significantly reduce needed tax revenue. Thus, in 2011 testimony presented to the Joint Select Committee on Deficit Reduction by CBO Director Douglas Elmendorf, retirement savings deferrals were calculated as tax "expenditures" comparable to employee health costs, mortgage interest deductions and charitable giving.[9]

We disagree with this assessment. Retirement savings deferrals, clearly, are not permanent tax expenditures -- only temporary postponements of tax obligations. When retirement savings are drawn down, the money is taxed as ordinary income, even though the retirement accounts themselves are typically composed mostly of long-term capital gains.

Equally misleading, the Congressional Budget Office uses a 10-year window for analyzing the costs of tax deferrals. As a result, it neither accurately measures the true cost of tax provisions that are incurred over the periods of decades that make up the typical worker's career, nor calculates the substantial tax flow-backs to Treasury decades into the future. Today's tax deferrals are counted as revenue losses, but the taxes that will be paid beyond a decade forward are not counted at all. This practice distorts the true "full-lifecycle" costs of these incentives, understates their social and economic benefits, and overstates the cost of the tax deferrals to the Treasury and the revenue that would be generated by cutting back on them.

In a recent report analyzing the challenge of individual income tax reform, the Congressional Research Service again included savings incentives in calculating revenue loss due to tax expenditures. But the researchers did note some obstacles facing proposals to cut savings incentives. In the report they found, "Modification of many of the savings incentives face significant technical or administrative barriers. Most of these tax benefits are associated with unrealized income (pension benefits, including those associated with defined benefit plans, unrealized gains at death, and inside buildup in insurance plans), which can be difficult or impossible to value properly."[10]

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[9] Congressional Budget Office, "Confronting the Nation's Fiscal Policy Challenges," Statement of Douglas W. Elmendorf, Director, September 13, 2011, p. 46

[10] Congressional Record Service, "The Challenge of Individual Tax Reform: An Economic Analysis of Tax Base Broadening," March 22, 2012

There are also many valuable economic and social benefits of the tax incentives that are not captured by government accounting methods – but which definitely should be taken into account by policymakers. Tax deferrals that support and strengthen our retirement savings system help:

• Fuel the rise of a robust American financial services industry, centered on capital markets, which, in turn, help finance innovation and thereby economic growth.

• Enable parents to provide for their own retirement without burdening their children, which is a foundational element in offering dignity and self-respect for older people.

• Free governments from possible demands for aid/welfare for elderly indigents – at least until their savings are exhausted

• Offer a counter-cyclical, smoothing influence on consumption patterns by capturing somewhat higher savings flows in boom times and enabling continued consumption by retirees right through economic downturns.

• Give all holders of retirement savings a material stake in political stability and in growth-oriented economic policy.

• Allow young and middle-aged people, who know they are on track to adequate retirement incomes, to take greater risks with other assets, including making the choice to pursue skills training or launch a business.

Congress should avoid any radical shift in savings policy

In the wake of the Great Recession, Americans are already struggling to save. As EBRI reported, two thirds of all workers saving for retirement report total assets under $50,000. Only about one quarter of U.S. workers have assets of $100,000 or more.[11]

Access to workplace savings is vital to workers' ability to save. Indeed, very little retirement savings by low to moderate income workers takes place outside the workplace system. An analysis by EBRI found that more than 70% of workers with annual incomes of between $30,000 and $50,000 do save for retirement if they have access to a workplace plan. Yet fewer than five percent of their peers who lack access to a workplace plan save through IRAs.[12]

[11] EBRI, "The 2011 Retirement Confidence Survey," April 2011
[12] EBRI 2010 estimate using 2008 Panel of SIPP (covered by an employer plan) and EBRI estimate (not covered by an employer plan — IRA only)

Absent access to workplace-based savings, then, most American workers simply fail to accumulate any serious savings with which to fund their retirements or supplement their Social Security benefits. Reducing the incentive for retirement plan sponsors to offer workplace savings plans, then, could force millions of low- and moderate-income workers to face retirement with little or no savings. Building on these retirement savings programs, improving them and extending them to the tens of millions of Americans who still lack access to on-the-job savings plans should be among our most important national goals.

That is why we believe that Congress should not only preserve all existing savings incentives, but also support solid, bipartisan ideas such as the Auto-IRA, which could extend access to workplace savings coverage for millions of workers who lack such plans.

Capping or eliminating incentives for workplace savings would have almost the exact opposite effect. Indeed, cutting into tax advantages for retirement accounts would be far more than just a marginal revenue measure. It would mark a fundamental shift away from highly successful programs that Congress has supported for the past several decades. Long-term it would inflict compounding harm on millions of future retirees and by reducing investment flows to the capital markets, might also limit future economic growth. By reducing the incentive for millions of small- and medium-sized businesses to offer such plans to their employees, such a policy shift could send millions of low and moderate-income workers toward retirement with essentially no savings.

We live in a globalized economic and financial world. Whether we like it -- or not -- the United States, like every country interested in guarding its fiscal health, is caught up in a global "race to solvency." Nations everywhere are struggling to achieve fiscal balance and growth policies that will secure and sustain access to global capital markets and investment flows. The alternative is to lose global market confidence and risk the kind of debt-driven crisis Europe is struggling with today. We believe that strong national savings policies are vital to success in this competition. For that Reason, Putnam Investments supports policy choices that will sustain and strengthen all of America's retirement savings systems — public and private.

We do also view skyrocketing federal debt as a genuine threat to our nation's long-term prosperity. But attempting to reduce federal "dis-saving" by cutting incentives for personal savings is a bizarre and short-sighted policy option that would take our nation in the wrong direction.

Whatever limited tax revenues we might realize today from reducing savings incentives would be immediately offset by the loss of capital flows for investment in new business formation, job creation and economic growth. And such losses would compound, over time, by the loss of investment gains in workers' retirement portfolios and by the risk that many of these less-well-off workers may need public assistance in their later years.

Policy changes that could diminish retirement security for future generations of workers and increase poverty among elderly Americans would erode public confidence and betray the optimistic vision that has driven Americans for generations. For all of these reasons, we urge all members of Congress to oppose any policy change that would undermine incentives for employers to offer workplace savings plans or for individuals to use them to save for their retirement.

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See attached page for contact information.

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STATEMENT OF

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IN CONNECTION WITH THE

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

HEARING ON

TAX REFORM AND TAX FAVORED RETIREMENT ACCOUNTS

HELD ON

APRIL 17, 2012

Statement
of
Kathy Hamor
The Savings Coalition of America

SUBMITTED TO THE
Committee on Ways and Means
U.S. House of Representatives
April 17, 2012

April 27, 2012

On behalf of its 45 member organizations, the Savings Coalition of America ("Coalition") is pleased to submit these comments and commends the Committee on Ways and Means for its efforts to make it easier for American to save for their retirements. Currently, tens of millions of Americans are saving for retirement because of the enhancements made to retirement savings vehicles. The Coalition believes that more people will save if these vehicles are easier to understand.

While there are many aspects of the current system to be addressed, the Savings Coalition brings to your attention the provisions of the tax code that concern income limits and required minimum distributions from IRAs. These areas of the law are unnecessarily complex, unfair and distort personal financial decisions for Americans.

The Savings Coalition of America was established in 1991 to support incentives to increase the level of personal savings in the United States. It has actively supported the expanded Individual Retirement Account (IRA) provisions that increased contributions to spousal IRAs from $250 to $2000 in 1996; the increased income limits for IRAs and the establishment of the Roth IRA in 1997; and the increase in contribution limits for IRAs and the creation of catch up contributions in the 2001 tax bill and making these provisions permanent in 2006. Savings is a key component of economic policy. Treasury Secretary Timothy Geitner, in an October 2009 interview with German weekly Die Zeit, stated," If the U.S. starts saving more, that changes the whole world's economic reality," he said, according to the German text of the interview.

In 2001, the Congressional Joint Committee on Taxation made recommendations for tax simplification in which it recommended the elimination of income limits on all IRAs and the elimination of the age requirement for minimum required distributions and described the complexity surrounding these sections of the tax code. The Coalition shares the view that these sections of the tax code are complex and confusing and urges the Committee on Ways and Means to review them.

Universally Available IRAs

Currently the tax code has a number of income limits for eligibility to contribute to IRAs. In addition to different income limits for single and married Americans, there are different income eligibilities for the traditional, deductible IRA, the Roth IRA, and the nondeductible IRA. The lesson that we learned in the early 1980s, when IRAs were universally available to all Americans, is that more Americans saved. The universal eligibility led to mass marketing of these savings vehicles, which increased participation and more savings, something essential to our economy. When income limits were imposed after the Tax Reform Act of 1986, there was a precipitous drop in contributions to IRAs. The 1986 experience teaches us that limiting IRA eligibility based on income confuses people and scares them away from establishing a pattern of savings that IRAs would otherwise promote. One of the most important effects of the IRA cutbacks in the Tax Reform Act of 1986 is the fact that IRA contributions for those who continued to be eligible for deductible IRAs dropped by more than 40% in the first year and have since dropped by over 65%.

The Savings Coalition of America

Members of the Savings Coalition believe that eliminating income limits and creating a universally available IRA will help more Americans save. An IRA that is universally available to all American workers would leave no doubt to their understanding of their eligibility. Universally available IRAs will be marketed and advertised on a massive scale and this advertising will have an ancillary benefit of educating people about the need to save. History demonstrates that the simpler it is to save, the more Americans are inclined to do so.

Under current law, deductible IRA and Roth IRA eligibility is determined based on whether a taxpayer falls under or between certain income thresholds, and for deductible IRAs, whether the taxpayer or the spouse, has access to an employer-sponsored retirement plan – a so called active participant. The 2012 income thresholds for the deducting IRA contributions are $58,000 - $68,000 for single taxpayers and $92,000 - $112,000 for married couples filing a joint return. If the taxpayer does not have access to a plan but the spouse does, the phase-out range is $169,000 - $179,000. Roth eligibility thresholds are $110,000 - $125,000 for single individuals and $173,000 - $183,000 for married couples filing a joint return. No income limits apply to single taxpayers and married couples where neither spouse is an active participant for deductible IRAs. Taxpayers making excess contributions are subject to penalties.

The confusing array of income limits and perceived lack of benefits discourages many workers from establishing and contributing to IRAs. Taxpayers who could make IRA contributions do not bother to establish a regular contribution schedule because they are concerned about income fluctuations and the fear that they will be "penalized" for making excess contributions that are not deductible. Further, the taxpayer could also establish a payroll deduction schedule or direct deposit schedule with his financial institution. Being able to establish a periodic contribution deposit schedule early in the year without the worry of a possible ineligible contribution or penalty is critical to facilitating IRA contributions because it is a challenge for most individuals to come up with the funds necessary to make a lump sum contribution at year end.

This simplification will lead to less confusion for taxpayers and likely encourage more marketing of IRAs by financial institutions. Taxpayers need additional options to shore up their financial position because of the market downturn – easy to understand options will boost participation with confidence that contributions they make will not later be rendered ineligible.

Another area of confusion with income limits are the restrictions, for joint filers, around contributing to an IRA and deducting it is limited by participating in an employer plan in addition to income. If one spouse is covered by an employer plan and the other is not, as long as their income is below $169,000, the non-covered spouse is eligible to make a deductible traditional IRA contribution. If they are both covered, then the phase out is in place which is between $92,000 and $112,000. Income is also considered for making a Roth IRA contribution. If income exceeds the limits, the person simply can't make a contribution. Also, if a person is not covered, or both spouses are not covered by an employer plan, then there is no income limit to making a deductible traditional IRA contribution. This adds a layer of complexity and confusion to already complex eligibility requirements which can have the result of reducing Americans savings in these important savings vehicles.

To add to the confusion, there were income limits for conversion from a traditional, deductible IRA to a Roth IRA until 2010 when the law changed to remove income limits for converting from a traditional IRA to a Roth IRA. Prior to that time, American savers' eligibility to change from a traditional IRA to a Roth was based on having an adjusted gross income of $100,000 or less. Now Americans wanting to save more for their retirements can make IRA contributions in a nondeductible IRA and convert the account to a Roth IRA the following year and incur the tax on it then. The Savings Coalition feels that it would be much less confusing to have IRAs that are universally available to lessen the confusion and encourage more retirement savings.

Members of the Savings Coalition of America feel strongly that tax reform should encourage Americans to take more responsibility for their retirements. One way in which this can be achieved is to promote values that we all share; such as savings and thrift. When it comes to savings, our tax code should encourage Americans to save for their futures and make it easier to do so. The variety of income limits for current tax-favored IRAs are cumbersome and confusing and we encourage the Committee to recommend substantial simplification in this area. Provisions that encourage individually responsible behavior such as savings should apply to all Americans. Our current tax-favored savings vehicles already limit the amount that can be saved. We should not limit eligibility of the people who can save through them. That just makes them more confusing.

Required Minimum Distributions

Under present law, Americans who reach age 70 ½ are required to begin taking distributions from their IRAs. This is one of the most complex areas of tax law affecting retirees. For this reason, the staff of the Joint Committee on Taxation has recommended that the age limit for minimum required distributions be eliminated. One unintended consequence of the requirement is that individuals may be forced to take a distribution at a time when their investment has declined in value. Over the past several years, many retirees and workers about to retire have seen a drop in the value of their retirement nest eggs. Those subject to the requirement may be forced to realize losses on part of their investments at a time when they can least afford to do so. The minimum required distributions rules merely determine when taxes will be imposed on retirement savings, not if. When the IRA owner withdraws funds, it will be taxed as ordinary income.

In addition, tax reform should take into account such things as a longer life expectancy for most Americans. U.S. life expectancy rates have increased substantially since the minimum distribution rules were first extended to all types of retirement plans. According to the Social Security Administration (SSA), in 1974, the year in which IRAs were created, the life expectancies for males & females were 68.3 years and 76.0 years respectively. In 2000, SSA projected life expectancies of almost 74 years for males and 80 years for females. With such substantial increases in longevity, it is important that the minimum distribution rules be updated to ensure that American workers are not forced to take distributions prematurely.

Critics also overlook recent trends in the numbers of seniors working past the age of 65 and into their seventies. According to the U.S. Bureau of Labor Statistics, more than 7 million workers are age 65 and over – an increase of more than 100 percent since 1985[1]. With the recent market downturn, more and more seniors are putting off their retirement. According to a 2002 survey, 1.9 million households will be delaying retirement, contributing further to the numbers of seniors in the workforce. It is shortsighted policy to force distributions from retirement accounts when seniors are pushing back retirement dates to ensure they will have enough to live comfortably throughout their retirement years. As Americans live longer, we have learned that the minimum required distribution rules have become more burdensome and need to be eliminated or at the very least, changed to reflect gains in life expectancy.

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[1] US Bureau of Labor Statistics, **Labor Force Statistics from the Current Population Survey Database**

The Savings Coalition of America

The Savings Coalition supports the Committee on Ways and Means' goal towards tax simplification and offers its assistance in this effort. We look forward to working with you on this important initiative.

Statement of Gerald E. Scorse

This statement recommends new rules for mandatory distributions from tax-advantaged retirement accounts, and for the taxation of such distributions. They should begin at age 65, not at age 70 1/2, as is now the case. The percentage amounts of the distributions should be increased across the board. In addition, so-called "stretch IRAs" should be prohibited.

The reasons for these recommendations are spelled out in an article which I wrote, "Retirement Taxes Shield the Affluent, Short-Change the Nation." The current system is inherently inequitable. The benefits flow entirely to affluent taxpayers, and they cost the Treasury untold billions a year. The Committee is well aware of America's large and growing federal deficit. Reforming the rules for mandatory distributions could make a significant contribution to deficit reduction.

Here is the text of the article noted above:

For almost 40 years, starting in 1974, Uncle Sam has generously subsidized retirement accounts for the golden years. Annual contributions are commonly tax-free. Gains accumulate tax-deferred, usually for decades. Only on the back end do taxes enter the picture. They're due and payable when withdrawals begin, starting at age 59 1/2 (if desired) or at 70 1/2 (mandatory each year from then on).

The time for mandatory tax payback is exactly when the affluent—with help from both sides of the aisle—begin to welsh on their end of the retirement bargain. New ways are dreamt up, legislation enacted, and rules adopted to avoid, delay and minimize taxes on retirement account withdrawals. Ironically, it's the affluent who enjoy the lion's share of the subsidies all along. The Treasury foregoes $52 billion a year for high-contribution 401(k) accounts, making them the third largest tax break in America.

Let's look at some of the ways that Uncle Sam's generosity has been repaid by outright welshing and systematic nickel-and-diming. Then let's adopt John McCain's 2008 campaign mantra. Let's put "Country First," and see how retirement taxes could help cut our record federal deficit. Tens of millions of baby boomers will begin to hit the mandatory retirement account withdrawal age in 2016—enough time for Congress to make new rules that more fairly enforce the tax payback portion of the retirement account bargain.

A bi-partisan Congress twice crafted laws specifically inviting well-heeled taxpayers to renege on the tax payback. For 2009, in a move that could only benefit the affluent, lawmakers suspended mandatory distributions. Any taxpayer who actually needed the distribution had no choice but to take it and pay taxes; those who didn't need it took a pass and saved thousands, adding those thousands to the federal deficit. Earlier, in another deficit-hiking move, Congress allowed up to $100,000 per-year in retirement distributions to be signed over to private charities—denying the Treasury the taxes it had coming, and state and city treasuries as well.

Both laws rested on ultra-flimsy rationales, and both have lapsed. There's plenty more that still needs fixing, starting with the mandatory distribution age itself. Who benefits, after all, from a tax payback that doesn't even have to begin until 70 1/2? Uncle Sam doesn't benefit. Those who depend on retirement accounts to help them get along don't benefit; they're drawing down well before that. The only real beneficiaries are those who simply don't need the money.

The same can be said for the withdrawal formulas, which start out low and creep up ever so slowly. The formula that applies to most people calls for a starting minimum required distribution of under 3.7 percent. Twenty-five years later, at age 95, the required distribution is just11.6 percent. While the formulas apply to all taxpayers, the benefits flow solely to those in no need and no hurry.

Now let's apply McCain's "Country First" to retirement taxes. First, let's move up the mandatory distribution age from 70 1/2 to 65: when it's Medicare time, it's also time to start paying back Uncle Sam for those retirement tax breaks. Second, let's increase the minimum withdrawal percentages to bring them more in line with actual life expectancies. Third, let's forbid so-called "stretch IRAs". These are multi-generational transfers, now permitted, which can string out distributions (and the taxes on those distributions) into the next century. Multi-generational transfers are fine, but America deserves its full cut first.

It's the least the affluent can do (or anybody for that matter) to square accounts with a generous uncle.

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In closing, I want to thank the Committee for the opportunity to make this statement. It's a great country where an ordinary citizen can speak directly to the highest legislative body in the land. As I hope the statement makes clear, it's the country's interests that I have in mind.

Statement of Susan Crase

April 18, 2012

To: Congressman Dave Camp, Chairman of the Committee on Ways and Means

Re: Hearing on Tax Reform and Tax-Favored Retirement Accounts, April 17, 2012

Congressman Camp,
I listened, intently, to your discussion regarding how you, the government, would handle We The People's retirement savings. 1st of all, Congress cannot manage it's own money; I do not think you are qualified to dictate how much and through whom I must automatically contribute my retirement savings. If I choose to save through my employer (an employer contribution is a benefit), another venue or put my money in a quart jar, this should be *my* decision. All people are not the same. We have different goals, needs and dreams for retirement, therefore, each individual will save differently. The more levels, rules and savings plans you make, the more complex you make it to understand. We The People see this as more government interference in our lives.

I lost my full time job at the beginning of the recession in 2007. I rolled my retirement into a savings venue in my bank. Since I am over 55 and have been out of work for 5 years, I am deemed "unemployable". My Vietnam Veteran husband has nearly 20 years in at his employer, but the pay is so low, we have a hard time making ends meet. (2011 gross was $33,739, but after taxes we had $28,604 to survive on). We do not try to live a life of luxury. We were forced to retrieve my entire retirement savings to keep our home. I paid taxes on that income when I earned it. When I took the money out, I paid taxes on it again plus I paid the government a penalty to take it out early. The government also dictated what I could take it out for. This is where the problem lies. Your policies are set up to give the government my retirement. It's not yours, it's MINE! Now you want to make more policies to dictate the amount of money a person pays into a savings account, then make it automatic (I view this as mandatory) to make sure we have enough funds to supplement the Social Security taxes we have paid in order to live comfortably in retirement. Who are YOU to decide the level of my retirement existence?

Your opening statement says your three goals are simplification, efficiency, and increasing retirement and financial security for American families. Simplier would be to eliminate the titles 401(k), 403(b), 457(b), IRA, SIMPLE IRA and SEP IRA. Call it what it is, a Long-Term Savings Account. More than 5 years is long-term and less than 5 years is short-term. I would hope the tax brackets also get revamped so as not to penalize a person for making more money than his neighbor. The vast majority of U.S. Citizens have worked for their money. If they want to invest in the stock market, a CD or a local business, it should be up to the saver/invester. An efficent way for the government to tax the savings and encourage financial security in our later years would be to tax it at 50% of the federal, state and local rates, combined. If I paid a total combined tax of 10%, then tax my Long-Term Savings at 5%. But, don't tax it again when I take it out and don't fine me for taking it out when I need it. Tax it as a deduction on my yearly tax return. All of the above current savings plans force We The People to invest in the stock market. Evidence has shown there is corruption within the stock exchange, yet YOU the government want We The People to contribute our hard earned money to the hedge fund managers, speculators and other market crooks who are only out for their own financial gain...and at OUR expense! If a saver/investor chooses to invest in stocks, there are plenty of advisors in every town to whom we can turn for guidence. The last company I worked for provided such an advisor to explain options for saving. This is the right place to educate the population on savings venues. Not Ms. Miller's idea of another government entity deciding for the masses.

In closing, I encourage your committee to take this opportunity to reduce government waste. Reduce the paperwork, confusion and the creation of another govenment department that wreaks of interference in We The People's life after work.

Respectfully,
Susan Crase

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