

**Testimony of Jania Stout  
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**House Ways & Means Subcommittee on Tax Policy**

**Hearing on How Tax Reform Will Simplify Our Broken Tax Code and Help  
Individuals and Families**

**How to Best Promote Retirement Security through the Tax Code**

**July 19, 2017**

Thank you Chairman Roskam, Ranking Member Doggett and members of the Tax Policy Subcommittee for the opportunity to speak with you about the importance of the tax incentives for retirement savings and our workplace-based retirement plan system. My name is Jania Stout and I am a Practice Leader and the Co-Founder of Fiduciary Plan Advisors at HighTower. HighTower is an independently owned, registered investment advisory firm led by a partnership of experienced investment professionals with their own established practices. I bring more than 20 years of experience in retirement plan consulting to the organization. My professional practice is located in Owings Mills, Maryland where I advise about 140 retirement plans. Approximately 50,000 employees have \$2.4 billion in assets invested in my plans. My clients — located mainly on the East Coast — range from small businesses with 5 to 20 employees to larger employers with 10,000 to 15,000 employees.

I also serve as Vice President of the National Association of Plan Advisors (NAPA). NAPA is the voice of the retirement plan advisory community and its mission is to improve transparency, effectiveness and governance of workplace-based retirement plans to enhance retirement outcomes for participants. NAPA is one of the premier retirement industry associations that is part of the American Retirement Association (ARA). The ARA is a non-profit professional organization with more than 22,000 members nationwide. The ARA has two key missions: to educate and inform retirement benefits professionals like myself, and to advocate for policies that give every working American the ability to have a comfortable retirement.

A major objective of tax reform is to provide long term economic growth to build financial security for the middle class. The current tax incentives that underpin workplace-based retirement plans achieve this objective by enabling good savings behavior for the tens of millions of Americans who participate. This critical savings component results in \$67 trillion or 59% of the non-bank financial capital provided to the equity and bond markets.<sup>1</sup> Tax reform is a once in a lifetime opportunity to simplify the retirement plans rules and expand retirement plan coverage in the workforce that will build even further on this success. Increasing retirement savings would increase long-term economic growth by 3% or \$3,500 per person over the next 25 years.<sup>2</sup>

<sup>1</sup>Oxford Economics, *Another Penny Saved: The Economic Benefits of Higher US Household Savings*, (June 2014), available at: <http://www.oxfordeconomics.com/anotherpennysaved>

<sup>2</sup>*Ibid.*

Reducing the tax incentives — like freezing the retirement plan contribution limits that are currently indexed to inflation or capping the retirement savings exclusion rate for individuals in certain income tax brackets — would be the wrong way to go. Reducing the incentives in these ways would discourage small business owners from offering and contributing to workplace-based retirement plans. The result would be fewer retirement plans and lower employer contributions for rank-and-file employees, putting the retirement security of middle class Americans at risk and undermining long term economic growth.

### **Workplace Plans are the Foundation for A Secure Retirement**

The tax incentives for retirement savings are unique in that the tax incentive is a deferral, not a permanent exclusion — so every dollar that is excluded from income this year will be included in income in a future year. The tax incentives for employer-sponsored retirement plans are also unique in that the nondiscrimination rules, coupled with dollar limits on contributions and a limit on the amount of compensation that can be included in determining benefits, assure that the plans do not unduly favor highly compensated employees.

The current system of tax incentives that powers workplace retirement plans has been successful at accumulating a large amount of assets to improve the retirement security of tens of millions of American households. Seventy-seven million households — 61 percent — have an employer-sponsored plan or an individual retirement account (IRA). At the end of 2016, private employer-sponsored defined contribution plans held about \$7 trillion in assets, private employer-sponsored defined benefit plans held \$2.9 trillion and state and local retirement plans held \$3.9 trillion. Another \$7.9 trillion is held in IRA accounts. Although IRAs include contributions made by individuals to the IRA on their own behalf, a substantial portion of IRA contributions are attributable to rollovers from employer-sponsored plans and direct employer contributions. Together, defined contribution plans and IRAs comprise 59 percent of retirement assets.<sup>3</sup>

Data show that 401(k) and similar plans — such as 403(b) and 457 arrangements — have been successful in getting workers to save for retirement. The most important factor in determining whether workers across the income spectrum save for retirement is whether there is a workplace-based retirement plan. Contrary to the common assertion that only half of working Americans are covered by a retirement plan, a recent update of a study from the Social Security Administration shows that 75 percent of private-sector workers have access to a retirement plan at work, and 82 percent of eligible workers with access to a plan participate in the plan.<sup>4</sup> The success of saving through a workplace-based retirement plan extends to moderate-income workers. More than 70 percent of workers earning \$30,000 to \$50,000 participate in a plan at work, but fewer than 5 percent will save through an IRA on their own (see chart one).<sup>5</sup> These plans primarily benefit the middle class: 68 percent of active participants in 401(k) plans have an adjusted gross income (AGI) of less than \$100,000 per year. Thirty-five percent of participants have an AGI of less than

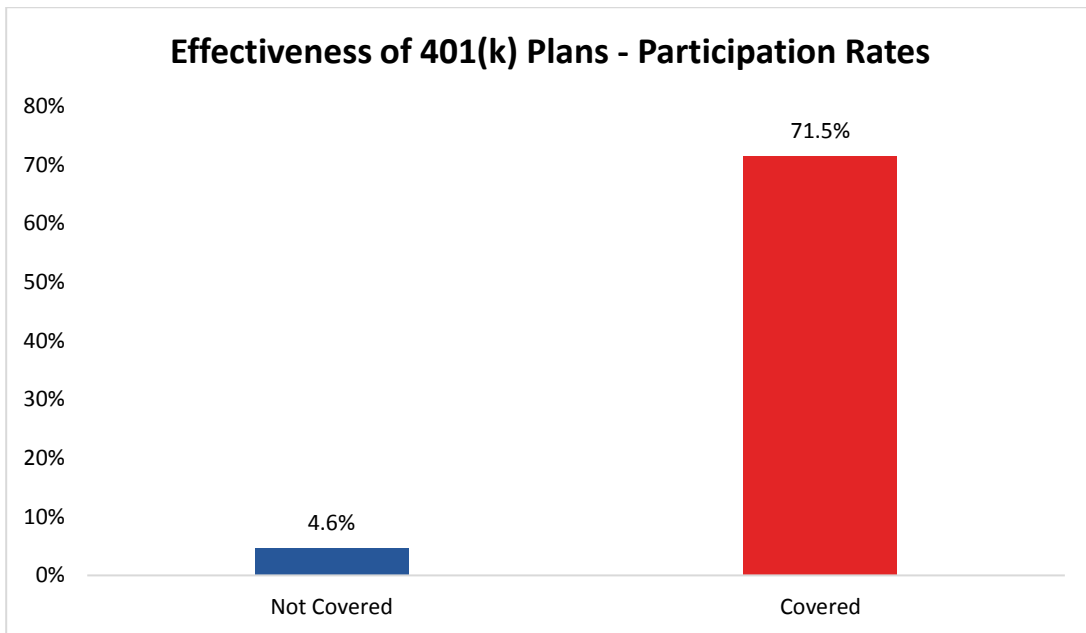
<sup>3</sup>Investment Company Institute, *2017 Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*, available at: [http://www.icifactbook.org/ch7/17\\_fb\\_ch7](http://www.icifactbook.org/ch7/17_fb_ch7)

<sup>4</sup>Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Retirement Plan Coverage by Firm Size: An Update*, Social Security Bulletin (May 2015), available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2604116](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604116)

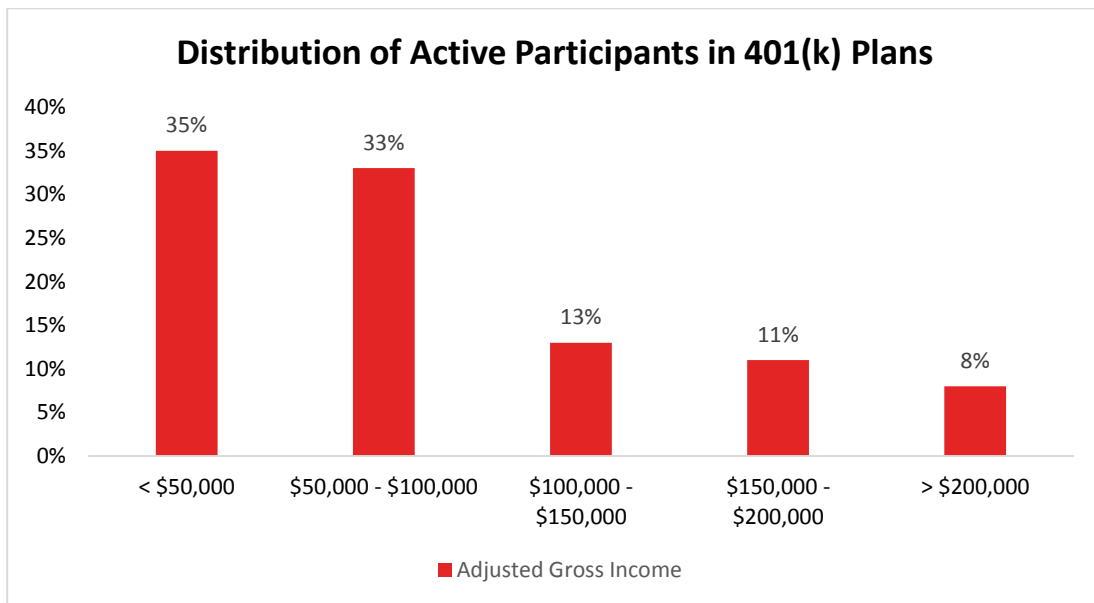
<sup>5</sup>Employee Benefit Research Institute (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan – IRA only)

\$50,000 (see chart two).<sup>6</sup> Americans earning between \$25,000 and \$75,000 save seven times more in retirement savings than any other type of savings.<sup>7</sup>

**Chart One**



**Chart Two**



<sup>6</sup>Internal Revenue Service, Statistics of Income, IRA Studies, 2014

<sup>7</sup>Employee Benefit Research Institute estimate of the 2013 Survey of Consumer Finance

## **Participants Value Tax Treatment Choice**

Seventy-six percent of employers that sponsor a qualified retirement plan offer both traditional pre-tax contributions and Roth after-tax options to employees.<sup>8</sup> When I meet with plan sponsors, I always recommend to them that they include an after-tax or Roth savings option within their plan in addition to the traditional pre-tax savings option. In my experience, most employers agree to add the option in their plan design, but there are still some employers that are reticent to take that step.

Under Roth contributions, employees pay income tax currently on their contributions with the promise that their earnings on their account will be distributed tax-free at retirement. In most cases, employees can allocate all or a portion of their contributions to their employer's plan into these accounts. Like traditional pre-tax contributions, Roth contributions also offer tax incentives to employees to motivate them to contribute. This feature is especially attractive to Millennial savers in the early stages of their working career, when their income tax liability is expected to be relatively low and the money saved in the account is expected to earn the most interest over time. Furthermore, Roth contributions and earnings are also exempt from required minimum distributions beginning at age 70 ½. This proves to be an important planning tool for many retirees. While Roth contributions comprise a smaller percentage of overall 401(k) contributions, they are growing in popularity. I think that participants should enjoy the widest array of options with a workplace plan so they can make a decision that is best for them. Any policy move toward more reliance on Roth contributions must accompany other changes to the tax incentives to continue to motivate both the employer to sponsor a workplace-based retirement plan and the employee to contribute to it.

## **Expanding Workplace Retirement Plan Coverage**

If increasing the financial and retirement security of American families is the goal, increasing the availability of workplace savings plans is the way to get there. By making it easier and more meaningful for a small business to adopt a workplace retirement savings plan, access to saving through payroll deduction will increase.

I support proposals that will both enhance the incentives for and simplify the administration of workplace-based retirement savings plans. Increasing the pension plan startup tax credit would further reduce the cost to new small businesses that choose to sponsor qualified retirement plans for their employees. Adding an additional credit to encourage the automatic enrollment of those workers into both new and existing plans will increase the number of workers saving.

I applaud Congressmen Buchanan, Neal, Renacci and Kind for introducing the Retirement Security for American Workers Act (H.R. 854). H.R. 854 expands retirement plan coverage by allowing two or more unrelated private employers to join a pooled employer retirement plan. Importantly, the legislation requires the provider of such an arrangement to take responsibility for the proper operation of the plan. The clear lines of responsibility prescribed in the legislation give adopting employers — many of which could be small business owners — more security. Additionally, adopting employers will not have to worry about the actions of one participating

<sup>8</sup>Plan Sponsor Council of America, *Tax Reform Impact on DC Plans* (June 2017), available at: [https://www.pasca.org/Snapshot\\_Roth](https://www.pasca.org/Snapshot_Roth)

employer disqualifying the plan for all the other employers. Furthermore, H.R. 854 allows retirement plan providers to offer a payroll deduction IRA program with automatic enrollment through a pooled employer plan to small business owners. Pooling unrelated employers together into one plan creates economies of scale that lower both employer and plan participant cost, which will ultimately boost retirement plan coverage in the private sector.

In this digital age, it remains frustrating to me that retirement plan disclosure rules remain stuck in the 20<sup>th</sup> Century. Retirement plan participants must still receive these notices on paper unless they affirmatively choose to receive the disclosures electronically. The result is a lot of wasted business time, expense and paper. Fortunately, Congressmen Polis, Roe, Kelly, and Kind introduced the Receiving Electronic Statements to Improve Retiree Earnings (RETIRE) Act in the last Congress that would update these rules for the 21<sup>st</sup> Century. The bill would allow for these disclosures to be furnished electronically as the default while protecting individuals who still wish to receive information about their retirement benefits on paper. According to a recent study, switching to an electronic delivery default would produce \$200 to \$500 million in aggregate savings annually that would accrue directly to retirement plan participants.<sup>9</sup> These lower expenses would lead to higher net investment returns for participants and allow these notices to be provided in a more interactive and useful way.

### **How to Minimize Workplace Retirement Plan Leakage**

A special area of concern of mine involves pre-retirement distributions from retirement accounts or “leakage” as we call it in the industry. The Employee Benefits Research Institute (EBRI) found that approximately two-thirds of the impact of diminished retirement savings due to leakage was associated with the cashouts that sometimes occur at job change.<sup>10</sup> In addition, a Transamerica survey found that 25 percent of workers in small companies either take a loan or cash out part of their retirement savings for a variety of non-retirement purposes.<sup>11</sup> Other workers simply leave their small balance retirement accounts behind when they change jobs. Confronted with the pressures of everyday life, it is easy to lose track of many small accounts. This seriously jeopardizes the retirement security of millions of Americans. Sadly, the current structures make it difficult and time consuming for individuals to keep their retirement savings in retirement accounts.

We need to find an easier way for participants to rollover their existing retirement savings into the new employer’s plan when employees change jobs. I help hundreds of retirement plan participants every year with this daunting and time-consuming task. The good news is there are a handful of simple legislative fixes that can help solve this problem. I support the recommendations from both the Bipartisan Policy Center and the ERISA Advisory Council that propose the authorization of a national retirement security clearinghouse to streamline transfers

<sup>9</sup> Quantria Strategies prepared for The SPARK Institute, *Improving Outcomes with Electronic Delivery of Retirement Plan Documents* (June 2015), available at: [http://www.sparkinstitute.org/content-files/improving\\_outcomes\\_with\\_electronic\\_delivery\\_of\\_retirement\\_plan\\_documents.pdf](http://www.sparkinstitute.org/content-files/improving_outcomes_with_electronic_delivery_of_retirement_plan_documents.pdf)

<sup>10</sup> Jack VanDerhei, *The Impact of Leakages on 401(k) Accumulations at Retirement Age*, ERISA Advisory Council (June 17, 2014), available at: [www.ebri.org/pdf/publications/testimony/T-180.pdf](http://www.ebri.org/pdf/publications/testimony/T-180.pdf)

<sup>11</sup> Transamerica Center for Retirement Studies, *17<sup>th</sup> Annual Transamerica Retirement Survey: A Compendium of Findings About American Workers* (December 2016), available at: [https://www.transamericacenter.org/docs/default-source/retirement-survey-of-workers/tcrs2016\\_sr\\_retirement\\_survey\\_of\\_workers\\_compendium.pdf](https://www.transamericacenter.org/docs/default-source/retirement-survey-of-workers/tcrs2016_sr_retirement_survey_of_workers_compendium.pdf)

and rollovers among workplace-based retirement plans and IRAs. With this new rollover infrastructure in place, we can leverage the lessons of behavioral finance and automatically transfer retirement assets with the worker — from a former employer’s retirement plan to their active account in a new employer plan — when workers change jobs. This process is called auto-portability. With auto-portability, workers will now be able to easily consolidate their retirement accounts and more quickly grow their retirement assets.

Second, the Committee should consider Congressmen Johnson and Neal’s Savings Enhancement by Alleviating Leakage in 401(k) Savings or SEAL Act. The SEAL Act permits individuals to continue to pay plan loans if a plan is terminated or a plan participant becomes unemployed. This reduces the risk that the employee will default on his or her plan loan and suffer taxes and penalties on his or her retirement savings. The legislation also modifies the hardship distribution rules to allow participants to make additional contributions to a plan during the six-month period following a hardship distribution.

As the Committee considers increases to restrict leakage from workplace-based retirement plans, it is important to be mindful of the tension between restrictions on distributions and the willingness of workers to save. If access to these assets in true emergency situations is too restricted, some may be reluctant to save in the first place.

### **Integrate Health Savings Accounts (HSAs) with 401(k) Plans**

As this Congress is considering expanding health savings accounts (HSAs) as part of the healthcare legislation, we need to further integrate these accounts into the market to improve employees’ understanding and utilization of them. Today, HSAs are largely treated separately from retirement savings accounts. According to a Fidelity analysis, a healthy Medicare-eligible couple age 65 will need at least \$260,000 in savings for health care in retirement.<sup>12</sup> Help with these important savings decisions becomes more critical if Congress expands HSAs as part of health care or tax reform.

To address this need, I propose modifying the tax code to give plan sponsors the option of offering an HSA as a “sidecar” account to their 401(k) plans. Congress included a similar provision allowing plan sponsors to add a “deemed” or sidecar IRA to their 401(k) plans in the 2001 tax bill. As someone who works with thousands of employees a year to help them with their savings decisions, it makes the most sense for employees to be able to make the 401(k) and HSA contribution decisions together, on a holistic basis. Integrating HSAs into the 401(k) in this fashion has the added benefit of providing participants with access to lower cost investment options offered in the 401(k) plan. In addition, the proposal will spur the development of financial advice tools that will help employees make savings decisions that best fit the financial and health needs of their families. And last, the HSA sidecar proposal preserves all of the unique characteristics of HSAs under current law to keep things simple.

<sup>12</sup>Fidelity Investments, *Health Care Costs for Couples in Retirement Rise to an Estimated \$260,000, Fidelity Analysis Shows – Long-Term Care Insurance Could Add an Additional \$130,000* (August 16, 2016), available at: <https://www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise>

## **Pass-through Tax Rate Caps Could Eliminate Small Business Retirement Plans**

I applaud this Committee's work on tax reform. It is long overdue and we offer our support and help. I also applaud this Committee's work to make the tax rates on small businesses more competitive by reducing the tax on pass-through income. In that spirit, I do want to raise an important technical issue related to retirement plans. As you develop a proposal related to the taxation of pass-through entities, it is critical that any retirement contributions (whether deferrals, matches, profit-sharing, or defined benefit) allocable to the partner or subchapter S shareholder be deducted directly against only the amount of income that is classified as reasonable compensation. Otherwise, the small business owners' incentive for contributing and frankly having the plan in the first place would go away since distributions from the plan would be taxed at a higher, ordinary income tax rate. In other words, the value of having a retirement plan goes away for the small business owner unless the tax rate value of the deduction matches the tax rate he or she will pay when the money is later distributed. The issue is easily resolved by making sure in both cases this is at ordinary income tax rates.

## **Helping Millennials Achieve a Secure Retirement**

Millennial workers comprise the largest generation of American workers. As an advisor, I work with them every day with the goal of helping them establish good financial and retirement savings habits, which I hope will last a lifetime. Saving early in one's working life takes advantage of the power of earnings compounding. Waiting to save later in life puts one at a serious disadvantage because it is so difficult to catch up.

As I mentioned above, when I design plans for employers with Millennial workers I recommend adding a Roth contribution feature to their 401(k) plans along with the traditional pre-tax feature. This is because Millennial workers can accumulate larger 401(k) account balances by electing Roth after-tax contributions with their accounts. Roth contributions require employees to pay tax on their contributions up front with the promise of tax-free withdrawals at retirement. This makes sense for Millennial workers because their tax rate will be the lowest in their early working life. In fact, I have been recently working with some plan sponsors with large Millennial workforces to modify their auto-enrollment so that workers are automatically enrolled into Roth 401(k) accounts versus pre-tax 401(k) accounts.

In addition, I support a proposal that aims to solve another vexing issue for Millennial workers — student loan debt. The proposal — included in Senator Wyden's Retirement Improvements and Savings Enhancements (RISE) Act discussion draft — would allow employees to receive employer matching contributions into 401(k) plans for making student loans payments. Paying student loans would be treated like a 401(k) contribution so they do not miss out on the "free money" on the table that represents the employer's matching contribution.

And last, I see many younger workers moving between contract worker and full-time employee status — a trend that has become more pronounced in the so-called "gig economy." Modifying the 401(k) rules to allow contract workers to make their own contributions to their contractor's retirement plan without jeopardizing the plan's tax status makes a lot of sense for today's economy.

## **Simplification not Consolidation**

Finally, a discussion of simplification has sometimes led to talk of retirement plan “consolidation.” For example, a 2004 Bush Administration proposal would have eliminated the different kinds of employee savings plans — 401(k), 403(b), and 457 plans — and replace them with a single “401(x)” plan. I would caution against tax reform proposals like this that would consolidate all the different types of defined contribution plans into a single type of plan. That would not be a simplification in my view. Each of these plans are designed to meet the needs of the various employer sectors for which they were designed. These employers need the flexibility afforded by these alternate designs.

Improved retirement security, and meaningful simplification, will be accomplished through thoughtful modifications to the existing structure — like the above proposals — without wasting resources on cosmetic overhauls that produce pain rather than savings gain.

### **Summary**

To summarize, the current workplace-based retirement system is working well for tens of millions of working Americans. That said, more can definitely be done to make it easier for small businesses to offer retirement plans and for American workers to save in these plans. I look forward to working with the Committee to simplify the rules and regulations surrounding the tax incentives to save for retirement through workplace-based retirement plans.

Thank you again for this opportunity to participate in this important discussion. I would be pleased to discuss these issues further with the Committee and answer any questions that you may have.