SECURING RETIREMENT COVERAGE FOR FUTURE GENERATIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

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SECURING RETIREMENT COVERAGE FOR FUTURE GENERATIONS

Thursday, November 8, 2007
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and Labor
Washington, DC

The subcommittee met, pursuant to call, at 10:01 a.m., in room 2175, Rayburn House Office Building, Hon. Robert Andrews [chairman of the subcommittee] presiding.

Present: Representatives Andrews, McCarthy, Tierney, Wu, Holt, Loebsack, Courtney, and Kline.

Staff present: Aaron Albright, Press Secretary; Tylease Alli, Hearing Clerk; Carlos Fenwick, Policy Advisor for Subcommittee on Health, Employment, Labor and Pensions; Jeffrey Hancuff, Staff Assistant, Labor; Rachel Racusen, Deputy Communications Director; Michele Varnhagen, Labor Policy Director; Robert Borden, Minority General Counsel; Cameron Coursen, Minority Assistant Communications Director; Ed Gilroy, Minority Director of Workforce Policy; Rob Gregg, Minority Legislative Assistant; Alexa Marrero, Minority Communications Director; Jim Paretti, Minority Workforce Policy Counsel; and Ken Serafin, Minority Professional Staff Member.

Chairman ANDREWS [presiding]. Good morning, ladies and gentlemen.

We would like to thank the witnesses for their attendance and thank the members of the public and the press for their attendance, and we look forward to a very vigorous discussion this morning. I would like to thank my friend, the ranking member from Minnesota, Mr. Kline, for his participation, also.

I have become, because of my daughter's involvement as an actress—I have a 13-year-old daughter who is an actress—a fan of musical theater, and my daughter spent a year on the national tour of the Broadway show "Oliver," and she is in it again playing a role this fall, and there is a great scene in "Oliver." Fagan is the leader of a den of thieves. Some would say the House of Representatives sometimes resembles that, but I disagree.

But Fagan is the leader of a den of thieves, of boys. They are pickpockets. And Fagan is an abandoned sort of lonely old man, and there is a great scene where he pulls out, when the boys are sleeping, a treasure box that has in it a bunch of jewels, and these are the main scores that Fagan's been able to get in his life as a

bandit and a thief, and he refers to the jewels as his pension. He says that this is what is going to carry him through his old age when he is abandoned in his old age.

And, of course, I will not spoil the end of the story, but something happens to the jewels at the end of the story.

Doing what I do for a living, when I watch this scene, I, of course, think of ERISA, and I think about the fact that we have moved somewhat beyond the Dickens era, where the way you provided for yourself in your old age was to horde something away and hope you could hang on to it, hopefully toward a more progressive era, where an intelligent social contract between employers and employees yields a safe and secure and reliable source of income in one's retirement age.

I view the ERISA law as a success, not a perfect success, but as a significant success since its enactment in 1974. Measured on the scale of reliability and security of pension assets, it is an overwhelming success. Failures of pension plans are so rare that they are extremely newsworthy if and when they happen, and that is a testament to the authors of that law and even more so a testament to the integrity and skill of men and women across the country who serve as trustees, as fiduciaries, as professionals and others who work for plans. The law works.

Where I do think we have had a shortfall is the 69 million Americans who work for a living and have no pension at all. Now I do not think that is the fault of the ERISA statute. I think it is because it is not an issue that was thoroughly contemplated in 1974 and since then. It is an issue that is long overdue in contemplation.

In 1999 when I was privileged to serve as the ranking member of the subcommittee, then-Congressman Major Owens and I—he at the time was the ranking member of the Labor Standards Subcommittee—asked for a GAO report on the number of people without a pension, and that number, as I said, came through at about 69 million people. There is reason to believe that that number has grown since then because of various dynamics in the economy.

This is a problem, I think, on two levels.

The first, it is a problem, obviously, for the worker who has worked for many, many years and does not have sufficient income to carry himself or herself through retirement age.

This problem becomes especially acute when one thinks about the glorious advent of longer life expectancy in our country. We can reasonably expect that many of our younger workers will live well into their 80s and perhaps their 90s, which is very, very good, but it does raise the issue of needing more income to stretch oneself beyond one's full-time working years.

So there is sort of a ticking time bomb where the baby boom generation in particular will begin to retire, as it has now, and many, many members of that generation will have no retirement income other than their Social Security check, and that is a very precarious financial position in which to find oneself. There is, obviously, that implication.

The second implication is more societal and systemic, and I make this prediction with no criticism either of Republican or Democratic Parties. I make it with an eye toward the way things work in politics. If we continue to have tens of millions of Americans with no

private pension, I think the day is coming when they will retire, they will notice that their Social Security check keeps them at or below the poverty level, and they will be very unhappy about that.

And there will be a political movement to blame the government, and the political movement will say that it is the government's fault that people do not have this nest egg or security that they ought to have, and the remedy, of course, will be to increase Social Security benefits, and my fear is that the two parties will get into a bidding war as to see who can increase Social Security benefits fastest for the highest number of people.

This would be precisely the wrong prescription for Social Security, given its own fiscal standing. I think that we have a strong societal interest in alleviating or at least reducing this problem by expanding the number of working Americans who have a private pension. So the pressure on their incomes is lessened by the existence of that private pension.

The purpose of today's hearing, which I hope will be the first in a series of serious inquiries into this question, is what good ideas people have to dealing with the needs of the 69 million Americans or more who do not have a private pension. I come to this hearing with no bias, no preconceived notion of what the right answer is. I am frankly not eager to rule anything out or to say that anything must be included.

The only quasi-bias that I have is I do think that an employer-based pension system has a lot to recommend it. I do not think an employer-based system should be the sole means of retirement saving by any stretch of the imagination, but I do think history has shown us, particularly since 1974, that a retirement system based on the employer-employee relationship works. It is stable, it is sound, it is well managed, and although, again, I would not rule out other possibilities, my initial inclination is to try to build a system for the 69 million people who have no pension that relies heavily upon that employer-employee model.

So the ground rules for today are there are no ground rules. We are interested in hearing what everyone thinks about this broad question. The committee would like to follow up on this inquiry with further inquiries which I hope will grow out of this. At this time, I would like to turn to my friend from Minnesota for his opening statement.

[The statement of Mr. Andrews follows:]

Prepared Statement of Hon. Robert E. Andrews, Chairman, Subcommittee on Health, Employment, Labor, and Pensions

In 2000, under the leadership of the distinguished Minority Leader, Mr. Boehner, this subcommittee held a hearing on improving pension coverage for American workers. Unfortunately, almost seven years later, the number of working Americans without a pension remains unchanged.

Today, over 75 million working Americans continue without a retirement plan. Until recently, retirees with pension benefits received a defined benefit plan. Although many public sector workers continue to enjoy the benefits of a defined benefit plan, many private sector workers must rely on a defined contribution plan for their retirement.

Moreover, Americans working for a small employer are less likely to have access to any type of retirement plan. Understandably, many small businesses find it unaffordable to implement and maintain such a plan.

I am gravely concerned with the potential crisis we may face in the next few decades with retirement savings. Retirement participation in employer-sponsored plans

is on the decline and over 80 million baby boomers are quickly approaching retirement with about half of them not adequately prepared for retirement. Coupled with over 69 million working Americans without access to a pension plan, the need for action is imperative.

The experts before us today will hopefully provide us with viable solutions to address this concern. I look forward to examining each of their proposals today and thank them for their testimony.

Mr. KLINE. Thank you, Mr. Chairman.

I want to thank the witnesses for being here. This is truly a distinguished panel of experts, and they have a lot more to offer, I am certain, than my musings. So I will ask unanimous consent to submit my prepared statement for the record and just make a couple of comments.

[The statement of Mr. Kline follows:]

Prepared Statement of Hon. John Kline, Ranking Republican Member, Subcommittee on Health, Employment, Labor, and Pensions

Good morning, Mr. Chairman, and welcome to each of our witnesses.

Last year, this Committee took the lead in enacting the most comprehensive reform of our nation's pension laws in more than three decades. The Pension Protection Act of 2006 embodied sweeping reform of these laws on every level. We strengthened funding requirements for defined benefit pension plans to ensure that plan sponsors were meeting their obligations to workers and retirees. We reformed the multiemployer pension plan system to ensure that these plans remain stable and viable for the millions of Americans who rely or will rely on them. We greatly enhanced pension plan financial disclosure requirements to participants, and modernized our defined contribution pension plan system to foster greater retirement savings. And we helped shield taxpayers from the possibility of a multi-billion dollar bailout by the federal Pension Benefit Guaranty Corporation.

The Pension Protection Act fixed broken pension rules that no longer served the workers who count on their retirement savings being there for them when they need it, and represented a major victory for American workers, retirees, and taxpayers. The fact that we were able to do it in a bipartisan way—with 76 Democrats supporting the bill, and in an election year, no less—demonstrated the critical nature of this issue.

Of particular relevance to today's hearing were provisions we included in the Pension Protection Act to ensure that Americans have greater opportunities to save for their retirement. These automatic enrollment provisions have encouraged employers to automatically enroll workers in defined contribution pension plans, while preserving for workers the choice to opt-out of them. These alone represent a giant leap forward for increasing our nation's savings rate and retirement security for workers.

The Pension Protection Act represented an enormous step toward moving our nation's pension system into the 21st Century. That said, there are few who would argue that our nation's retirement security is where it should be, or that more cannot be done to preserve and build on our voluntary, employer-based retirement system. I look forward to hearing suggestions this morning from the range of excellent witnesses before us.

Before we get into the details of testimony, I would stress one point. As we will hear today, our nation's voluntary employer-based pension system is very much a story of success. Is it perfect? Nothing is. Is there room for improvement? I'm sure of it. But a fundamental principle must be that any further reforms we examine or undertake must first "do no harm." By that I mean to say that we would be doing our nation's workers a tremendous disservice if we adopt policies that "break" the parts that are not broken.

Finally, I'd offer a historical note. The Pension Protection Act we passed last year was the culmination of years of legislative preparation, hearings in our committee and in others, and a steady evolution of proposals, ideas, and language. As reflected in the overwhelming support this bipartisan bill enjoyed, the final product represented a careful balancing of the interest of various stakeholders and supporters, and most important, the interests of participants, workers, and beneficiaries. I hope that as we continue our examination of retirement security issues, and particularly as we contemplate future changes, we adhere to that model of thoughtful deliberation.

With that in mind, I look forward to today's hearing, and the testimony of our witnesses as to their views on what next steps we can take to further retirement security for all Americans. I welcome them and yield back my time.

Mr. KLINE. One, we worked very, very hard on a thing called the Pension Protection Act. We brought stakeholders in. If we did not bring them in, they came in anyway, and they worked together. And we put together a pretty good package that addressed defined benefit plans, multi-employer plans, defined contribution plans. We looked to protect the PBGC and the taxpayer. This was a very big, long collaborative effort.

And so, as we look to improve the situation, I would ask that we be very, very careful here to do no harm, that we do not inadvertently pull a thread on ERISA that leaves over half of Americans who get their health insurance now under ERISA out in the cold, that we be careful on pulling these threads as we look to make things better and stronger.

I agree completely with my good friend and colleague, the chairman, that we do not want to move the wrong direction in Social Security and put an ever-larger burden on that system which is already financially in some peril.

So the experts are here. I look forward to hearing what you have to say.

And with that, I will yield back.

Chairman ANDREWS. Thank you, Mr. Kline.

I would like to proceed to the panel. We have received and read your written statements. They will, without objection, be made a part of the record. We would ask each of you to give us a 5-minute synopsis of your testimony so we can get to questions from the members.

I am going to also remind the witnesses about the way our lighting system works. Many of you have testified here before, so you know. The green light means you are on, the yellow light means you have 1 minute, and we would like you to wrap up your testimony at that point, and the red light means we would ask you to stop so we can move on to the next person.

Michael Calabrese is managing director of the Retirement Security Project and vice president of the New America Foundation. He has previously served as general counsel of the Congressional Joint Economic Committee, as pension and benefits counsel at the national AFL-CIO, and as director of domestic policy programs at the Center for National Policy. Mr. Calabrese is an attorney and graduate of Stanford Business and Law Schools where he completed the joint JD-MBA program in 1984. He received his bachelor's in economics and government from Harvard College in 1979.

Welcome, Mr. Calabrese.

Lynn Dudley is vice president for retirement policy for the American Benefits Council. Prior to joining the council, Lynn was a legal consultant for Sungard Employee Benefits Systems in Birmingham, Alabama. In addition, she was engaged in the private practice of law for several years with the firm of Berkowitz, Lefkovitz, Isom and Kushner of Birmingham. After earning her undergraduate degree at Vanderbilt University, Lynn received an LLM in taxation

from the University of Florida in 1983 and a law degree from Cumberland School of Law at Samford University in 1982.

Lynn, it is good to see you this morning.

Mark Iwry is principal of the Retirement Security Project, a nonresident senior fellow at the Brookings Institution and a research professor at Georgetown University. Mr. Iwry is a graduate of Harvard College and Harvard Law School, has a master's degree from Harvard's Kennedy School of Government, and is a fellow of the American College of Employee Benefits Council and is a member of the bar of the United States Supreme Court.

Welcome. Glad to have you with us.

David John, welcome. Glad to have you here this morning.

He is a senior research fellow at the Heritage Foundation. Mr. John serves as Heritage's lead analyst on issues relating to pensions, financial institutions, asset building and Social Security reform. Mr. John also serves as managing director of the Retirement Security Project, a Pew Charitable Trust-funded joint effort at Georgetown University and the Brookings Institution.

Welcome, Mr. John.

Dr. Pamela Perun is testifying on behalf of the Aspen Institute. She is a lawyer, psychologist and expert on retirement income policy issues. I am sure being a lawyer and a psychologist are useful tools in either profession. I said that on Mr. Kline's proxy there. She received a JD from the University of California at Berkeley, a Ph.D. in human development from the University of Chicago and a BA from Wellesley College. She has practiced employee benefits law in Boston and in Washington and has held research positions at Duke University, Wellesley College and the Harvard University Medical School.

Doctor, welcome.

Michael Stapley is chair of the Task Force on a New Benefit Platform and serves as a member of the Health Policy Committee, the Medicare Task Force for the ERISA Industry Committee, ERIC, and is a member of ERIC's board of directors. He is president and chief executive officer of the Deseret Mutual Insurance Company and Deseret Mutual Benefits Administrators. He earned a BA in political science in 1969 from Brigham Young University, a master's of public administration in 1972 from the Institute of Public Management at Brigham Young University.

Welcome. Nice to have you with us.

And finally, last but not least, Professor Norman Stein received his BA in 1973 from New College in Sarasota, Florida, and his JD in 1978 from Duke University where he was elected to the Order of the Coif, which is not a hairdressing society. It is actually the legal honors society. I am a member. That is how I know this.

But Professor Stein is a member of the advisory panel of the BNA Pension Reporter, has served as counsel to the American Association of Retired Persons in several pension cases, was a consultant to the GAO, taught in the IRS general counsel's continuing education program, has testified before Congress on pension issues and has been chair of the employee benefits section of the American Association of Law Schools and teaching employee benefits subcommittee of the American Bar Association.

As Mr. Kline said, truly a distinguished panel. We are very happy to have you with us.

And, Mr. Calabrese, we would ask you to start.

STATEMENT OF MICHAEL CALABRESE, VICE PRESIDENT, NEW AMERICA FOUNDATION

Mr. CALABRESE. Good morning, Mr. Chairman and members of the committee. Thank you for inviting me to testify today.

I should also mention in addition to that flattering introduction that I served also as co-chairman of the Conversation on Coverage working group on individual and defined-contribution saving reform, which was a different working group than Norm co-chaired.

Today's employer-sponsored pension system works very well for workers who have consistent access to a plan and who choose to save. Our 401(k) system facilitates savings as well as it does for two key reasons.

First, 401(k)s provide powerful saving incentives, typically both matching contributions by employers and federal tax breaks, which are particularly valuable to higher income taxpayers.

A second reason is infrastructure. Employer-sponsored plans provide the convenience, discipline, and protection of automatic payroll deduction and professional investment management at relatively low cost. These two key features, matching contributions and infrastructure for automatic saving, is what needs to be extended to all Americans, to those 69 million—actually, probably closer to 75 million—workers that the chairman mentioned.

Unfortunately, employer-sponsored plans cover fewer than half of all workers. A steadily declining minority of American adults are participating in any retirement plan. Since I first proposed a universal 401(k) system in testimony before this subcommittee 7 years ago in September 2000, participation in private employer plans has fallen by another four million the lowest level in more than 30 years. Only 43 percent of all private-sector workers participated in an employer plan last year, a striking decline from the 50.3 percent participation rate in 2000.

The solution, I believe, is a universal 401(k) plan that gives every worker access to an automatic, professionally administered retirement saving plan and to a portable individual career account. Designed well, a universal 401(k) plan will supplement and strengthen the existing private pension system, not supplant it.

Some analysts say, "Well, why doesn't that other 57 percent of the workforce go out and open an IRA and make regular saving deposits on their own?" The answer, of course, rests in part on human nature and in part on public policy choices. It is not primarily eligibility for an individual savings account that spurs participation, but rather what I call the three I's—incentives, infrastructure and inertia.

A universal 401(k) would recast federal pension policy by adding each of those three components.

First, incentives: Federal tax expenditures for retirement saving exceed $135 billion each year, yet by relying on deductions instead of credits, only a fragment of that spending goes to encourage middle-to lower-wage workers who find it most difficult to save.

We need a tax incentive for saving that is more inclusive and potent. This can be done by expanding the saver's credit, making it a refundable matching contribution that is directly deposited into the worker's account rather than rebated.

Second, we need infrastructure. We need an account-based infrastructure that enables every worker to save by automatic payroll deduction into a simple, low-cost, portable and professionally invested account.

The third ingredient is inertia. We need to harness human nature with default options that convert myopia into positive inertia. We should simply require that the default options for retirement saving be automatic enrollment, automatic escalation, automatic payroll deduction, automatic asset allocation and automatic annuitization.

A universal 401(k) system can extend the most proven, effective features of employer-sponsored plans to all Americans. Eligibility should be open to all workers not participating in their employer plan, including recent hires and part-time employees. All workers not participating in a qualified employer plan should be automatically enrolled and contribute by payroll deduction, although an individual could opt out and choose not to save.

I would like to close by focusing on the first and most critical building block for this vision, which is infrastructure.

Enrollment and access to payroll——

Chairman ANDREWS. Mr. Calabrese, can we just ask you to very briefly summarize here that first point, okay?

Mr. CALABRESE. Okay. Right. Okay.

And, essentially, it is that this infrastructure has two essential pieces, easy access to automatic payroll withholding and a central clearinghouse to receive the deposits and manage very low-cost investment accounts, and so, along those lines, I would commend to you the Automatic IRA Act of 2007 introduced in the House by Representatives Richard Neal and Phil English, although we believe the limits are too low. It is a critical next step.

[The statement of Mr. Calabrese follows:]

Prepared Statement of Michael Calabrese, Vice President and Co-Director, Next Social Contract Initiative, New America Foundation

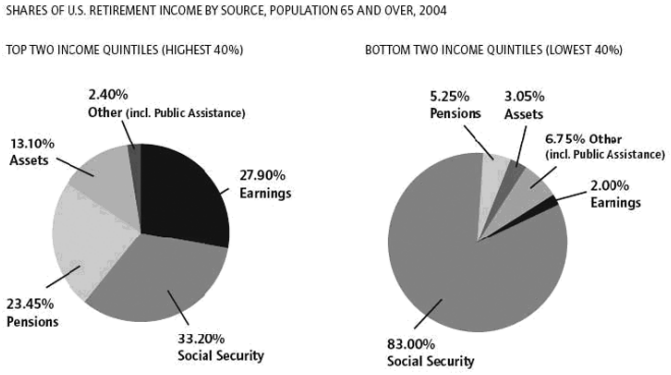
Thank you, Mr. Chairman and members of the Committee, for this opportunity to testify today. I am Vice President of the New America Foundation, a nonpartisan policy institute here in Washington. I co-direct New America's Next Social Contract Initiative, which focuses on updating the nation's policy framework for promoting the basic economic security of workers and their families, particularly with respect to health insurance, retirement saving, income security and access to higher education.

I also served as co-chairman—with John Kimpel, former deputy general counsel at Fidelity Investments—of the Conversation on Coverage Working Group on individual, defined-contribution saving reform. That diverse Working Group developed a universal "Retirement Investment Account" proposal that is very similar to New America's Universal 401(k) plan that I describe in my testimony today.

With over $12 trillion in assets, traditional pension trusts and 401(k)-style saving plans account for the vast majority of financial assets accumulated by households in recent years. For those with access, America's employer-based private pension system provides powerful saving incentives—both tax breaks and employer contributions—as well as the convenience and discipline of automatic payroll deduction.

Unfortunately, employer-sponsored plans cover fewer than half of all workers. America's real retirement security crisis is not Social Security solvency, nor even the many big companies freezing their traditional pension plans. The larger problem is

that a steadily declining minority of American adults are participating in any retirement plan—whether pension or 401(k) plans or Individual Retirement Accounts (IRAs). Participation in employer plans peaked back in the late 1970s. Since I first proposed this Universal 401(k) reform in testimony before the Subcommittee back in September 2000, participation in private employer plans has fallen by 4 million to what appears to be the lowest level in more than 30 years.



Only 43.2 percent of all private-sector workers participated in an employer-sponsored retirement plan in 2006, a striking decline from the 50.3 percent participation rate in 2000, according to a recently updated Congressional Research Service (CRS). Only 54 percent of older workers (aged 45 to 64) participate in a retirement plan. The percentage of private sector workers whose employer even sponsors a plan (whether or not they are eligible or participate) has fallen steadily to 57 percent in 2006.

One result is that fewer than 55 percent of today's older workers, those aged 47 to 64, are on track to replace even half of their pre-retirement standard of living during retirement, based on projections using the Federal Reserve's Survey of Consumer Finances. SCF data indicate that even among workers and families with a defined contribution account (including 401(k)s, IRAs or Keoghs), the median balance is $25,000—and less than $10,000 for households with incomes below $50,000.

As a nation, we are saving too little and not doing enough to give lower-paid workers the combination of opportunity and security they need to cope with accelerating economic and technological change. A projected 40 percent of today's baby boomers are likely to depend almost completely on Social Security's poverty-level benefit after age 70, just as today's lower-income seniors do today (see chart above). We need to facilitate pension portability while simultaneously shifting the burden of subsidizing basic benefits from American business to society as a whole.

The solution is a Universal 401(k) plan that gives every worker access to an automatic, professionally administered retirement saving plan—what I call an Individual Career Account (ICA). The plan would supplement, not supplant, the existing private pension system.

Individual Career Accounts: A Universal 401(k)

Today's private pension system works well for those workers who have consistent access to a plan and choose to save. One big reason retirement plans are effective in generating saving is the powerful incentives provided by immediate tax deductions and employer matching contributions. Another reason is infrastructure: employer-sponsored plans create the positive inertia of automatic payroll deductions while also managing the complexities of investment management at relatively low cost. These two key attributes—incentives and an infrastructure for automatic saving—is what needs to be replicated for all Americans.

Every working American needs access to both a potent tax incentive to save and automatic payroll deduction into a portable, professionally-managed account whether or not his current employer sponsors a retirement plan. The fact that so few workers save regularly in IRAs reinforces what demonstration projects in asset-building among low-income families have found: it is not primarily access to a savings account that spurs participation, but the three "I's" Incentives, Infrastructure, and Inertia.

A Universal 401(k) would recast federal pension policy by adding:

• A tax incentive for saving that is more inclusive—and potent—by expanding the Savers Credit, making it refundable and directly deposited into an ICA.

• An account-based infrastructure that is citizen-based, rather than strictly employer-based, yet enables every worker to save by automatic payroll deduction.

• Default options that convert myopia into positive inertia, through automatic enrollment, automatic escalation, automatic payroll deduction, automatic asset allocation, and automatic annuitization.

Under a Universal 401(k) plan with these three key attributes, all workers not participating in an employer plan, including recent hires and part-time employees, would be automatically enrolled and contribute by payroll deduction, although an individual could opt out and choose not to save. The government would match voluntary contributions by workers and their employers with refundable tax credits deposited directly into the worker's account. Workers participating in their employer's plan would receive stronger tax incentives to save, but otherwise see no difference. Contributions for workers not participating in an employer plan would be forwarded to a federally-chartered clearinghouse, which would manage small accounts at low cost and could even convert account balances into guaranteed income for life at retirement. Individuals could maintain the account throughout their careers, since it would remain open as they moved from job to job. This supplemental system would make saving easier, automatic, and fair.

The Limitations of America's Employer-Based Pension System

When the landmark Employee Retirement Security Act (ERISA) became law in 1974, its fiduciary, funding, vesting and other provisions were designed to perfect what was then a system of employer-sponsored defined-benefit (DB) pensions. From 1945 to the late 1970s, the percentage of private-sector workers covered by pension plans grew rapidly from 20 percent to just above 50 percent. Employers made all the contributions and shouldered all the investment risk, managing pooled trusts subject to government oversight at relatively low costs. Workers—at least those who clocked more than 20 hours per week—were automatically covered and received, at retirement, guaranteed monthly income for life.

This industrial-era system was based on assumptions of career-long job tenure, stable corporate structures, pressure from strong unions, and large doses of employer paternalism—conditions that have been eroding as steadily over the past two decades as the prevalence of DB plans. Since the first 401(k) plan emerged out of an unintended tax loophole in 1981, the number of U.S. firms with DB plans has plunged from 100,000 to fewer than 30,000 now. Today, we are a 401(k) nation. More than 60 percent of private-sector workers lucky enough to have any pension benefit work at firms that sponsor only a 401(k)-type contribution plan.

This shift makes perfect sense from the perspective of employers who face increased health benefit costs, more intense competition, less pressure from unions, more corporate volatility, shorter job tenures and a desire to appeal to younger workers who don't expect to remain until retirement. But although 401(k)s are less expensive and risky to employers, there has been no great increase in plan sponsorship among smaller firms—and a distinct decline in participation among workers at every income level, particularly middle-to-low earners, compared to the automatic inclusion that characterized traditional DB plans. Clearly the nation needs a new approach to promoting retirement saving that can offer the best features of private sector 401(k)s to all workers lacking coverage.

What Is Needed

A renewed and updated effort to facilitate saving and retirement security for all Americans should be designed to address the following unmet needs:

Improve individual retirement security.

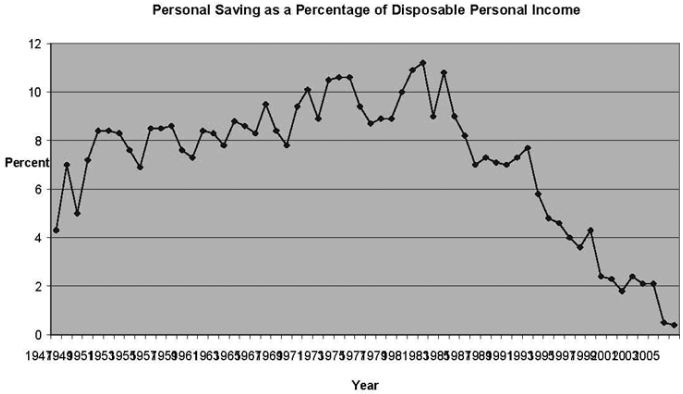
More than 75 million American workers do not participate in a tax-subsidized, payroll deduction saving plan—and therefore they tend to save very little for retirement. While participation is slightly higher among full-time workers (49 percent), participation rates are also strikingly lower among workers who are low-income, young, work part-time, or work at small firms. Approximately 85 percent of Americans without a pension benefit at work shared one or more of these four characteristics, according to a General Accounting Office study. Whereas 63 percent of full-time workers at firms with more than 100 employees participate in retirement plans, that rate sinks to 42.6 percent at firms with fewer than 100 employees, and it plunges to 23 percent at firms employing fewer than 25, according to a CRS analysis of

Current Population Survey data. Rising numbers of part-time and contingent workers are even less likely to be offered coverage. Only 23.3 of part-time workers participated in private sector plans in 2006, according to CRS.

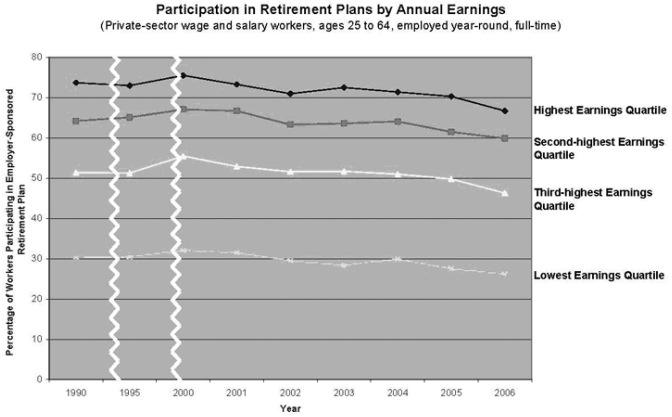
A similarly striking disparity in pension participation occurs at different income levels—and not primarily because low-income workers choose to save in 401(k) plans at lower rates. In 2006, whereas 71 percent of full-time private sector workers in the top quartile by earnings worked at a firm offering pension coverage, among workers in the lowest-earning quartile, only 36.6 percent worked at a firm sponsoring a retirement plan. Even in the second earnings quartile, only 56 percent worked at a firm that sponsored a plan.

Too many individuals and families are headed toward retirement age with little more than Social Security's safety net. A great deal of the opposition to partial privatization of Social Security undoubtedly related to the average citizen's keen awareness of how many elderly desperately depend on the program's meager but guaranteed (and inflation-adjusted) monthly payment. More than a third of Americans over age 65 rely on Social Security's poverty-level benefit for 90 percent or more of their income—a dependency ratio that is even higher for widows and unlikely to improve for the baby boomer generation, according to government projections.

Boost national saving and investment. Despite the fact that baby boomers—the largest segment of the adult population—are in their prime saving years, the personal saving rate actually turned negative during 2005 for the first time since 1933, during the Great Depression, and has averaged less than one-half of one percent (0.48 percent) over the past eight quarters. If we truly want to promote national saving, reduce dependency on social insurance, and create an inclusive "ownership society," we will need new mechanisms that extend the advantages of private pensions to everyone. After all, accounted for the vast majority of net new personal saving in recent years. Among households with an IRA or 401(k)-type plan, which are more affluent on average, retirement account balances represented 62.5 percent of their total financial assets, according to an EBRI analysis of the 2004 Survey of Consumer Finances.



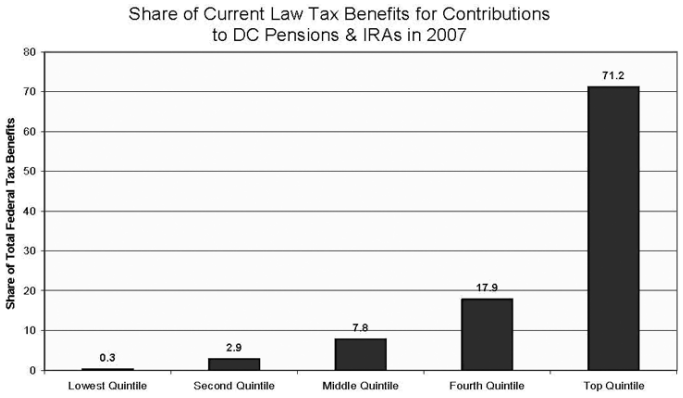
Not surprisingly, pension participation is lowest among workers whose savings would truly add to net national saving: workers who earn less than the median wage. While the affluent can respond to tax incentives for saving by shifting rather than actually increasing their net saving effort, households that would not otherwise save genenew national saving. Indeed, a majority of middle-to-low-income households are not responding to current incentives. Among the bottom 60 percent of all workers by income—those earning less than $40,000—only about a third (36 percent) participemployer plans, according to the Congressional Budget Office.



We might at least expect the workers lucky enough to participate in 401(k)-type plans to be accumulating significant savings. Among the subset of high-tax-bracket earners with steady access to a 401(k), this is the case. But participation rates in the bottom two quintiles of the earning distribution are far lower, and the average account balance ibelow $10,000 for this group. One reason for the low participation rates and accumulations is that even if a worker has coverage today, he or she may not to a plan next year in a new job. Even if the new employer sponsors a plan, new hires are not eligible to participate for at least one year. The result is gaps in coverage. What is needed is a seamless, lifelong saving system.

Stronger tax incentives for saving. Even when lower-wage workers have consistent access to an employer plan, the tax incentives for saving are upside-down. The tax break for retirement saving is one of Washington's most expensive programs, costing a projected $134 billion in uncollected federal tax revenue in fiscal 2007 alone, according to Joint Tax Committee estimates. Yet at least 70 percent of those tax subsidies for retirement saving goes to the most affluent 20 percent of taxpayers—and virtually none (3 percent) goes to encourage saving by the lowest-earning 40 percent. The reason is simple but too often overlooked even by liberal policymakers: a program subsidized by tax deductions, as opposed to refundable tax credits, is highly regressive.

Qualified retirement saving today reduces taxable income, a deduction that is worth 35 cents on the dollar to high-bracket taxpayers who need little incentive to save. In contrast, a tax deduction for saving is worth zero to the more than 40 million low-earning taxpayers who have payroll tax liability, but who don't have any income tax liability to offset. Even median-income families in the 10 and 15 percent income tax brackets receive a weak subsidy compared to the 35 percent subsidy rate that applies to those earning over $200,000 a year. In contrast, the effect on higher-income workers—who would likely save anyway—is primarily a shifting of assets from taxable to tax-deferred accounts.

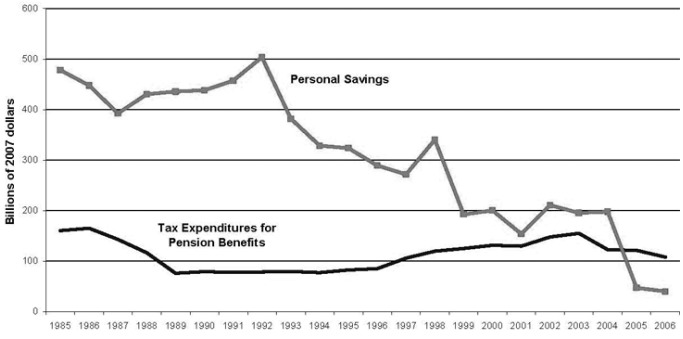


Source: Adam Carasso and Jon Forman, using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3a).

As the chart just below indicates, the fact that the revenue loss from federal tax deductions for retirement savings now actually exceeds net new personal saving suggests that the current tax expenditure is highly inefficient and needs to be retargeted at low-to-middle-income earners who are not saving (and whose new saving would therefore add to net national saving, as well as boost their retirement income adequacy).

The most effective way to target a saving subsidy using the tax code is through a credit, which directly reduces taxes due. In fact, the Saver's Credit, made permanent last year in the Pension Protection Act, creates this incentive and could be used as the matching incentive for a Universal 401(k). Unfortunately, because the current Savers Credit is limited to very low-income taxpayers with income tax liabilities to offset, it fails to provide a meaningful saving incentive to most workers and families who need it most. According to estimates by the Urban-Brookings Tax Policy Center, only one in seven tax filers with incomes low enough to qualify for the 50 percent credit receives any benefit—and less than one out of every 500 qualified filers could receive the maximum credit of $1,000 per person. And while a larger share of lower-income workers benefit from the Savers Credit in its 20 and 10 percent phase out range (for single incomes between $15,500 and $26,000), the lower benefit and uncertainty that surrounds receiving any subsidy in a given year undermines the effectiveness of the incentive.

Figure 1. Federal Retirement Savings Subsidies Vs. Personal Savings, 1985-2006



Federal amounts are by fiscal year and personal savings are by calendar year. Note: Tax expenditures are not strictly additive. The cash flow measures above do not reflect the present value of pension subsidies. Source: Adam Carasso and C. Eugene Steuerle, 2007. Based on data from the Office of Management and Budget, Analytical Perspectives (prior to 1990, Special Analyses), Budget of the United States Government, 1987-2008. Personal savings data from the Bureau of Economic Analysis NIPA Table 2.1 as of November 2007.

The most powerful way to ensure that low-income workers receive an incentive at least as generous as an affluent worker is to make the Saver's Credit refundable, as the Earned Income Tax Credit (EITC) is, so that the low-wage worker receives it even if she has only payroll tax and not income tax liability. Moreover, directly depositing the Savers Credit into a worker's personal account—rather than rebating it, as current law provides—doubles the amount of saving actually accumulated (at

the 50% credit level and assuming the worker would save the same amount). The design of a Universal 401(k) match is discussed further below.

Increase benefit portability and workforce flexibility. In yesterday's more stable, goods-producing economy, traditional pensions were designed to reward seniority and to retain older, long-tenured workers with firm-specific skills. Domestic firms were more insulated from foreign competition, unions were stronger, job tenures were longer, and a much higher share of the (predominantly male) workforce occupied standard full-time jobs.

The 21st century workforce is very different. The service and information technology economy puts a premium on younger, more educated workers with transferable skills. Competition, both foreign and domestic, creates enormous volatility for companies and workers alike. Median job tenure has declined significantly over the past two decades, especially for older workers. Even at firms with retirement plans, an increasing number of workers cycle through jobs without earning employer-paid benefits, since it typically takes one year to be eligible to participate and multiple years to vest. A combination of two-income families and just-in-time labor strategies by firms has increased the share of nonstandard work arrangements. Nearly 30 percent of U.S. workers are working in part-time, temporary, or contract arrangements that rarely include pension coverage. While this emerging "free agent" workforce may be good for flexibility and productivity, it makes the current employer-based pension system increasingly inadequate.

Lighten the social benefit burden on business. It's clear that most small and start-up companies either cannot or prefer not to shoulder the administrative burden and financial risk of sponsoring a pension plan. Indeed, despite the "carrot" of tax subsidies for pension plans, a majority of firms with fewer than 500 employees do not offer one. In addition, even very large companies with a predominantly low-income workforce—the Wal-Marts and McDonalds among employers—have little incentive to sponsor a plan for workers who (a) receive little or no financial benefit from a tax deduction, and (b) without a strong incentive would prefer a higher wage now to an employer contribution for retirement. In contrast, large high-wage employers—the Microsofts and Intels—use retirement plans to steer tens of millions of dollars in pension tax subsidies to their employees every year.

This creates the anomalous situation whereby the federal government provides more than $100 billion in compensation subsidies to the employees of a minority of companies—most of which are large firms with workers paid above-average wages. Meanwhile, companies with a substantial percentage of low-wage workers that do offer good benefits (employers like Starbucks) are paternalistically shouldering a cost that should be borne by society as a whole—and which will need to be if we want to achieve universal retirement security. If, instead, contributions by both workers and firms were matched by a refundable federal tax credit, then—as with the EITC—the after-tax value of benefits paid to low-wage workers would be less expensive, rather than more so.

Basic Program Elements: Incentives, Infrastructure, Inertia

A Universal 401(k) system can accomplish the various national policy objectives described above by combining the following basic elements:

1. Incentives: Matching, Refundable, and Deposited Credits for New Saving.

Just as most employers match contributions to 401(k) accounts, the government could provide the strongest saving incentive by matching voluntary saving with a refundable tax credit that would be deposited directly into the worker's account. This would create a far more powerful saving incentive for middle- and low-wage workers than current law. As noted above, a tax deduction is neither an effective nor an equitable means to encourage pension saving among lower-income and younger workers, whether or not they participate in an employer plan. And although the current Savers Credit provides (most commonly) a 10 percent tax credit for retirement saving by low-income taxpayers, the lack of refundability means that millions of working-poor families—who have payroll tax but no current income tax liability to offset—receive no credit at all.

Instead, a refundable credit would operate just like an employer match in a company 401(k) plan. Studies show that workers are far more likely to save if given generous matching credits—and once they develop the habit of saving by payroll deduction, most continue even when the match rate is reduced. A sliding-scale credit could give a greater incentive to low-income workers who are least likely to save. For example, using the existing limits that apply to the Savers Credit for 2007, workers in families (joint filers) earning below $31,000 could receive a $1 per $1 (1:1) matching credit on their first $2,000 in savings; whereas workers in families earning above that level (up to $52,000 if the Savers Credit phase out is main-

tained) could receive a $0.50 per $1 (1:2) matching credit on their first $4,000 in savings. This would give all workers the opportunity to receive as much as $2,000 each year in matching deposits to their accounts, but the higher-wage earners would need to make twice the saving effort.

Like the current Saver's Credit, the refundable credit should apply equally to contributions to 401(k)s and other employer-sponsored plans. Eligibility for the credit would be reconciled annually through the income tax return process, which would also be used to encourage taxpayers to save all or a portion of their tax refunds.

It is important to note that a $1:1 matching credit that is deposited into the workers' personal account is equivalent to the 50 percent Savers Credit in terms of cost to the Treasury for a given amount of saving. The $1:1 match appears to be more generous because the credit adds directly to saving—just like an employer match on a worker's 401(k) contribution—and so the worker can achieve the same net saving with a far lower monthly deduction from pay. For example, if today a low-wage worker eligible for the 50 percent Savers Credit contributes $1,000 to their company 401(k), at tax time the $500 credit reduces other taxes owed—and new net retirement saving for that year is $1,000. In contrast, a worker who receives a $1:1 match deposited into his account would only need to make a $500 contribution upfront to end up with net new retirement savings of $1,000. If this worker contributes $1,000 over the course of the year, he ends up with $2,000 in new saving. While more research is needed to compare the behavioral impact of these two approaches, it seems likely that a dollar-for-dollar match will be perceived as a more generous incentive and, since it also requires the worker to save less each pay period to achieve the same outcome, yield more savings over time.

Matching credits should be available for both individual and employer contributions. This would give employers a greater incentive to make deposits on behalf of their low-wage workers. Yet, by extending pension saving incentives to all workers as individuals, employers would have the option to provide a pension benefit without the need to administer a pension plan. Employers would have the flexibility to decide from year to year whether to contribute to their workers' accounts, in many cases doing so as a type of year-end, profit-sharing bonus depending on circumstances. Employer contributions should also be deductible from income and payroll tax liability, as they are with other qualified pension contributions. However, employer contributions should be limited to a flat percentage of wage income, or a flat dollar amount, and made on behalf of all payroll employees, including part-time workers. Without such a requirement, ICAs could undermine ERISA antidiscrimination rules to ensure that employers are not using the tax subsidies to favor only their higher-wage employees. In fact, the Conversation on Coverage Working Group that developed the similar RIA plan was concerned enough about this risk that they decided to initially limit contributions to workers.

2. Infrastructure: Automatic Payroll Deduction and Account Administration.

Equally important is replicating the retirement plan infrastructure that is key to the success of employer-sponsored 401(k) plans. As with 401(k) plans, every worker should have access to the convenience, discipline, and protections provided by automatic payroll deduction and professional asset management. This will require two essential pieces of infrastructure: access to automatic payroll withholding and a central clearinghouse to receive the deposits and manage very low-cost investment accounts. We are very encouraged to see legislation in both the House and Senate this year that addresses both of these critical needs: the Automatic IRA Act of 2007 (H.R. 2167), introduced in the House by Reps. Richard Neal and Phil English.

Enrollment and access to payroll-deducted saving should be easy and automatic for every employee whether or not their firm sponsors a retirement plan. When a worker fills out the required IRS Form W-4 (used to calculate tax withholding), he or she can simply specify a monthly saving deduction. That's the only decision a worker needs to make—a choice to save. In fact, as described in the next section, it would be even better to combine this with automatic enrollment, so that the W-4 actually indicates that 3 percent of pay (initially) will be deducted for saving unless the worker either opts out or chooses a different saving level.

The sole burden on employers would be to forward this automatic payroll deduction to the employer's own retirement saving plan (if there is one and the employee participates) or to a government clearinghouse. Since most employers today use automated payroll processing services, there would be virtually no cost to forward the deduction to a central clearinghouse. Even employers who do not automate payroll must forward income and payroll tax withholding to the Treasury, so including withholding amounts for saving would be a minor burden. It appears that small business owners recognize that given today's technology, payroll withholding is not overly burdensome compared to the benefit. The Economic Opportunity Institute,

based in Seattle, conducted focus groups with owners and managers of small firms (between 5 and 25, and between 25 and 100 employees). Although two-thirds of the firms participating provided no retirement saving program for their workers, 17 out of 18 participants supported a proposed state-level program, called Washington Voluntary Accounts, even if employers were required to withhold and forward payroll deductions for participating workers.

With respect to cost, the Conversation on Coverage Working Group investigated the mechanics and cost of payroll deduction and account administration during a day-long session in Boston with the defined-contribution experts at Fidelity Investments. They confirmed that for any firm using a payroll processing service or software (which is typical for all but the smallest employers), multiple deductions and electronic fund transfers have become so routine that it should not increase the cost of payroll processing at all. This would particularly be the case if—like income tax and FICA withholding—the saving deduction for each worker is sent to a common clearinghouse. The Conversation on Coverage Group nevertheless observed that Congress could initially exempt the very smallest employers (e.g., under 10 employees) and/or enact as part of the program a tax credit for small businesses to offset the cost of implementation. The Automatic IRA Act of 2007 sensibly adopts both of these approaches, allowing startups and employers with fewer than 10 employees to opt out, while providing a tax credit of up to $250 during the first two years for participating small employers.

The second critical piece of "plumbing" is a new entity—a clearinghouse akin to the Federal Thrift Savings Plan (TSP), which manages very low-cost 401(k)-style saving accounts for 3 million federal military and civilian personnel. The clearinghouse would receive all deposits and be the default administrator for small accounts. Record keeping should be centralized—primarily because of the need to coordinate with the IRS—but the investment management would be contracted out to private investment firms, as TSP does today. The clearinghouse would strive to keep costs and complexity to a minimum.

As the Auto IRA Act proposes, participants should have at most a choice among a small number of very low-cost index funds, similar to the approach used by TSP. Although payroll-deducted savings and matching tax credits would flow through the clearinghouse, the assets should be fully portable and transferable at any time at the worker's request to another qualified financial institution, or to a future employer's pension plan. Indeed, because the primary function (in addition to record keeping) is to manage relatively small accounts that would be unprofitable to a private money manager, we would expect that as account accumulations grow over time, most participants will eventually roll over to a more full-service IRA provider.

The Neal-English Automatic IRA Act of 2007—and its Senate companion, S. 1141, introduced by Senators Jeff Bingaman and Gordon Smith—is an essential step toward giving every American worker access to an easy, automatic and professionally-administered saving system. We applaud the co-sponsors for their well-designed and carefully balanced proposal.

Although the Auto IRA Act would be a very positive first step, the one design issue where the bill falls short is in restricting contributions to today's meager IRA limits ($4,000 or $5,000 for workers over age 50). While this may be as much as we can realistically expect very low-income workers to save in a year, most middle-income workers—of whom there are tens of millions who lack access to a 401(k), SIMPLE or other employer-sponsored plan—simply cannot hope to achieve retirement adequacy with their saving restricted at this level. Moreover, while higher-income earners can contribute $15,500 to a 401(k)—receiving $5,425 in tax breaks (at the 35 percent bracket)—the bill would limit the majority of American workers limited to far less. We concur with the concern that an Auto IRA—or Universal 401(k)—not undermine the incentives for business owners to sponsor a SIMPLE or 401(k). However, as the Conversation on Coverage Working Group agreed, we believe the best way to balance these concerns is with a contribution limit that is between today's IRA and SIMPLE limit (which is $10,500). An individual limit in the neighborhood of $8,000 would still leave business owners with the incentive to "graduate" up to the higher SIMPLE or 401(k) limits if they personally wish to save more. The reality, however, is that for a variety of reasons, a very substantial number of new, small and even medium-sized employers will not sponsor a qualified plan and may welcome the ability to facilitate an adequate level of saving by their employees—and even to contribute to those accounts if it could be done at their discretion and with minimum regulation (as proposed in the section above).

3. Inertia: Default Options for Enrollment, Escalation, Investment and Annuitization.

The W-4 form required of every worker would provide a simple means of indicating how much an individual wants withheld and saved each pay period. Even better, the Universal 401(k) system could convert myopia into positive inertia by making participation the default option for everyone. Studies have shown that automatic enrollment has boosted 401(k) participation rates as high as 95 percent (when there is also an employer match) and to 80 percent among low-income workers.

Although the Pension Protection Act clarified that plan sponsors can choose to implement automatic enrollment, it is not required. It should be. The Economic Benefit Research Institute estimated this year that if automatic enrollment was required for all employer-sponsored plans, it would raise the median replacement rate for lowest-earning 20 percent of workers from 23 to 37 percent (with a 3 percent default contribution rate) or to 52 percent (with a 6 percent default).

Under a Universal 401(k) plan, unless the worker decided to opt out, the W-4 should give notice of the amount to be deducted and saved each pay period. The initial default contribution could be modest—probably the 3 percent currently specified in the Pension Protection Act. This default contribution rate should escalate automatically by 1 percent a year thereafter, as pay increases, until it reaches a level likely to achieve an adequate accumulation over time (probably up to 6 or 8 percent of pay on a default basis).

Unless a worker opts out—or participates in his employer's plan—the payroll deduction would flow automatically each pay period to the federal clearinghouse and into his or her Individual Career Account. Although the worker should be able to switch, periodically, between a very limited number of broad and low-cost index funds, there would be a default asset allocation for workers who made no choice at all—most likely a life-cycle fund, or other balanced fund, that would automatically adjust the mix of stocks and bonds to match the worker's age and years until retirement age.

Finally, at retirement age, the default payout option should be in the form of an annuity: monthly payments, rather than a lump-sum withdrawal, to ensure that retirees do not outlive their benefits. Although individuals could choose to withdraw (or roll over) all or part of their nest egg, there should be incentives to encourage and facilitate annuitization, which is one of the great (and disappearing) advantages of a defined-benefit plan. This annuity benefit could be contracted to one or several private insurers, as DB plan sponsors do when they purchase a Guaranteed Investment Contract, or taken on by the Pension Benefit Guarantee Corporation, the federal pension insurer that currently manages guaranteed annuity payments each month for millions of private-sector retirees who were participants in a defaulted employer plan.

Although the Universal 401(k) system proposed here would be voluntary and rely on the stronger incentives of a refundable matching tax credit, a similar system of universal "add-on" accounts could be implemented on a non-voluntary basis. My colleague Adam Carasso, and Jon Forman of the University of Oklahoma, have proposed a universal pension system ("UPS ") comprising a system of individual retirement savings accounts financed by a compulsory 3 percent of payroll contribution by individual workers. They propose to collect these individual savings account deposits automatically by piggybacking onto the existing Social Security withholding system. The individual accounts would be taxed like 401(k)s and traditional IRAs under their proposal. Carasso and Forman's rationale for making a base contribution mandatory is the likelihood that even with retargeted tax incentives and employer matching contributions, many young and middle-to-low-income workers will not save consistently for retirement on a voluntary basis. Mandatory savings proposals are not new. In 1981, for example, the President's Commission on Pension Policy recommended adoption of a Mandatory Universal Pension System (MUPS). That proposal would have required all employers to contribute at least 3 percent of wages to private pensions for their workers.

While Americans clearly support retaining Social Security's defined-benefit safety net, neither Social Security nor the inadequate coverage of today's private pension system are providing enough income in retirement. Thus, the combination of a citizen-based, portable, and automatic system—providing those who find it most difficult to save with both powerful right-side-up tax incentives and an infrastructure for automatic saving—may be exactly the retirement revolution we need.

Chairman ANDREWS. I have looked at that bill. I think it is an excellent starting point for discussion.

As I say, your written testimony is a part of the record. We appreciate very much your statement.

And, Ms. Dudley, we turn to you.

STATEMENT OF LYNN DUDLEY, VICE PRESIDENT FOR RETIREMENT POLICY, AMERICAN BENEFITS COUNCIL

Ms. DUDLEY. Thank you, Mr. Chairman and members of the subcommittee. I am here today on behalf of the American Benefits Council whose members directly sponsor or service health and retirement plans covering more than 100 million Americans.

My comments today are drawn from Safe and Sound, a 10-year plan promoting personal financial security which was published by our board of directors in 2004. The report contains nine measurable goals that the retirement and health system can and should attain within 10 years. Three and a half years into this 10-year plan, we will be issuing in the coming months a more formal evaluation of how far the country has come in meeting the goals of Safe and Sound. The purpose of Safe and Sound is to help Americans achieve personal financial security with regard to their health, retirement and long-term care needs.

After much consideration, our board of directors concluded that in the future, individuals, government, and employers will continue to be the key stakeholders in employee benefits, but that their roles would change. Indeed, we have already begun seeing individuals take on more responsibility for ensuring their financial security.

This does not mean the government and employers have less of a role. Demographic challenges lying ahead dictate that all stakeholders will need to do more.

Employers and government are already being called upon to provide individuals with the tools they need to more successfully assume a larger and more direct role.

I would like to focus the rest of my comments on five key points.

First, raising financial literacy is essential to achieving personal financial security. Knowledge about the value of savings and the importance of retirement coverage will empower future generations to be more active in preparing for retirement. Proficiency in financial literacy should be made a high school and college graduation requirement.

Second, given the tremendous evolution in plan design, there are lots of new ideas for alternative retirement saving vehicles, many of them represented here today. The council has actively participated in the Conversation on Coverage and applauds the conversations and others' important contributions to the discussion on coverage.

The council, however, believes that the current voluntary system has many valuable plan designs as well, both personal and employer-sponsored, that hold promise for retirement plan coverage in the future, and we urge policymakers to both look at new vehicles and to continuously evaluate how government can make the rules governing existing plans more administrable.

Third, debate as to which type of plan is preferable, defined benefits or defined contributions, focuses on the wrong question. Both types of plans serve a valuable purpose, and the more important

question is how to make those plan designs more workable so employers will feel comfortable maintaining them.

We are gratified that many defined contribution proposals included in Safe and Sound were incorporated in the Pension Protection Act, including automatic enrollment in 401(k) plans and the delivery of investment advice in the workplace, as well as making permanent the retirement provisions of the 2001 EGTTRA law. This included the catch-up contribution you may be familiar with for those people who are age 50 and older.

We believe these changes will foster greater retirement plan coverage. However, Congress must be wary not to inadvertently discourage defined contribution plans, such as 401(k) plans, either through excessive new regulation or exposure to liability.

To the extent that the country does transition for greater use of defined contribution plans, we encourage Congress to consider access to, and incorporation of, defined benefit pension features that promote retirement security. Of course, one area for which Congress deserves much credit is the confirmation of the legitimacy of cash balance in other hybrid plan designs. Congress made clear that the future of the defined benefit plan system may well fall within the hybrid plan model.

Unfortunately, Congress's intent is being undermined by regulatory interpretations that discourage hybrid plan sponsorship, including the fact that some of the most participant-favorable transition rules are being questioned on audits. Congress must send another clear and unequivocal message that this is not the result intended.

Fourth, health care coverage is an essential component of personal financial security, and health care costs are inextricably connected to retirement security, since it does use up dollars that would otherwise be used for retirement income purposes. Neither employees, nor workers, nor Congress can consider health and retirement as separate silos.

If you will bear with me, I have one last point.

Finally, policymakers should not allow federal tax revenue projections to dictate retirement policy. The tax preferences accorded private retirement plans make possible a level of retirement income that would be far more costly if provided through a vastly expanded Social Security or other government-provided retirement system. Our retirement system is a great bargain for all of us.

Thank you, and I would be happy to answer questions.

[The statement of Ms. Dudley follows:]

Prepared Statement of Lynn Dudley, Vice President, Retirement Policy, American Benefits Council

Mr. Chairman, thank you for the opportunity to appear before this Subcommittee. My name is Lynn Dudley, Vice President, Retirement Policy for the American Benefits Council. The Council is a public policy organization representing principally large companies and other organizations that assist employers of all sizes in providing benefits to employees. Our members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

Mr. Chairman, I commend you and Ranking Member Kline for your leadership in retirement policy. Your knowledge and commitment contribute enormously to a successful voluntary employer-based retirement system that provides a secure retirement for millions of workers and their families. I also commend you and the other Members of the Committee for shining the spotlight on the need to improve retirement coverage for future generations. The Council's members offer some of the

most generous health and retirement benefits programs available to workers, but remain committed to addressing the continuing problem of coverage among employees of other organizations. Retirement plan coverage is integral to achieving personal financial security. Achieving personal financial security provides employees and their families the ability to successfully meet both their retirement and health care needs.

We urge you to continue to be active in fostering policies that encourage American employers to offer retirement programs to their employees. The voluntary employer-sponsored retirement system is a bright spot on the savings landscape. As of 2005 (the most recent year for which data is available), American families had accumulated more than $14 trillion in retirement. This tremendous pool of capital is an essential source of retirement income security for millions of Americans and a major driver of the U.S. economy. The nation's private sector defined benefit pension system provides coverage to one-fifth of all working Americans, totaling nearly $2.3 trillion in assets, and remains a cornerstone retirement program for many. Meanwhile, the defined contribution plan system has expanded over the last 20 years, now covering more than half of all working Americans, and represents a great source of retirement income security. Financial assets in 401(k) and similar defined contribution plans now total almost $3.3 trillion.

While individuals can save on their own without an employer-sponsored plan, savings rates are much higher when employees have the opportunity to save through an employer plan. Though there are proposals for designs that would create new universal retirement vehicles, the value of the role of the employer who has designed a plan with a specific workforce in mind should not be underestimated. While there is a certainly a role for personal non-workplace savings vehicles in achieving personal financial security, we firmly believe more can and should be done to promote the voluntary establishment and maintenance of retirement plans by employers.

In 2004, the Council released a long-term public policy strategic plan, Safe and Sound: A Ten-Year Plan for Promoting Personal Financial Security, which is attached to this testimony. It assembles in one document a comprehensive analysis of the dimensions of the health, retirement and demographic challenges facing our nation. The report sets forth very specific measurable goals for the retirement (and health benefits) system to be achieved by the year 2014. During the last Congress, we saw the passage of the Pension Protection Act which contained a number of very important changes to the rules governing retirement plans, many of which were advocated by the Council, including the permanence of EGTRRA dollar limits applicable to retirement plans, the promotion of automatic enrollment and automatic increase features and access to investment advice. Safe and Sound contains additional important recommendations we believe will lead to greater coverage of workers in employment-based retirement plans and increased savings by those that are covered.

Employment-Based Retirement Plans Increase Savings

The success of the employment-based retirement system at spurring employee savings, even when not supplemented by employer contributions or other employer-funded benefits, is largely attributable to the characteristics of the employment setting. For example, savings are greatly enhanced by the opportunity for payroll deduction. If workers can elect to have a portion of their pay regularly set aside for savings, rather than having to affirmatively make a decision to set aside funds, it is clear that more is saved. Further, pooling money in employer-sponsored retirement savings vehicles enables individual participants to benefit from economies of scale and to lower their transaction costs, thereby increasing asset accumulation and wealth.

That the system has been a success with respect to spurring savings is nearly indisputable. Of the $14 trillion in the U.S. retirement system in 2005, more than $5.5 trillion had been put aside through the use of private employer-sponsored retirement plans, including defined benefit and defined contribution plans. An additional $3.7 trillion had been collected through the use of federal, state and local government plans and individuals had accumulated more than $3.5 trillion in IRAs—amounts which are largely attributable to rollovers from employment-based plans. While some of these funds undoubtedly would otherwise have been contributed to other types of accounts, it seems apparent that much of the savings in the U.S. retirement system is new savings.

Many of the new individual savings programs that have been proposed are modeled on this idea and include payroll deduction and pooled money. Their proponents' goals, like the Council's, are to improve savings opportunities and coverage. Virtually all Council members already sponsor retirement programs that provide very

meaningful benefits across the income spectrum. Any new savings vehicles need to complement the employer-based system. New ideas should not be structured so as to undermine the maintenance of retirement plans by employers and participation in employer-based plans by employees. Policymakers need to weigh the objectives of new proposals with an eye towards (1) whether they create new savings or pull savings away from existing retirement vehicles, (2) whether they create new administrative complexities, and (3) whether they replace savings features carefully designed for a particular workforce with savings features based on bureaucratic determinations far removed from the people they are intended to help.

American workers value their employer-sponsored retirement plans and so do American businesses. A recent survey by Watson Wyatt concluded that an attractive retirement plan plays a significant role both in attracting and retaining employees. Employers of all sizes have an interest in attracting and retaining workers and voluntarily offer retirement plans to meet these challenges. Additionally, evidence indicates that satisfaction with retirement plans increases worker productivity and improves shareholder returns. These are powerful business incentives upon which employers—given a good regulatory and legal framework—are likely to act.

It has been suggested that the size of the employer and the income range of the workers are often determinative of the employer's commitment to maintaining a plan. However, we believe employers of all sizes have reasons to attract and retain talented workers. It is simply that there are unique issues that affect small employers' decisions about retirement plans that have more to do with capital needs and stability in their business. Once stable, there is every reason to believe that small employers would be interested in maintaining a retirement plan for their workers. In addition, we find that plan sponsors provide retirement plans even where significant portions of their workforces have more modest incomes.

However, the voluntary retirement system involves a careful balancing of interests designed to encourage employers to maintain plans while ensuring that retirement savings are accumulated for the benefit of workers at all income levels. Generally, this entails not overburdening the sponsors with costs, complexities or administrative burdens and yet providing reasonably objective criteria for determining whether plans are providing widespread coverage. Increasingly, concerns about unanticipated liability are playing an important role in the decision as to whether to offer a retirement plan.

For many workers who are living from paycheck to paycheck, the savings created by employer contributions and other employer-funded benefits are their only savings. For others, matching contributions offer an important incentive to save more. Even for active savers, the convenience of payroll deduction encourages greater savings. In one recent study conducted on behalf of the National Bureau of Economic Research (NBER), economists found that in addition to increasing retirement savings, employer-sponsored retirement plans significantly increase overall savings. The study even suggests that having a retirement plan may "induce an increase in the holding of other assets," thereby resulting in a further increase in total savings.

In this regard, the employment-based retirement system serves two essential public policy goals. It increases overall capital accumulation and wealth, and it enhances retirement security of American families. In both respects, the U.S. retirement system has been an enormous success.

Recent Law Changes Encourage Coverage

We believe the recent passage of the Pension Protection Act (PPA), including the permanence of EGTRRA contribution limits coupled with provisions promoting automatic enrollment and automatic increase designs, will significantly improve coverage amongst employees that have access to a retirement plan but do not take advantage of it and will increase the employees' savings levels. According to a recent survey conducted by Hewitt Associates, 36 percent of plan sponsors offered automatic enrollment to new employees in 2007, with more than half of the remainder very or somewhat likely to implement it within the year.

Expanding access to investment advice in the PPA was also an enormously important step. It will improve participation amongst employees who have access to a retirement plan and will contribute significantly to a culture of savings that helps employees remain committed to savings programs and increased savings levels. We applaud the leadership of Congress and this Committee in the efforts to expand access to investment advice while ensuring appropriate protections for employees using the advice. We also commend the sensitivity to the importance of limiting plan sponsors' exposure to fiduciary liability in connection with the provision of such advice in the workplace.

However, more can and should be done to expand the number of employers maintaining retirement plans and to encourage employers to remain in the system. This

is not limited to small employers where there is less likely a retirement plan already being sponsored. Small start-up companies often do have the fundamental issues associated with worrying about sufficient capitalization and stability of their business. However, all employers are struggling with the current health care system. The health care issues are inextricably related to a successful employer-sponsored retirement system. Addressing the spiraling health care costs and quality issues will free resources of both employers and employees currently being drained to pay for health care. Finally, in addressing retirement plan coverage, the need for integrated savings and benefit vehicles that address growing longevity and retiree health needs cannot be ignored.

The nine aspirational goals contained in Safe and Sound to be achieved within 10 years, would greatly improve the benefit security of the American workforce, and would strengthen overall personal financial security. They include goals relating both to retirement income and goals relating to improving the ability of the individual to meet health care needs as they arise. While all of the goals and recommendations included within the report are important elements of the Council's vision for the future, I would like to focus specifically on two of them in this testimony.

Raise Financial Literacy

The first goal relates to enhancing financial literacy. Specifically, Safe and Sound states the following goal:, "by 2014, virtually all households will have access to some form of investment education and advice and 75 percent of households will have calculated the amount of retirement savings needed to maintain their standard of living throughout retirement, as well as the savings rate necessary to achieve this target."

One of the most basic elements of savings is understanding the need to save. Yet financial literacy is deficient across all generations and socio-economic levels. The National Council for Economic Education Studies (NCEE) reports that nearly two thirds of American adults and students do not understand basic economic principles such as "inflation."

One aspect of financial literacy is understanding how much one needs to save to reach one's retirement goals. The goal of 75 percent was chosen because it represented a significant increase from the peak level reported in the 2000 Retirement Confidence Survey conducted by the Employee Benefit Research Institute (EBRI). The 2007 Retirement Confidence Survey by the Employee Benefit Research Institute (EBRI) underscores the continuing need to promote financial literacy, noting that the majority of Americans—57 percent—have not calculated how much money they will need to save in order to live comfortably in retirement. Of those individuals that have considered retirement, data from the survey suggests that many of these individuals may be underestimating how much savings they will need for a secure retirement. The calculation regarding the amount needed to save was chosen as a critical benchmark because it indicates that a worker has achieved enough financial literacy to begin retirement planning and is prepared to take steps to act on what has been learned.

Another aspect of financial literacy is managing the investment of retirement assets. Many lack the knowledge necessary to make prudent investment decisions. Even participants who are relatively knowledgeable may lack the time to make and update investment decisions in a consistent and well-informed manner. While the number of people who have access to investment advice is small, it is growing. According to a Hewitt Associates 2007 survey, 31 percent of the employers surveyed offer investment education (education regarding asset class allocation) and 30 percent offer third-party investment advice. However, of the employers who do not currently offer either "education" or "advice," 59 percent and 52 percent, respectively, indicated they were somewhat likely to begin offering it in 2007. We believe, however, that offering advice is a first step in a two step process. The participants have to avail themselves of the advice and then act on it. As regulations are issued in this area and more employers adopt investment advice, we look forward to continuing to work with policymakers to consider ways in which the government and employers can partner to encourage use of these important programs.

It is clear that savings would be materially enhanced if Americans were more financially literate. Listed below are initial policy recommendations drawn from Safe and Sound for achieving the goal of raising financial literacy.

Policy Recommendations

• Support efforts to expand financial education. Provide public sector and private foundation funding to develop educational tools that can be used by employers, the government and other stakeholders in educating workers about saving, investment

and income management principles. First and foremost, the value of participating in employer-sponsored and individual savings programs needs to be emphasized. Education efforts should also include information about the impact of debt and the trade-offs of spending versus saving. Fundamental is the amount needed to be saved and the level of replacement income likely to be needed. Education must include information about the longer life spans people are expected to have in the future, how working longer in the same or another job can enhance savings and how workers can financially prepare for longevity risk.

• Establish financial literacy educational requirements. Financial education should be a high school and college graduation requirement. More states need to be encouraged to adopt financial literacy requirements.

• Promote a focus on retirement planning. Include in the Social Security Administration annual statement mailed to workers information on how to calculate a rough estimate of the amount one needs to save that, when combined with one's projected Social Security benefit, will provide a replacement income of 70 percent of one's pre-retirement earnings (generally considered a benchmark goal of income replacement).

Increase the Share of Workers in Workplace Retirement Plans

Safe and Sound's second goal is to increase employer-sponsored retirement plan coverage and participation. Specifically the goal states that: "by 2014, 96 million (74 percent) of full-time and part-time private sector employees will participate in workplace retirement plans." According to the most recent federal data from a survey of employers, about 74 million full-time and part-time private sector workers in 2006—approximately 51 percent of 146 million workers—were covered by a workplace retirement plan.

If participation is to increase, more employers will have to offer retirement plans. This outcome, in turn, depends on devising innovative and flexible plans that are attractive to employers, especially small- and mid-sized businesses.

Defined benefit plans remain a critical part of how many large and mid-sized employers provide retirement security to their workers. All types of defined benefit plans, including hybrid plans, can play a role in increasing participation rates in workplace retirement plans. To the extent that new, innovative hybrid designs can attract more employers to offer defined benefit plans or plans with defined benefit type features, it can help increase both coverage and participation rates. In this regard, it is critical that workable regulations relating to defined benefit pension plans and hybrid plans that implement the intent of Congress in the Pension Protection Act be issued.

Enrolling more employees in defined benefit plans of various designs can provide more workers a guaranteed income in retirement. We are supportive of simplified designs that address employer concerns about volatility and administrative complexity in addition to efforts to support existing arrangements already covering millions of workers.

For many employers, the defined contribution plan design provides flexibility and allows for a more active role for employees in preparing for retirement. Recognizing that even sponsorship of a defined contribution plan is a significant commitment with respect to cost, administration and liability, the Council continues to be supportive of improving simplified defined contribution plans, such as SIMPLE IRAs, that ease employers into the voluntary system without overburdening them with excessive requirements. We believe improvements can be made to these programs to facilitate their use among small employers.

In addition, we believe there is reason to support inclusion in our overall retirement system of an additional savings mechanism that would ensure continuous coverage for individuals, but we recognize it raises numerous administrative questions and problems including the management of very small accounts and the identification and location of missing participants.

Listed below are initial policy recommendations drawn from Safe and Sound for achieving the goal of increasing the number of workers in employer-sponsored retirement plans.

Policy Recommendations

• Provide a "clearinghouse" plan. Authorize the creation of a "clearinghouse" model plan through federal legislation so workers who change jobs frequently can contribute to one retirement plan. This plan would be modeled on a multi-employer plan model that could provide individuals with one account that would stay with them when they change jobs. Employer contributions to the plan would be voluntary and no financial or administrative requirements would be imposed on employers (other than transferring worker contributions to the plan). This model plan would accept differing levels of employee contributions and employer contributions, and

would be able to accommodate different investment vehicles. Any financial services firm meeting certain qualification criteria would be able to offer the "clearinghouse" model plan. Facilitate new models for retirement. The Pension Protection Act reduced the age at which employees can begin receiving retirement benefits and remain employed. More should be done, however, to encourage flexible working relationships and benefits arrangements through phased retirement programs.

Conclusion

The current voluntary employer-sponsored retirement system has been an enormous success. While individuals can save on their own without an employer-sponsored plan, savings rates are much higher when employees have the opportunity to save through an employer-provided plan. A broad array of demographic, workplace and economic changes in the decade ahead will provide challenges to personal financial security and the employment-based retirement system. These challenges include the aging of America, changes in the composition of the workforce, evolving changes in social structure and families, and continuously rising health care costs.

Our nation's employer-based retirement system will continue to be an engine for increased retirement coverage and retirement security if policymakers remain committed to partnering with business to ensure a legal and regulatory framework that both promotes establishment and maintenance of retirement plans by employers and fosters education of Americans on the importance of personal financial security.

Chairman ANDREWS. Thank you, Ms. Dudley.

Now my understanding is that Mr. Iwry, who is from Brookings, and Mr. John from Heritage are going to share 5 minutes. I think that is remarkable in and of itself. [Laughter.]

I think that is great. So anything the two of you need to say must be very profound and important, as I know your statements were. So, please, proceed.

STATEMENT OF MARK IWRY, MANAGING DIRECTOR, RETIREMENT SECURITY PROJECT

Mr. IWRY. Mr. Chairman, thank you. It is good to be with you again. Mr. Kline, distinguished members.

And, Mr. Chairman, you are right. The medium is the message here to a great extent. In addition to our Brookings and Heritage affiliations respectively, David John and I are both principals of a nonprofit Retirement Security Project, a Brookings-Georgetown University partnership, which is supported by the Pew Charitable Trust, and we are here to present a joint proposal, the automatic IRA, which Mr. Calabrese has referred to, that is intended to create common ground but transcends partisan or ideological differences.

Mr. Neal, Mr. English, Mr. Emanuel and others have introduced H.R. 2167, and a companion Senate bill has been introduced, the Automatic IRA Act of 2007, that combines the basic building blocks that we have seen work effectively in our current private pension system.

One of those is saving through 401(k)-type payroll deposits, a second is automatic enrollment which we have already started talking about today, and a third is IRAs. The IRAs are eminently portable, they make sense in a market-led proposal, such as this one, and they have a $5,000 maximum contribution starting in 2008 which is high enough to serve the needs of most Americans.

The average 401(k) contribution for people who could contribute up to $15,500, the average, is less than $3,000. So $5,000 is ample for most folks. But it is low enough—and, Mr. Kline, this goes to your do no harm point in your introductory remarks—to avoid com-

peting with employer plans or encouraging any employers that have a 401(k) or even a SIMPLE IRA plan to drop it in favor of this sort of universal coverage vehicle. Employer plans allow employees and employers combined to contribute up to $45,000 a year, compared to the IRA $5,000 starting next year.

We would give those 69 million people you referred to, Mr. Chairman, and, as you say, it has grown some. We think it is 75 million, actually about 78 million by 2007, unfortunately. These people have no employer-sponsored plan, the opportunity through automatic enrollment to save and build wealth using their employer's payroll system to send their own pay to an IRA.

And to accomplish that, we would call upon employers, the ones that are not able or willing to sponsor a plan for their employees now, not in neither a 401(k), nor a DB, nor anything else, and that have more than 10 employees and that have been in business for at least a couple of years. We would call upon those employers to act as a forwarding agent, a conduit, for their employees' contributions to IRAs.

[The joint statement of Mr. Iwry and Mr. John follows:]

Prepared Statement of David C. John and J. Mark Iwry, Managing Directors, the Retirement Security Project

Chairman Andrews and Ranking Member Kline, we appreciate the opportunity to testify before you.[1] We are submitting our testimony as a single joint statement because we believe strongly in the need for a common strategy to expand retirement savings in a manner that transcends ideological and partisan differences.

Our statement focuses on our joint proposal—introduced as H.R. 2167 and S. 1141—to expand retirement savings for small business workers—the Automatic IRA.[2] We are pleased by the positive reaction the proposal has received and are grateful to our colleagues, including those in government and in various stakeholder organizations, who have contributed to these ideas.[3]

With the looming retirement security crisis facing our country, policy-makers from both parties are focused on ways to strengthen pensions and increase savings. Our proposal 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.[4] It would enable these employees to save for retirement by allowing them to have their employers regularly transfer amounts from their paycheck to an IRA.

These people—half of our workforce—have no effective way to save at work. This fact, a national saving rate that has been declining steadily 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, which we call the "automatic IRA."

We are by no means suggesting that the automatic IRA proposal is the only step that should be taken to expand retirement savings for small business workers or others. In fact, we have long believed in the primacy of employer-sponsored retirement plans as vehicles for pension coverage.[5] Additionally, the Retirement Security Project continues to advocate strongly for the expansion of pension coverage through automatic features in 401(k) and similar retirement savings plans[6] 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.[7]

Making saving easier by making it automatic has been shown to be remarkably effective at boosting participation in 401(k) plans, but roughly half of U.S. workers are not offered a 401(k) or any other type of employer-sponsored plan. We would 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 approach we propose offers most employees not covered by an 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 should involve no out of pocket cost. In addition, the arrangement is market-oriented and realistic: it uses a well estab-

lished and familiar vehicle, IRAs, provided by the same banks, mutual funds, insurance carriers, brokerage firms, credit unions, and other private financial institutions that currently provide them. As a fallback, if individuals or employers could not find an acceptable 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 or another nonprofit or government-contracted entity that contracts out asset management and other functions to the private sector.

The Basic Problem

In 2004 half of all households headed by adults aged 55 to 59 had $13,000 or less in an employer-based 401(k)-type plan or tax-preferred saving plan account.[8] The U.S. personal saving rate has declined steadily over the last two decades and has been negative since 2005.[9]

Moreover, traditional corporate defined benefit pension plans are declining, and few expect Social Security to provide increased benefits in the future. The households that tend to be in the best financial position to confront retirement are the 41 percent of the workforce that participate in an employer-sponsored retirement plan.[10]

The most vulnerable employees are those lacking access to an employer-sponsored plan. In a recent survey conducted by AARP with 700 private sector workers at companies with 10-250 employees that do not offer a 401(k) or some other retirement plan, fewer than half of these workers without access to an employer plan said they had taken the following actions: Saved money in a non-retirement account (45%); Saved money in a retirement account (35%); Read articles or other information about retirement (35%); Talked with friends, relatives, and/or coworkers about retirement (31%); Used a retirement calculator (14%).[11]

Generally, the rate of participation (those who contribute as a percentage of those who are eligible) for 401(k) plans is on the order of 7 or 8 out of 10. An increasing share of plans are including automatic features that make saving easier and raise participation, often to levels exceeding 9 out of 10. While more can and should be done to expand 401(k) and other employer plan coverage,[12] the fraction of the workforce that is covered by employer plans has hovered around half for at least three decades. The uncovered employees have no effective way to save at work. IRAs do not cover enough people because many fail to exercise the initiative required to make the decisions and take the actions necessary to save in an IRA. More broadly, many people find it too difficult or lack the financial sophistication to plan for retirement and defer consumption. As a result, only about 1 in 10 eligible individuals contributes to an IRA.

The AARP-commissioned study also shows that workers at companies that would be covered by the Auto IRA legislation favor the concept of automatic IRAs and are likely to participate: Over seven in ten (71%) of those without access to an employer-provided retirement savings plan agree that "employers who do not offer a 401(k) or other retirement plan should be required by law to offer workers the option to regularly save a part of their paycheck in an individual retirement account" and nearly eight in ten (79%) of those without access say they would be likely to participate if their company offered them the option to regularly save a part of their paycheck in an IRA through payroll deduction.

The Automatic IRA

The automatic IRA approach is intended to help households overcome the barriers to saving by building on the successful use in 401(k) plans of automatic features which encourage employees toward sensible decisions while allowing them to make alternative choices. The automatic IRA would feature direct payroll deposits to a low-cost, diversified IRA. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years but that still do not sponsor any plan for their employees would be called upon to offer employees this payroll-deduction saving option. The automatic IRA would apply many of the lessons learned from 401(k) plans so that more workers could enjoy automated saving to build assets—without imposing any significant burden on employers. Employers that do not sponsor plans for their employees could facilitate saving—without sponsoring a plan, without making employer matching contributions, and without complying with plan qualification or fiduciary standards. They would simply offer to act as a conduit, remitting a portion of employees' pay to an IRA, preferably by direct deposit, at little or no cost to the employer.

The automatic IRA is also designed to address the concern that financial providers have found it less profitable to serve groups of people with a small average account size. The proposal would provide a backstop arrangement contracted to the

private sector that would give an option to any employee groups that the financial services industry is not currently interested in serving.

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.[13] 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, we propose a new strategy designed to induce employers to offer, and employees to take up, direct deposit or payroll deposit saving. For many if not most employers, offering direct deposit or payroll deduction IRAs would involve little or no cost. 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[14] 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.

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) tax from employees' pay (based partly on employee elections on IRS Form W-4) and remitting those amounts to the federal tax deposit system.

Tax Credit for Employers that Serve as Conduit for Employee Contributions

Firms that do not provide employees a qualified retirement plan, such as a pension, profit-sharing, or 401(k) plan, would be given a temporary tax credit to establish automatic IRAs. The tax credit would be available to a firm for the first two years in which it offered payroll deposit saving to an IRA and 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 payroll deposit and to very small or new firms that are not required to but do so voluntarily.

Tax 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, the automatic IRA tax credit would be lower, e.g. $25 per employee enrolled, capped at $250 in the aggregate per employer. Employers could not claim both the new plan startup credit and the proposed automatic IRA credit.

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 IRA would entail no additional cost, even in the short term. A large proportion of the employers that still process their payroll by hand would be exempted under the exception for very small employers. As a result, our 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. Employers that do not use electronic payroll would have the option of "piggybacking" the payroll deposits to IRAs onto the federal tax deposits they currently make, whether online, by mail, or by delivery to the local bank.

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 retire-

ment 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.[15]

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 generally would be tax-favored. It either would be a contribution to a Roth IRA, which receives tax-favored treatment upon distribution, or a "pre-tax" contribution to a traditional, tax-deductible IRA. To spare households the need to undertake the comparative analysis of Roth versus traditional IRA, one or the other would be the default or presumptive choice. Of course, presented with an automatic or standard option, many households will simply go along with it, while others will consider whether to choose the other alternative. Accordingly, the automatic approach strikes a balance between simplicity and individual choice. In either case, the use of IRAs maximizes portability of savings. IRAs generally continue in existence without 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

Obstacles to Participation

Today, individuals who want to save in an IRA must make a variety of decisions to open an account. In addition, they must overcome a natural tendency to delay making important decisions until the last minute. 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.

Automatic Enrollment or an Explicit "Up or Down" Employee Election

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.[16] In view of the basic similarities between employee payroll-deduction saving in a 401(k) and under a direct deposit IRA arrangement, the law should, at a minimum, permit employers to automatically enroll employees in direct deposit IRAs.

However, simply allowing employers to use automatic enrollment with direct deposit IRAs may not be enough. Requiring employers to use automatic enrollment in conjunction with the payroll deduction IRAs (with a tax credit and legal protections) likely would increase participation dramatically while preserving employee choice. However, a workforce that presumably has not shown sufficient demand for a retirement plan to induce the employer to offer one might react unfavorably to being automatically enrolled in direct deposit savings without a matching contribution. In addition, some small business owners who work with all of their employees closely each day might regard automatic enrollment as unnecessary.

Accordingly, automatic enrollment would be the presumptive or standard enrollment method, but 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 an election that explicitly either accepts or declines payroll deposit to an 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.[17] Any employee who fails to comply with the election requirement is automatically enrolled. In either case, to maximize participation, employers receive a standard enrollment module reflecting current best practices in enrollment procedures.[18]

In addition, employees like automatic enrollment. Retirement Made Simpler—a coalition of advocacy, regulatory and policy organizations, including AARP, the Financial Industry Regulatory Authority (FINRA), and the Retirement Security Project (RSP)—was launched to encourage employers to help their employees be better prepared financially for retirement. Retirement Made Simpler recently released a survey on employee satisfaction with automatic enrollment. The survey, a first of

its kind, reached out to employees who work at firms that use automatic enrollment. The results are striking. Of these employees, 97% agreed that they were satisfied with automatic enrollment, and 74% of them were "very satisfied." Agreement that automatic 401(k) has helped them start saving for retirement earlier than planned is 85%, with 62% at "Strongly agree". And agreement that automatic enrollment has made saving for retirement easy is 95%, with 71% at "Strongly agree." Even among those who opted out of their company's 401(k) plan, a full 79% were glad their company offered automatic enrollment to employees.

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. If the employer chose to use automatic enrollment, the notice would also inform 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 in the payroll deduction saving. Employers would be required to certify annually to the IRS that they were in compliance with the payroll deposit saving requirements.[19]

Making a Saving Vehicle Available To Everyone

Under the automatic IRA, individuals who wish to direct their contributions to a specific IRA can do so. To make this happen, the employer has the option of either

- following employee directions as is ordinarily done when employers make direct deposits of paychecks to accounts specified by employees, or
- remitting all employee contributions in the first instance to IRAs at a single private financial institution (chosen by the employer), from which employees can transfer the contributions, without cost, to their own IRA.

However, if an employer or employees could not find an IRA provider willing to serve their market for an acceptably low fee, they could resort to a standard fallback IRA account, as described below.

A Low-Cost Standard Automatic Account

The fallback arrangement, which might take the form of an industry consortium or nonprofit organization, would make a standard IRA account automatically available to receive direct deposit contributions from employees. These accounts would be maintained and operated by private financial institutions under contract with the federal government. By contrast to the wide-open array of investment options provided in most current IRAs (which can be daunting for many savers) and the high (and costlier) level of customer service provided in many 401(k) plans, the standard account would provide only a few investment options (to maximize economies of scale and reduce cost). It would permit individuals to change their investments only once or twice a year, and would emphasize transparency of investment and other fees and expenses. Like the investment options under the federal Thrift Savings Plan for federal employees, it is contemplated that costs would be minimized through the use of passive investments such as index funds provided and managed by private financial institutions. This would not limit anyone's choices: individuals who preferred other IRA investments could simply continue contributing to an IRA outside the context of these proposed new arrangements.

Automatic Investment Fund Choice

The IRAs selected by employees or employers from among those offered by private financial institutions as well as the fallback standard IRAs would provide low-cost professional asset management to millions of savers, with a view to improving their aggregate investment results. To that end, these IRAs would offer an automatic or default investment fund (generally similar, at least initially, to the kinds of investments described as "Qualified Default Investment Alternatives" in Department of Labor regulations)[20] for all deposits unless the individual chose otherwise. This automatic investment choice could be a highly diversified "target asset allocation" or "life-cycle" fund comprised of a mix of equities and fixed income or stable value investments, and probably relying heavily on index funds. It could also make available some elements of guarantee against loss of principal, in exchange for a limited reduction in the rate of return. Because it is desirable to maintain a degree of flexibility in order to accommodate and reflect market creativity, best practices, and the evolving consensus of expert financial advice over time, the proposed legislation would not fully specify the automatic investment. General statutory guidelines would be fleshed out at the administrative level after a process of extensive consultation with private-sector investment experts. In addition, the IRAs employees or

employers select from private financial institutions would also offer at least a few investment alternatives, consistent with normal market practice, but would not be limited to any prescribed array of investment options.

Employers Protected from any Risk of Fiduciary Liability

Employers making payroll deposits would be insulated from potential liability or fiduciary responsibility with respect to the manner in which direct deposits are invested in automatic IRAs, regardless of whether the IRA provider is selected by the employer or the employee. Nor would employers be exposed to potential liability with respect to any employee's choice of IRA provider or type of IRA. This protection of employers would be facilitated by regulatory designation of standard investment types that reduces the need for continuous professional investment advice. In addition, employers could avoid responsibility even for the selection of an IRA provider for their employees by allowing employees to designate their preferred IRA providers (or by specifying the government-contracted fallback automatic IRA).

The Importance of Protecting Employer Plans

The automatic IRA proposal 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 $4,000 (for 2007; $5,000 beginning in 2008, 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 $15,500 of their own salary to a 401(k) (or $20,500 if age 50 or older) plus matching or nonmatching employer contributions that can bring the total annual 401(k) contributions on their behalf to $45,000 a year ($46,000 in 2008).[21] In addition, by design, the employer tax credit for providing access to automatic IRAs is significantly less than 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 does not allow employer contributions. Second, the automatic IRA gives consultants, third-party administrators, financial institutions, and other plan providers a new way to penetrate the small business pension market with 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.

Encouraging Contributions by the Self-Employed and Independent Contractors

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

- Expanding access to automatic debit arrangements, including through professional and trade associations that could help arrange for automatic debit and direct deposit to IRAs. Automatic debit essentially replicates the power of payroll deduction insofar as it continues automatically once the individual has chosen to initiate it.
- Extending the payroll deposit option 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);
- Enabling taxpayers to direct the IRS to make direct deposit of a portion of their income tax refunds to an IRA (which became possible for the first time earlier this year); and
- Allowing the self-employed to transmit IRA deposits with their quarterly estimated income taxes.

Matching Deposits as a Financial Incentive

A powerful financial incentive for direct deposit saving by those who are not in the higher tax brackets (and who therefore derive little benefit from a tax deduction or exclusion) would be a matching deposit to their payroll deposit IRA. By increasing assets under management, a match would also increase private financial institutions' interest in providing IRAs. One means of delivering such a matching deposit would be via the financial institution that provides the payroll deposit IRA. For example, the first $500 contributed to an IRA by an individual who is eligible to make deductible contributions to an IRA might be matched by the private IRA provider on a dollar-for-dollar basis, and the next $1,000 of contributions might be matched at the rate of 50 cents on the dollar. The financial provider would be reimbursed for its matching contributions through federal income tax credits.[22]

Evidence from a randomized experiment involving matched contributions to IRAs suggests that a simple matching deposit to an IRA can make individuals significantly more likely to contribute and more likely to contribute larger amounts.[23] Matching contributions—similar to those provided by most 401(k) plan sponsors—not only would help induce individuals to contribute directly from their own pay, but also, if the match were automatically deposited in the IRA, would add to the amount saved in the IRA. The use of matching deposits would require procedures to prevent gaming—contributing to induce the matching deposit, then quickly withdrawing those contributions to retain the use of those funds.[24]

Guaranteed Lifetime Income

The automatic IRA could also serve as a natural platform or proving ground for best practices in retirement savings, possibly including, over time, 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 income. Yet most are reluctant to do so. The same automatic strategy used to promote enrollment and sensible investment could encourage more workers to obtain the security of an annuity or other guaranteed lifetime income, 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 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.[25]

As former Chair of the Council of Economic Advisers Laura Tyson pointed out in a Wall Street Journal op-ed article last week endorsing the automatic IRA, "[j]ust as the Automatic 401(k) and Automatic IRA would help to ensure that employees have enough retirement savings, automatic guaranteed lifetime income would help to ensure that they do not outlive their savings"[26] and have an income stream they can count on.

Conclusion

American households have a compelling need to increase their personal saving, especially for long-term needs such as retirement. This testimony summarizes a strategy to make saving more automatic—hence easier, more convenient, and more likely to occur. By adapting to the IRA universe practices and arrangements that have proven successful in promoting 401(k) participation, the automatic IRA approach holds considerable promise of expanding retirement saving for millions of workers.

ENDNOTES

[1] Mark Iwry is a Managing Director of the Retirement Security Project, a Nonresident Senior Fellow at the Brookings Institution, Research Professor at Georgetown University, and formerly the Benefits Tax Counsel, in charge of national private pension policy and regulation, at the U.S. Department of the Treasury. David John is a Managing Director of the Retirement Security Project and a Senior Research Fellow for Retirement Security and Financial Institutions at the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. (Biographical information attached and at footnote 5.)

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The views expressed in this testimony are those of the two witnesses and the Retirement Security Project, but should not be attributed to The Heritage Foundation, the Brookings Institution, Georgetown University's Public Policy Institute, The Pew Charitable Trusts, or any other organization.

[2] This testimony is based on a more detailed proposal the witnesses have set forth in a series of research and policy papers (see, e.g., Retirement Security Project Publication No. 2007-2 "Pursuing Universal Retirement Security through Automatic IRAs ") which are available at *www.retirementsecurityproject.org.* (Major portions of this testimony are taken verbatim from the witnesses' research and policy papers cited above.) The proposal has been introduced in the 110th Congress as the "Automatic IRA Act of 2007", H.R. 2167, sponsored by Rep. Richard Neal (D-MA) and Rep. Phil English (R-PA), and S. 1141, sponsored by Senators Jeff Bingaman (D-NM) and Gordon Smith (R-OR).

[3] See *http://www.retirementsecurityproject.org/pubs/File/AutoIRAQuoteSheetFinal7.6.07.pdf.* Crenshaw, Albert, "Automatic IRAs—a Quick Fix for Workers Without Pensions?" Washington Post, February 19, 2006; "The Way to Save" Editorial, New York Times, February 20, 2006; Bernard, Tara, "Groups Propose Payroll Deductions for IRAs," The Wall Street Journal, February 16, 2006; Editorial, Newsday, February 22, 2006; Marketwatch.com (February 16, 2006); Lambro, Donald, "A Broader Retirement Plan," The Washington Times, April 12, 2007; "Another Black Eye for H&R Block" Editorial, New York Times, March 18, 2006; Quinn, Jane Bryant, "A Nest Egg for Low Earners," Newsweek, February 26, 2007; Commission on the Regulation of U.S. Capital Markets in the 21st Century, Report and Recommendations, March 2007. The

automatic IRA proposal emerged as one of the leading recommendations of the 2006 National Summit on Retirement Savings (Saver Summit).

[4] Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2005: Employee Benefit Research Institute Issue Brief No. 299," November 2006 (referred to below as "Copeland, EBRI Issue Brief No. 299 "), Figure 1, p. 7. An additional 16 million workers either are not eligible for their employer's plan or are eligible but fail to participate. Similar but updated figures for 2006 are available in the Employee Benefit Research Institute Issue Brief 311.

[5] We have previously written and testified before Congress on various aspects of employer-sponsored retirement plans. David John has written and testified about the funding problems faced by defined benefit pension plans and about the United Kingdom's pension situation. Mark Iwry led the Executive Branch efforts in the 1990s to develop the SIMPLE plan for small business, the startup tax credit for small employers that adopt new plans, and the saver's credit for moderate- and lower-income workers, as well as the Executive Branch initiatives to define, approve and promote 401(k) automatic enrollment, automatic rollover to restrict pension leakage, and automatic 401(k) features generally. See also William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Saver's Credit" (The Retirement Security Project, Policy Brief No. 2005-2; available at *www.retirementsecurityproject.org*).

[6] William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Automatic 401(k): A Simple Way to Strengthen Retirement Savings," (The Retirement Security Project, Policy Brief No. 2005-1; available at *www.retirementsecurityproject.org*); William G. Gale and J. Mark Iwry, "Automatic Investment: Improving 401(k) Portfolio Investment Choices" (The Retirement Security Project, Policy Brief No. 2005-4; available at *www.retirementsecurityproject.org*).

See also the description of the joint AARP, FINRA, Retirement Security Project "Retirement Made Simpler" campaign on page 10, below.

[7] See, for example, the following (all of which are available at *www.retirementsecurityproject.org*): J. Mark Iwry, William Gale, and Peter Orszag, "The Potential Effects of Retirement Security Project Proposals on Private and National Saving: Exploratory Calculations," Retirement Security Project Policy Brief No. 2006-2; Peter Orszag and Eric Rodriguez, "Retirement for Latinos: Bolstering Coverage, Savings and Adequacy," Retirement Security Project Policy Brief No. 2005-7; William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Saver's Credit," Retirement Security Project Policy Brief No. 2005-2; J. Mark Iwry, "Using Tax Refunds to Increase Savings and Retirement Security," Retirement Security Project Policy Brief No. 2005-9; Peter Orszag, "Protecting Low-Income Families' Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving," Retirement Security Project Policy Brief No. 2005-6.

[8] Even among those households that had savings in 401(k)s and IRAs, the median account balance was only $69,000. Authors' calculations using the 2004 Survey of Consumer Finances.

[9] As measured in the National Income and Product Accounts.

[10] Copeland, EBRI Issue Brief No. 299, Figure 1, page 7. Similar but updated figures for 2006 are available in the Employee Benefit Research Institute Issue Brief 311.

[11] Thayer, Colette, "Automatic IRAs: Worker Attitudes and Likelihood of Participation," April 2007

[12] See William G. Gale, J. Mark Iwry, and Spencer Walters, The Pension Protection Act of 2006 and the Unfinished Agenda. (Retirement Security Project Publication No. 2007-1, April 2007).

[13] 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).

[14] Employee Retirement Income Security Act of 1974, as amended.

[15] 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.

[16] Brigitte Madrian and Dennis Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," Quarterly Journal of Economics 116, no. 4 (November 2001): 1149-87; and James Choi and others, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in Tax Policy and the Economy, vol. 16, edited by James Poterba (Cambridge, Mass.: MIT Press, 2002), pp. 67-113. See also Sarah Holden and Jack VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," Employee Benefit Research Institute Issue Brief No. 283 (July 2005).

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

[18] 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.

[19] This might be done in conjunction with the existing IRS Form W-3 that employers file annually to transmit Forms W-2 to the government. Failure to offer payroll deposit saving would ultimately be backed up by an excise tax similar to (but much lower than) that imposed for employer violations of the COBRA health care continuation coverage requirements. The intent is that employers would never have to pay such an excise tax; it is simply a deterrent to noncompliance, accompanied by a rather forgiving array of exceptions, opportunities for correction,

and relief for unintentional noncompliance that is generally patterned after the corresponding COBRA provisions. Compare Internal Revenue Code Section 4980B.

[20] "Default Investment Alternatives Under Participant Directed Individual Account Plans; Final Rule," Department of Labor Employee Benefits Security Administration, Federal Register (Vol. 72, No. 205), October 24, 2007. See also letter from J. Mark Iwry, Principal, Retirement Security Project, to Department of Labor Employee Benefits Security Administration, dated November 13, 2006 (available at *www.retirementsecurityproject.org*), commenting on the Department's proposed regulations.

[21] These 401(k) limits apply to both 2007 and 2008. IRA and 401(k) contribution limits (as well as the limits applicable to SIMPLE plans) are indexed for cost-of-living.

[22] This raises a number of issues. For further discussion, see discussion of proposed reforms of the Saver's Credit, e.g., William G. Gale, J. Mark Iwry, and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans" (Retirement Security Project Publication No. 2005-02, March 2005).

[23] Esther Duflo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block" (Retirement Security Project, May 2005).

[24] Among the possible approaches would be to place matching deposits in a separate sub-account subject to tight withdrawal rules and to impose a financial penalty on early withdrawals of matched contributions.

[25] Accordingly, H.R. 2167 and S. 1141 require a joint study by the Labor and Treasury Departments of the feasibility and desirability of promoting the use of low-cost annuities, longevity insurance, or other guaranteed lifetime income arrangements in automatic IRAs, including consideration of—(i) appropriate means of arranging for , or encouraging, individuals to receive at least a portion of their distributions in some form of low-cost guaranteed lifetime income, and (ii) issues presented by possible additional differences in, or uniformity of, provisions governing different IRAs. Section 4(b)(1)(B). The bills also would provide for a joint study of the feasibility and desirability of extending to automatic IRAs spousal consent requirements similar to, or based on, those that apply under the Federal employees' Thrift Savings Plan, including consideration of whether modifications of such requirements are necessary to apply them to automatic IRAs. Section 4(b)(1)(A).

[26] Laura D'Andrea Tyson, "Some No-Brainer Savings Ideas," Wall Street Journal, October 30, 2007, page A-18.

[Additional materials submitted by Mr. John follow:]

[Internet address to the Retirement Security Project policy brief, "Pursuing Universal Retirement Security Through Automatic IRAs," follows:]

http://www.retirementsecurityproject.org/pubs/File/RSPAutoIRALongpaperFINAL7.10.2007.pdf

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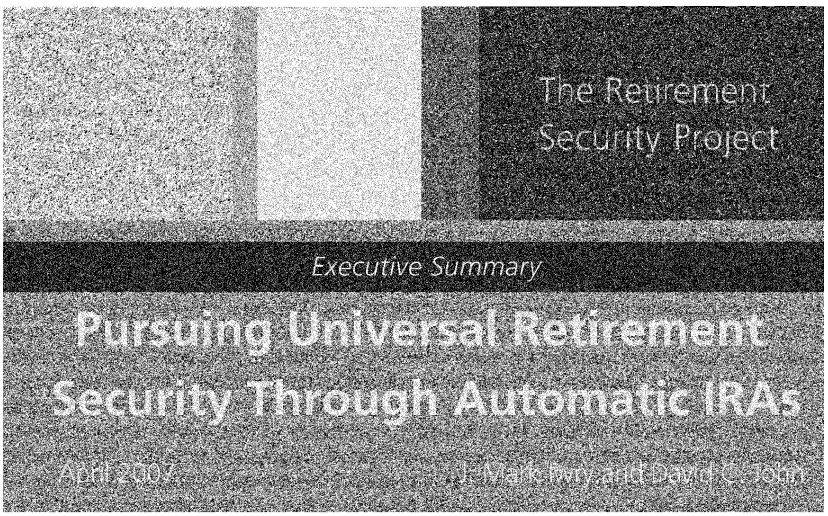
[Executive summary of the Retirement Security Project policy brief, "Pursuing Universal Retirement Security Through Automatic IRAs," follows:]



Introduction[1]

This paper summarizes an ambitious yet practical set of initiatives to expand dramatically retirement saving in the United States – especially for the 75 million Americans working for employers that do not offer a retirement plan.[2] These people – half of our workforce – have no effective way to save at work. This fact, a national saving rate that has been declining steadily 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, which we call the "automatic IRA."

Making saving easier by making it automatic has been shown to be remarkably effective at boosting participation in 401(k) plans, but roughly half of U.S. workers are not offered a 401(k) or any other type of employer-sponsored plan. We would 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 approach we propose offers most employees not covered by an employer-sponsored retirement plan the opportunity to save through the powerful mechanism of regular payroll deposits that continue automatically.[3] The employer's administrative functions are minimal and should involve no out of pocket cost. In addition, the arrangement is market-oriented: IRAs are provided by the same banks, mutual funds, insurance carriers, brokerage firms, credit unions, and other private financial institutions that currently provide them. As a fallback, individuals and employers who cannot find an acceptable IRA on the market can use ready-made, low-cost automatic IRA accounts provided by an entity somewhat similar to the federal employees' Thrift Savings Plan with asset management contracted out to the private sector.

RSP

The Basic Problem

In 2004 half of all households headed by adults aged 55 to 59 had $13,000 or less in an employer-based 401(k)-type plan or tax-preferred saving plan account.[3] The U.S. personal saving rate has declined steadily over the last two decades and has been negative since 2005.[4] Moreover, traditional corporate defined benefit pension plans are declining, and few expect Social Security to provide increased benefits in the future.

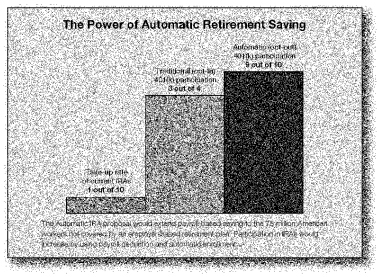
The households that tend to be in the best financial position to confront retirement are the 41 percent of the workforce that participate in an employer-sponsored retirement plan.[6] Generally, the rate of participation (those who contribute as a percentage of those who are eligible) for 401(k) plans is on the order of 7 or 8 out of 10. An increasing share of plans are including automatic features that make saving easier and raise participation, often to levels exceeding 9 out of 10. While more can and should be done to expand 401(k)-type plan coverage,[7] the fraction of the workforce that is covered by employer plans has hovered around half for at least three decades. The uncovered employees have no effective way to save at work.

IRAs do not cover enough people because many fail to exercise the initiative required to make the decisions and take the actions necessary to save in an IRA. More broadly, many people find it too difficult or lack the financial sophistication to plan for retirement and defer consumption. As a result, only about 1 in 10 eligible individuals contributes to an IRA.

The Automatic IRA

The automatic IRA approach is intended to help households overcome these barriers by building on the successful use in 401(k) plans of automatic features which encourage employees toward sensible decisions while allowing them to make alternative choices. The automatic IRA would feature direct payroll deposits to a low-cost, diversified IRA. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years but that still do not sponsor any plan for their employees would be called upon to offer employees this payroll-deduction saving option.

The automatic IRA would apply many of the lessons learned from 401(k) plans so that more workers could enjoy automated saving to build assets – without imposing any significant burden on employers. Employers that do not sponsor plans for their employees could facilitate saving – without sponsoring a plan, without making employer matching contributions, and without complying with plan qualification or fiduciary standards. They would simply offer to remit a portion of employees' pay to an IRA, preferably by direct deposit, at little or no cost to the employer.



The automatic IRA is also designed to address the concern that financial providers have found it less profitable to serve groups of people with a small average account size. The proposal would provide a backstop arrangement contracted to the private sector that would give an option to those employee groups that the financial services industry is not currently interested in serving.

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.[8] However, it appears that few employers actually have 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, we propose a new strategy designed to induce employers to offer, and employees to take up, direct deposit or payroll deposit saving. For many if not most employers, offering direct deposit or payroll deduction IRAs would involve little or no cost. 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[9] rules, (2) establish or maintain a trust to hold assets, (3) determine whether employees are actually eligible to contribute to an IRA, (4) select investments for employee contributions, (5) select among IRA providers, or (6) set up IRAs for employees. Employers would be required simply to allow employees to make a payroll-deduction deposit to IRAs and implement those deposits. Employers of course are already required to withhold income and payroll tax from employees' pay (based partly on employee elections on IRS Form W-4) and remit those amounts to the federal tax deposit system.

Tax Credit for Employers that Serve as Conduit for Employee Contributions

Firms that do not provide employees a qualified retirement plan, such as a pension, profit-sharing, or 401(k) plan, would be given a temporary tax credit to establish automatic IRAs. The tax credit would be available to a firm for the first two years in which it offered payroll deposit saving to an IRA and 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 payroll deposit and to very small or new firms that are not required to but do so voluntarily.

Small Business Credit

Under current law, a small business with fewer than 100 employees that adopts a new retirement plan for the first time can receive a tax credit for startup costs. The credit covers 50 percent of the cost of establishing and administering the plan (including educating employees about the plan) up to $500 per year for three years.

To maintain employer incentives to adopt an employer plan, the automatic IRA tax credit would be lower, e.g. $25 per employee enrolled, capped at $250 total. Employers could not claim both the new plan startup credit and the proposed automatic IRA credit.

For many if not most employers, offering direct deposit or payroll deduction IRAs would involve little or no cost.

The automatic IRA proposal is designed carefully to avoid competing with or crowding out employer plans.

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 IRA would entail no additional cost, even in the short term.

A large proportion of the employers that still process their payroll by hand would be exempted under the exception for very small employers. As a result, our 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. Employers that do not use electronic payroll could "piggyback" the payroll deposits to IRAs onto the federal tax deposits they currently make, whether online, by mail, or by delivery to the local bank.

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 under the qualified plan rules. However, an employer that limits retirement plan coverage to a portion of its workforce generally would be required to offer payroll deposit saving to the rest of the workforce.

Choice of Traditional Versus Roth IRA

Like a 401(k) contribution, the amount elected by the employee as a salary reduction contribution generally would be tax-favored. It either would be a "pre-tax" contribution to a traditional, tax-deductible IRA or a contribution to a Roth IRA, which instead receives tax-favored treatment upon distribution. To spare households the need to undertake the comparative analysis of Roth versus traditional IRA, one or the other would be the default or presumptive choice. Of course, presented with an automatic or standard option, many households will simply go along with it, while others will consider whether to choose the other alternative. Accordingly, the automatic approach strikes a balance between simplicity and individual choice.

Expanding Saving through Automatic Features

Obstacles to Participation

Today, individuals who want to save in an IRA must make a variety of decisions to open an account. In addition, they must overcome a natural tendency to delay making important decisions until the last minute. 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.

Automatic Enrollment or an Explicit "Up or Down" Employee Election

Automatic enrollment (more often applied to newly hired employees than to both new hires and other employees) has produced dramatic increases in 401(k) participation.[7] In view of the basic similarities between employee payroll-deduction saving in a 401(k) and under a direct deposit IRA arrangement, the law should, at a minimum, permit employers to automatically enroll employees in direct deposit IRAs.

However, simply *allowing* employers to use automatic enrollment with direct deposit IRAs may not be enough. Requiring employers to use automatic enrollment in conjunction with the payroll deduction IRAs (with a tax credit and legal protections) likely would increase participation dramatically while preserving employee choice. However, a workforce that presumably has not shown sufficient demand for a retirement plan to induce the employer to offer one might react unfavorably to being automatically enrolled in direct deposit savings without a matching contribution. In addition, some small business owners who work with all of their employees closely each day might regard automatic enrollment as unnecessary.

Accordingly, automatic enrollment would be the presumptive or standard enrollment method, but employers could opt out of it in favor of an alternative approach. The alternative requires all eligible employees to submit an election that explicitly either accepts or declines payroll deposit to an 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.[11] Any employee who fails to comply with the election requirement is automatically enrolled. In either case, to maximize participation, employers receive a standard enrollment module reflecting current best practices in enrollment procedures.[12]

Compliance and Enforcement

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. If the employer chose to use automatic enrollment, the notice would also inform 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 in the payroll deduction saving. Employers would be required to certify annually to the IRS that they were in compliance with the payroll deposit saving requirements.[13] Failure to offer payroll deposit saving would ultimately be backed up by an excise tax similar to (but lower than) that imposed for employer violations of the COBRA health care continuation coverage requirements.

Making a Saving Vehicle Available

Under the automatic IRA, individuals who wish to direct their contributions to a specific IRA can do so. To make this happen, the employer either

- follows employee directions as is ordinarily done when employers make direct deposits of paychecks to accounts specified by employees, or
- remits all employee contributions in the first instance to IRAs at a single private financial institution, from which employees can transfer the contributions, without cost, to their own IRA.

However, an employer or employees who cannot find an IRA provider willing to serve their market for an acceptably low fee could resort to a standard fallback IRA account that would in some respects resemble the federal employees' Thrift Savings Plan.

A Low-Cost Standard Automatic Account

The fallback arrangement, which might take the form of an industry consortium or nonprofit organization, would make a standard IRA account automatically available to receive direct deposit contributions from employees. These accounts would be maintained and operated by private financial institutions under contract with the federal government. By contrast to the wide-open investment options provided in most current IRAs and the high (and costlier) level of customer service

provided in many 401(k) plans, the standard account would provide only a few investment options (to maximize economics of scale and reduce cost), would permit individuals to change their investments only once or twice a year, and would emphasize transparency of investment and other fees and expenses.

Automatic Investment Fund Choice

The IRAs selected by employees or employers from among those offered by private financial institutions as well as the fallback standard IRAs would provide low-cost professional asset management to millions of savers, with a view to improving their aggregate investment results. To that end, all of these IRAs would offer an automatic or default investment fund (generally similar to the "Qualified Default Investment Alternatives" proposed in Department of Labor regulations)[14] for all deposits unless the individual chose otherwise. This automatic investment choice would at least initially be a highly diversified "target asset allocation" or "life-cycle" fund comprised of a mix of equities and fixed income or stable value investments, and probably relying heavily on index funds. Because it is desirable to maintain a degree of flexibility in order to reflect a consensus of expert financial advice over time, we would not fully specify the automatic investment by statute. General statutory guidelines would be fleshed out at the administrative level after a process of consultation with private-sector investment experts. In addition, the IRAs employees or employers select from private financial institutions would also offer at least a few investment alternatives, consistent with normal market practice, but would not be limited to any prescribed array of investment options.

Employers Protected from any Risk of Fiduciary Liability

Employers making payroll deposits would be insulated from potential liability or fiduciary responsibility with respect to the manner in which direct deposits are invested in automatic IRAs, regardless of whether the IRA provider or investments are selected by the employer or the employee. Nor would employers be exposed to potential liability with respect to any employee's choice of IRA provider or type of IRA. This protection of employers would be facilitated by regulatory designation of standard investment types that reduces the need for continuous professional investment advice. In addition, employers could avoid responsibility even for the selection of an IRA provider for their employees by allowing employees to designate their preferred IRA providers (or by specifying the government-contracted fallback automatic IRA).

The Importance of Protecting Employer Plans

The automatic IRA proposal 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 $4,000 (2007). 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 $15,500 to a 401(k) (or $20,500 if they are age 50 or older).[15] In addition, by design, the employer tax credit for providing access to automatic IRAs is significantly less than 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 by giving consultants, third-party administrators, financial institutions, and other plan providers a new way to penetrate the small business pension market with 401(k)s, SIMPLE-IRAs 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.

Encouraging Contributions by the Self-Employed and Independent Contractors

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

- Expanding access to automatic debit arrangements, including through professional and trade associations that could help arrange for automatic debit and direct deposit to IRAs. Automatic debit essentially replicates the power of payroll deduction insofar as it continues automatically once the individual has chosen to initiate it.
- Extending the payroll deposit option to many independent contractors through direct deposit with firms from which they receive regular payments;
- Enabling taxpayers to direct the IRS to make direct deposit of a portion of their income tax refunds to an IRA; and
- Allowing the self-employed to transmit IRA deposits with their quarterly estimated income taxes.

Matching Deposits as a Financial Incentive

A powerful financial incentive for direct deposit saving by those who are not in the higher tax brackets (and who therefore derive little benefit from a tax deduction or exclusion) would be a matching deposit to their payroll deposit IRA. One means of delivering such a matching deposit would be via the financial institution that provides the payroll deposit IRA. For example, the first $500 contributed to an IRA by an individual who is eligible to make deductible contributions to an IRA might be matched by the private IRA provider on a dollar-for-dollar basis, and the next $1,000 of contributions might be matched at the rate of 50 cents on the dollar. The financial provider would be reimbursed for its matching contributions through federal income tax credits.[16]

Recent evidence from a randomized experiment involving matched contributions to IRAs suggests that a simple matching deposit to an IRA can make individuals significantly more likely to contribute and more likely to contribute larger amounts.[17] Matching contributions – similar to those provided by most 401(k) plan sponsors – not only would help induce individuals to contribute directly from their own pay, but also, if the match were automatically deposited in the IRA, would add to the amount saved in the IRA. The use of matching deposits, however, would require procedures to prevent gaming – contributing to induce the matching deposit, then quickly withdrawing those contributions to retain the use of those funds.[18]

Conclusion

American households have a compelling need to increase their personal saving, especially for long-term needs such as retirement. This brief summarizes a strategy to make saving more automatic – hence easier, more convenient, and more likely to occur. By adapting to the IRA universe practices and arrangements that have proven successful in promoting 401(k) participation, the automatic IRA approach holds considerable promise of expanding retirement saving for millions of workers.

David John is a Principal at the Retirement Security Project and a Research Associate with the Thomas Roe Institute for Economic Policy Studies at the Heritage Foundation.

The authors thank many individuals for helpful comments and Spencer Walters for outstanding research assistance.

The views expressed in this paper are those of the authors alone and should not be attributed to the Brookings Institution, the Heritage Foundation, The Pew Charitable Trusts, or any other institutions with which the authors and the Retirement Security Project are affiliated.

[1]This executive summary is based on a more detailed proposal the authors have described in a research paper (Retirement Security Project Publication No. 2007-2) and Congressional testimony (Testimony before the Long-Term Growth and Debt Reduction Subcommittee of the Committee on Finance, United States Senate, June 29, 2006), both available at *www.retirementsecurityproject.org*.

[2]Craig Copeland, "Employer-Based Retirement Plan Participation: Geographic Differences and Trends: Employee Benefit Research Institute Issue Brief No. 299," December 2005 (referred to below as "Copeland, EBRI Issue Brief No. 299"), Figure 1, p. 7. An additional 16 million workers either are not eligible for their employer's plan or are eligible but fail to participate.

[3]The automatic IRA proposal was introduced as the "Automatic IRA Act of 2006" in the 109th Congress as S. 3952 by Senators Jeff Bingaman (D-NM) and Gordon Smith (R-OR) and cosponsored by Senator John Kerry (D-MA); as sections 101-104 of S. 3951 sponsored by Senators Smith and Kent Conrad (D-ND) and cosponsored by Senator Bingaman; and as H. 6210 sponsored by Rep. Phil English (R-PA). Another bill that takes a similar approach has been introduced by Senator Max Baucus (D-MT), S. 2431 (109th Congress, second session).

[4]Even among those households that had savings in 401(k)s and IRAs, the median account balance was only $69,000. Authors' calculations using the 2004 Survey of Consumer Finance.

[5]As measured in the National Income and Product Accounts.

[6]Copeland, EBRI Issue Brief No. 299, Figure 1, page 7.

[7]See William G. Gale, J. Mark Iwry, and Spencer Walters, The Pension Protection Act of 2006 and the Unfinished Agenda. (Retirement Security Project Publication No. 2007-1, April 2007).

[8]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 Department of Labor Interpretive Bulletin 99-1 (June 18, 1999), 29 C.F.R. 2509.99-1(b); and IRS Announcement 99-2.

[9]Employee Retirement Income Security Act of 1974, as amended.

[10]Brigitte Madrian and Dennis Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," Quarterly Journal of Economics 116, no. 4 (November 2001): 1149-87; and James Choi and others, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in Tax Policy and the Economy, vol. 16, edited by James Poterba (Cambridge, Mass.: MIT Press, 2002), pp. 67-113. See also Sarah Holden and Jack VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(K) Accumulations at Retirement," Employee Benefit Research Institute Issue Brief No. 283 (July 2005).

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

[12]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, annuitization.

[13]This might be done in conjunction with the existing IRS Form W-3 that employers file annually to transmit Forms W-2 to the government.

[14]"Default Investment Alternatives Under Participant Directed Individual Account Plans; Proposed Rule," Department of Labor Employee Benefits Security Administration, Federal Register (Vol. 71, No. 187), September 27, 2006. See also letter from J. Mark Iwry, Principal, Retirement Security Project, to Department of Labor Employee Benefits Security Administration, dated November 13, 2006 (available at *www.retirementsecurityproject.org*), commenting on the Department's proposed regulations.

[15]These are the limits for 2007. IRA and 401(k) contribution limits (as well as the limits applicable to SIMPLE plans) are indexed for cost-of-living.

[16]This raises a number of issues. For further discussion, see discussion of proposed reforms of the Saver's Credit, e.g., William G. Gale, J. Mark Iwry, and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans" (Retirement Security Project Publication No. 2005-02, March 2005).

[17]Esther Duflo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block" (Retirement Security Project, May 2005).

[18]Among the possible approaches would be to place matching deposits in a separate sub-account subject to tight withdrawal rules and to impose a financial penalty on early withdrawals of matched contributions.

STATEMENT OF DAVID JOHN, MANAGING DIRECTOR, RETIREMENT SECURITY PROJECT

Mr. JOHN. And although these employers would make no contributions or other outlays, they would receive a small temporary tax credit, as would smaller or newer employers that would be exempt from this requirement but choose to offer this voluntarily to their employers.

Employers would have three choices. They could tell their workers to "go out and find your own IRA." They could say, "All of these automatic IRAs at my company will be with X Financial Company." Or last but not least, they could take advantage, if they cannot find

any other cost-effective means for these accounts, through a national default investment platform.

This platform could be a consortium of private financial institutions, it could be a risk pool, it could be a consortium of nonprofit financial institutions, or, as is in the bill, it could be something similar to the Federal Thrift Savings Plan that currently is available to federal employers.

Now the budgetary impact of this is relatively low. We estimate, and we are still doing a lot of work on trying to get the exact numbers, that this will be somewhere in the neighborhood of $250 million annually and could be significantly lower than that.

It would also encourage smaller employers and the self-employed—and I think here of my daughter, Meredith, who is about to become a nurse when she graduates in February. She would be able to also have a retirement account if she was working as a private-duty nurse perhaps through a nursing association using direct debit from her checking account or a variety of other methods.

The one major advantage that we believe we have got here is that it is simple, it uses pieces that are already in existence, and last but not least, we do have a cross-ideological and bipartisan consensus.

This is not the solution to the problem, but it is a solution to the problem, and we think it would make an advance.

Thank you.

Chairman ANDREWS. Thank you very, very much. We appreciate that.

Dr. Perun, we look forward to your testimony.

STATEMENT OF PAMELA PERUN, POLICY DIRECTOR, THE ASPEN INSTITUTE

Ms. PERUN. Thank you, Mr. Chairman.

The mission of IFS is to promote increased savings in the United States so that all Americans can save, invest, and own, from cradle to grave. As part of that process, we have worked and continue to work closely with the financial services sector. Our advisory board consists of leaders of Bank of America, H&R Block, Goldman Sachs and ING, among others.

Last May, after 3 years of work, Aspen IFS issued its report, Savings for Life. Included in that report is the proposal about which I will speak today: America's IRA.

Mr. Chairman, I do not need to tell you, but it is worth reiterating: At any given moment, 59 percent of Americans who make less than $50,000 a year do not have access to pension benefits on the job. That is 62 million Americans.

Congress has tried to rectify this. As our recent report, "Towards a Sensible System for Saving" documented, there are now no fewer than eight different vehicles specifically designed for retirement saving, and yet pension coverage rates have not budged for decades. In fact, a study we recently conducted with the Center for Retirement Research at Boston College found that pension participation in 2004 was actually lower than it was in 1979.

It is time to accept the fact that a significant portion of employers cannot or will not sponsor a plan, no matter what the incentives or mandates are. It is time to think differently and to find al-

ternative ways to use employers to facilitate retirement savings. That is what we have tried to do with our proposal, America's IRA.

America's IRA would be available to any worker without an employer-sponsored plan. It would work just like any other IRA, a private-sector account opened at a private financial institution, with the usual cap placed on the amount of annual contributions.

But here is the difference, and here is the important point: America's IRA would have additional features designed to encourage new savings by those who are saving very little today. Specifically, for individuals with incomes under $30,000, the government would provide a starter contribution to encourage the opening of accounts. Then, to replicate the employer contributions that successfully encourage 401(k) savings, a government-matching contribution placed directly into an individual's IRA would be available to savers with incomes under $50,000.

We do not, unlike other proposals, impose any mandates on employers. A mandated product may expand coverage, but it does nothing to ensure that there will be an adequate level of savings at retirement. It does us very little good to say that more people will have IRAs if there is almost no money in them. That is why the start-up contributions and matching funds in our proposal are so important.

While we do not support mandates, we do believe there is a role for employers. They should be encouraged to voluntarily participate in an employee's pension savings. For example, federal law should be changed to allow employers to make matching contributions to employee IRAs without incurring the full legal burden of plan sponsorship.

And just how well will America's IRA work? Our financial models show what would happen to a 35-year old worker who makes $20,000 a year, if he or she contributes only 4 out of every 5 years, and just 3 percent of his or her income, about $50 a month at the start.

The result is that this worker will have over $133,000 at age 65. That is a significant supplement to Social Security. If converted to an annuity, it is nearly $500 more per month in today's dollars. And it would begin to make true retirement security a reality for millions of Americans.

For low-to moderate-income workers, their America's IRA savings, combined with Social Security benefits, would come close to replacing 80 percent of pre-retirement earnings, the target for a safe and secure financial retirement.

Mr. Chairman, building enough saving for a comfortable retirement is an essential part of the American dream. For too many Americans, however, that dream has been deferred. America's IRA would put it back within reach.

Thank you.

[The statement of Ms. Perun follows:]

Prepared Statement of Pamela Perun, Policy Director, Aspen Institute Initiative on Financial Security

Thank you, Mr. Chairman.

My name is Pamela Perun, and I am the Policy Director of the Aspen Institute Initiative on Financial Security—or IFS. It is an honor to be here today.

The mission of Aspen IFS is to promote increased savings in the United States so that all Americans can save, invest, and own—from cradle to grave.

As part of that process, we have worked, and continue to work, closely with the financial services sector. Our Advisory Board consists of leaders of Bank of America, H&R Block, Goldman Sachs, and ING, among others. We specifically reached out to the private sector because we believe that rather than creating an entirely new savings system at taxpayer expense, we should partner with existing companies that have a long-term interest in sustained financial relationships with individuals.

Last May, after three years of work, Aspen IFS issued its report, Savings for Life. Included in that report is the proposal about which I will speak today: America's IRA. And, I would ask that the America's IRA chapter of that report be included in the Record at the end of my statement.

Mr. Chairman, I do not need to tell you, but it is worth reiterating: at any given moment, 59 percent of Americans who make less than $50,000 per year do not have access to pension benefits on the job.

That is, 62 million Americans are working hard every day and making less than $50,000 a year, but when they retire, the only protection they may have is Social Security.

Social Security is a vital program that provides a solid foundation for retirement security. But it is not—and never was—intended to be the only source of a person's retirement income.

For millions of Americans, a private pension and private IRAs help to supplement Social Security. But, far too many Americans—hard-working Americans—have no supplement at all. For fully one in every five Americans aged 65 and older, Social Security is their sole source of income.

Congress has tried to rectify this. As our recent report—Towards a Sensible System for Saving—documented, there are now no fewer than eight different vehicles specifically designed for retirement savings. And yet, pension coverage rates have not budged for decades. In fact, a study we recently conducted with the Center for Retirement Research at Boston College found that pension participation in 2004 was actually lower than it was in 1979.

It is time to accept the fact that a significant portion of employers cannot or will not sponsor a plan, no matter what the incentives or mandates. It is time to think differently—it is time to find alternative ways to use employers to facilitate retirement savings.

That is what we have tried to do with our proposal—known as America's IRA.

America's IRA would be available to any worker without an employer-provided pension plan. It would work just like any other IRA—a private sector account opened at a private financial institution, with a cap placed on the amount of permitted annual contributions.

But, here's the difference—and here's the important point: America's IRA would have additional features designed to encourage new savings by those who are saving very little today.

Specifically, for individuals with incomes under $30,000, the government would provide a "starter" contribution to encourage the opening of the accounts.

Then, to replicate the employer contributions that successfully encourage 401(k) savings, a government matching contribution—placed directly into an individual's IRA—would be available to savers with incomes under $50,000.

We do not, like other proposals, impose any mandates on employers.

A mandated product may expand coverage, but it does nothing to ensure that there will be an adequate level of savings at retirement. Our America's IRA proposal is the only plan that seeks to ensure not just that more people have IRAs, but that the balance in those IRAs at retirement will be big enough to make a difference.

It does us very little good to say that more people will have IRAs if there is almost no money in them. That is why the start-up contributions and matching funds in our proposal are so important.

While we do not support mandates, we do believe there is a role for employers. They should be encouraged to voluntarily participate in an employee's pension savings. For example, federal law should be changed to allow employers to make matching contributions to employee IRAs without incurring the legal burden of plan sponsorship.

Our underlying goal is to make it easier for Americans to save. Mandates will not work—but simplified voluntary cooperation will.

And just how well will this work? We used our financial models to see what would happen to a 35-year old worker who makes $20,000 a year. We assumed he or she would contribute to an America's IRA only 4 out of every 5 years and would contribute just 3 percent of his or her income—about $50 a month at the start. This

modest individual contribution and the modest government match will result in that worker having over $133,000 at age 65—over $60,000 in today's dollars.

That is a significant supplement to Social Security. If converted to an annuity, it is nearly $500 more per month in today's dollars. And, it would begin to make true retirement security a reality for millions of Americans.

For low- to moderate-income workers, their America's IRA savings, combined with Social Security benefits, would come close to replacing 80 percent of pre-retirement earnings—the target for a safe and secure financial retirement.

Now I understand in this age of massive budget deficits, there is some concern about the cost of our proposal. And we acknowledge there will be a cost. But we believe this cost is necessary to achieve the ultimate objective.

Government contributions to encourage savings and to encourage people to save their own money are the linchpins of a successful savings policy and the key to helping low-income families attain adequate retirement savings. In fact, research demonstrates that workers—even low- and moderate-income workers—can and will save if given the right opportunities and incentives.

In exchange for a ten-year cost of $42.5 billion, the total asset accumulation in America's IRA at the end of that 10-year period will be more than $100 billion.

And let's put this cost in context. According to the Joint Committee on Taxation, over the next five years, the tax-preferred treatment of employer-provided pensions plus existing Individual Retirement Accounts—which largely benefit middle and upper-income Americans—will cost the federal government $701.4 billion. America's IRA would only cost the equivalent of about 3 percent of that total.

The bottom line is that the benefits—for individuals in terms of greater retirement security, and for the economy as a whole in terms of increased national savings—far outweigh the costs.

Finally, Mr. Chairman, I realize that this is not within the jurisdiction of this Subcommittee, but I want to just briefly mention the other retirement income proposal included in our report, Savings for Life. It is a proposal we call, Security Plus.

I mention this because while it is important to find ways to increase the number of Americans with retirement savings, it is also necessary to start thinking about what happens with those savings once a person reaches retirement age.

Security Plus would make it easier for all Americans to turn their savings into income that will last throughout their retirement, by allowing retirees to convert up to $100,000 in savings into a lifetime annuity. The annuities would be underwritten by the private sector, but the federal government would select annuity providers through a competitive-bid process and would distribute the annuity payments each month through Social Security checks.

Mr. Chairman, building enough savings for a comfortable retirement is an essential part of the American Dream. For too many Americans, however, that dream has been deferred. America's IRA would put it back within reach.

Thank you.

[Additional material submitted by Ms. Perun follows:]

SAVINGS FOR LIFE:

A PATHWAY TO FINANCIAL SECURITY FOR ALL AMERICANS

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America's IRA: Building Retirement Security for Working Americans

Building enough savings for a comfortable retirement is an essential part of the American Dream. Congress has put considerable effort into crafting a better national system for retirement saving. And yet, despite decades of work, most working Americans will not have saved enough to enjoy a financially secure retirement. The problem will only grow worse as 80 million baby boomers leave the workforce, stretching limited public resources.

America's IRA moves low- and moderate-income Americans toward greater income adequacy in retirement through good incentives for long-term saving. Its simple plan design allows the private sector to offer a profitable and simple savings vehicle through existing platforms.

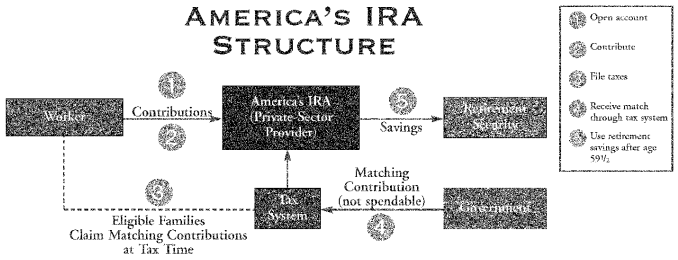
Basic Features

- The plan uses the existing IRA structure rather than creating another savings plan. The same financial services firms that offer IRAs today could easily offer America's IRA.
- America's IRA offers an annual dollar-for-dollar match, capped at $2,000 to savers earning under $40,000 (a partial match is available up to $50,000).
- The plan would also offer a "toaster:" a one-time incentive of $1,000 to those earning below $12,500, with a partial payment for incomes between $12,500 and $30,000.
- Matching contributions are deposited directly to accounts through the tax system.

To make savings simple, America's IRA offers only two investment options: an age-based mutual fund, and a risk-free principal preservation product.

Why America's IRA is Different—and Necessary

Recent studies from the Boston College Center for Retirement Research project that 43 percent of American households are at risk of an insecure retirement.[31] The basic American pension system—Social Security—by itself is insufficient, although it provides



over 90 percent of the retirement income received by low- and moderate-income workers.[32] And in the future, Social Security will provide even less income as replacement for pre-retirement earnings over time, requiring workers to find additional sources of income when they leave the workforce.

The obvious solution is to "scale up" the private pension system. But that system has two structural problems.

The first is coverage. Only about 50 percent of the private-sector workforce has access to work-based retirement plans at any point in their working lives—a percentage that has varied little for decades.[33] This percentage is substantially lower for low- and moderate-income workers who tend not to have the kind of jobs, or the consistent work histories, that are rewarded with plan participation. For example, the percentage of low- to moderate-income workers with access to employer retirement plans decreases dramatically below 50 percent as annual income drops below $40,000 per year.[34]

The second flaw in the current system is income adequacy. Over the last 20 years, the private pension system has shifted from defined benefit plans to defined contribution plans such as 401(k) plans. 401(k) plans put the burden of saving for retirement squarely on the shoulders of workers; employers usually only match worker contributions, if they contribute at all. Workers assume the risk of deciding whether to save, choosing the right amount to save, investing their funds in the right way, and spending down their accounts so they last a lifetime.

These are difficult assignments with no clear right answers that most workers are ill-equipped to handle. Many deal with the uncertainties inherent in 401(k) plans by failing to save at all, or by saving too little and by failing to invest appropriately.[35]

IRAs were created more than 30 years ago for workers without an employer-based plan.[36] However, few Americans actually contribute to IRAs. Most assets currently held in IRAs represent rollovers of accounts from employer-sponsored plans.

IRAs have failed to appeal because many potential savers lack a connection to the financial services marketplace. In turn, the financial services industry hasn't aggressively marketed IRAs to savers with small amounts to invest.

Low- and moderate-income savers have few incentives to save in IRAs. Tax deductions are irrelevant, and IRAs don't offer the matching contributions that help raise participation in work-based plans. The federal government does offer a Saver's Credit, but it is not refundable, so low-income savers with no tax liability do not benefit.

Why America's IRA is the Way Forward

America's IRA is designed to tackle both the coverage and retirement income adequacy problems.

First, America's IRA would give low- and moderate-income workers a well-designed retirement savings vehicle that is the functional equivalent of an employer-based plan using existing IRA products and channels.

Second, America's IRA will include a new government matching structure to provide savings incentives. The matching structure is designed to reward those who consistently save at least three percent of their income a year with substantial income on top of Social Security in retirement.

Benefits and Costs

- America's IRA gives the 62 million low- and moderate-income Americans who may never have an employer-based plan the ability to increase their retirement income significantly by saving just three percent of their income each year.
- The savings incentives in America's IRA—the dollar-for-dollar match and one-time grants—are estimated to cost roughly $40 billion over ten years with a 10 percent participation rate. By comparison, the Saver's Credit, for which only a small percentage of low- and moderate-income workers qualify, delivers only about $1 billion in savings incentives per year or $10 billion over ten years.[37]
- Low- and moderate-income workers can save more

than two times their salary, which, if converted into an annuity, could replace about an additional 20 percent of their pre-retirement income.

Questions and Answers about America's IRA

What is the purpose of America's IRA?

Many low- and moderate-income workers are at risk of financial insecurity in retirement because they are excluded from employer-based plans.[38] This risk will only increase in the future as Social Security provides less replacement income.[39]

How is America's IRA different from the traditional IRA?

In many ways, it's not. It's the same IRA available to everyone. But it has some extra features designed to replicate the benefits (and avoid the deterrents) to saving found in work-based plans:

- Matching contributions from the federal government—a dollar-for-dollar match for those earning $40,000 or less and a partial match for those earning between $40,000 and $50,000.
- A simple design—just two basic investment choices.
- Easy to administer—matching contributions are delivered through the income tax system directly to accounts.

What are the primary benefits of America's IRA?

America's IRA was designed with successful savings outcomes in mind. Those who participate have the opportunity to achieve an additional layer of retirement income on top of Social Security.

- Low- and moderate-income workers can save more than two times their salary, which, if annuitized, corresponds to replacement income of about 20 percent.
- Added to Social Security benefits, America's IRA could enable low- and moderate-income workers to achieve approximately an 80 percent income replacement rate.

Isn't America's IRA just a gimmick, a giveaway of tax dollars?

No. It just gives low- and moderate-income workers without an employer plan roughly the same financial incentives and savings support services enjoyed by workers with an employer plan. And it does so without creating a new government program.

Isn't there a way to include these workers in employer-based plans instead?

Congress has been trying since 1942 to require employers to include more low- and moderate-income workers in their plans. Pension coverage rates, however, haven't budged for decades. Having a better employer-based pension system is, of course, an important social goal but it is not one likely to be realized soon. In the meantime, workers without a plan need a more effective savings solution than existing IRAs which have failed to generate much new net saving since they were created over thirty years ago.

Will America's IRA jeopardize the employer-based pension system?

Unlikely. Employers with significant numbers of higher-income workers would not be tempted to terminate their current plans in favor of America's IRA for two reasons. First, workers can contribute far less to an IRA ($4,000) than to a 401(k)-type plan ($15,500) and, second, only low- and moderate-income workers are eligible for a matching contribution.

America's IRA will enhance the private pension system where it needs it the most. It will provide an efficient and effective savings vehicle for workers at small employers who have historically been reluctant to offer employer-based plans.

Wouldn't improving the Saver's Credit fix the problem?

The Saver's Credit currently provides a government match for saving by some low- and moderate-income workers. The match is modest and not available unless a worker owes taxes, which many low- and moderate-income workers do not.

Reforming the Saver's Credit to cover more workers and increase the match is a desirable improvement in the current system. It will not, however, replicate the synergies America's IRA is capable of creating between low- and moderate-income workers and the financial services industry.

Why is a private sector delivery system appropriate for America's IRA?

America's IRA harnesses the energy of the private sector to drive savings behavior in the same way 401(k) plans do. America's IRA is designed to grow savings accounts quickly beyond the small balance problem so that the private sector views low- and moderate-income consumers as a valuable market. This gives the private sector an incentive to extend the marketing, educational, and administrative and investment services it now provides to employer-based plans to individual low- and moderate-income savers. In turn, the industry will help persuade more low- and moderate-income workers to become savers.

Alternative proposals call for an intermediary between savers and the private sector. Some advocate expanding the Thrift Savings Plan for federal employees to include workers without an employer plan. Others would require employers to offer payroll deduction services to IRAs for such workers. The first approach requires building a new administrative system that will be costly to taxpayers. The second imposes a new employer mandate that fails to address the disconnect between low- and moderate-income savers and the financial services industry.

America's IRA is ultimately a more effective savings approach through its use of a familiar savings product, simpler investment options, existing private sector services, and expanded government funding for savings incentives to low- and moderate-income savers.

How much might the matching contributions cost?

We estimate that in today's labor force there are 62 million Americans who would be eligible for America's IRA.[40] If 10 percent decide to participate, the cost would be about $40 billion for 10 years.[41]

Why would a private-sector firm be interested in the America's IRA program?

At a 15% take-up rate, America's IRA is estimated to generate $155 billion in new assets under management in 10 years using existing financial products. As accounts grow, America's IRA should be as profitable for most firms as traditional IRAs. The "toaster" plus government match in the first year would help build the account size of America's IRA and increase its profitability.

America's IRA in the Real World

Jason is also born in Jefferson, Iowa, on February 2, 2008. His parents open a Child Account for him, but never contribute. As a result, he has no money for college or to start a business. He works in a small hardware store, and his income is around $20,000 in most years. His employer does not offer a pension plan at work.

When Jason turns 37, he decides that he needs to begin saving. Social Security is his parents' only income in retirement, and he realizes that won't be enough for him. So he opens an America's IRA and is able to save three percent of his income for four out of every five years. He also receives a dollar-for-dollar matching contribution from the government. At age 67, when he is eligible for full Social Security benefits, his account is worth about $134,000 (about $63,000 in today's dollars).[42]

Chairman ANDREWS. Doctor, thank you very much. You win the prize for finishing before the red light comes on, too.

No, thanks very much for your testimony.

Mr. Stapley, welcome.

STATEMENT OF MICHAEL STAPLEY, PRESIDENT AND CEO, DESERET MUTUAL

Mr. STAPLEY. Mr. Chairman and members of the committee, thank you very much for this opportunity. We are here today to present to you a new and forward-thinking idea about the way we deliver life security benefits to Americans.

The voluntary participation of employers in the American system for providing medical, retirement and other similar life security benefits has, over time, as you have mentioned, Mr. Chairman, improved the health and financial well-being of hundreds of millions of Americans.

However, there are significant challenges facing our current benefit system that cannot be ignored.

First, the benefit system does not, even after three decades, serve all Americans. Fewer than half of U.S. workers have a retirement plan through their employer, and of those that do, many do not save enough to achieve retirement security.

Second, employers that today provide retirement, medical, and similar life security benefits are under stress. In addition to increased national and global competition, U.S. employers face complex, inflexible, and often contradictory rules, as well as exposure to litigation that has increased over time.

In many cases, the administration of retirement, health, and other benefits has itself become a major enterprise within companies that often diverts their focus from competitive business challenges.

Because the benefit security needs of all Americans is a troubling issue of increasing importance to employers and to society as a whole, we created a design that took the best of the current system and developed an entirely new platform that would maximize the opportunity for life security for all Americans.

The following is a brief description:

One, benefit administrators would manage benefit plans competing for business and customers on the basis of product quality, service and cost.

Number two, retirement short-term savings plans and medical plans would be included. Retirement plans would include both defined benefit and defined contribution plans. Other benefits, such as life insurance and disability, could be added at a later date. We strongly believe that integrating retirement savings and health coverage is critical.

Three, a uniform national regulatory structure would be established to ensure that there is effective and fair competition among administrators and that there is total transparency for consumers. The structure could be developed by the federal government or a federally enabled nongovernmental entity.

Four, employers would have the option of continuing in the current system, purchasing benefits for their employees from a regional benefit administrator, or providing benefit funding to their employees who could purchase benefits from the administrator of their choice.

Five, individuals would be guaranteed the opportunity to purchase benefits directly from benefit administrators on the same basis as those accessing benefits through an employer.

Six, benefits would be portable among benefit administrators.

Seven, employers and individuals would share in funding, and the tax treatment of qualified lifetime security benefits would be uniform for all Americans.

Eight, benefit administrators would provide financial planning services through salaried financial planners to optimize the potential for retirement security.

Nine, all individuals would be required to establish a retirement savings account apart from Social Security, and, eventually, we would support a subsidy for low-income savers.

And, ten, we believe that many of the ideas of other stakeholders could be incorporated into this proposal.

The new system combines a market-based structure with individual choice and enhanced group risk sharing, ensuring the voluntary continuation and expansion of the employers' role. It leaves employers to do what they do best and administration to those that do it best.

In summary, ERIC's proposal significantly simplifies and rationalizes the current retirement system by: expanding opportunities for individuals and employers to participate in retirement plans; enhancing competition by leveling the playing field and providing better tools and improved information to consumers; providing simple, clear and easy-to-understand choices for employers and consumers; establishing equity and fairness in the tax structure that supports the benefits system.

We recognize that our proposal is controversial and exceeds the breadth of proposals that would simply create additional burdens or build upon components of the current system. ERIC's proposal is designed to spark new thinking about replacing such limiting silos with more creative options. It permits us all to do what Americans do best: create and innovate.

This is an urgent debate. The life security of millions of Americans and the vitality of many American businesses depends on the outcome.

Thank you, Mr. Chairman and members of the Committee.

[The statement of Mr. Stapley follows:]

Prepared Statement of Michael Stapley, President and CEO, Deseret Mutual Chairman, ERIC* Task Force on New Benefit Platform for Life Security

Thank you, Mr. Chairman and members of the committee.

We are here today to present to you a new and forward thinking idea about the way we deliver life security benefits to Americans.

The voluntary participation of employers in the American system for providing medical, retirement and other similar "life security" benefits has, over time, improved the health and financial well being of hundreds of millions of Americans.

However, there are significant challenges facing our current benefit system that cannot be ignored.

First, the benefit system does not, even after three decades, serve all Americans. Fewer than half of U.S. workers have a retirement plan through their employer and of those that do, many do not save enough to achieve retirement security.

Second, employers that today provide retirement, medical and similar life security benefits are under stress. In addition to increased national and global competition, U.S. employers face complex, inflexible, and often contradictory rules as well exposure to litigation that has increased over time. In many cases, the administration

*The ERISA Industry Committee (ERIC) is a non-profit association committed to the advancement of employee retirement, health, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive benchmark retirement, health care coverage, compensation, and other life security benefits directly to tens of millions of active and retired workers and their families. The association has a strong interest in proposals affecting its members' ability to deliver those benefits, their cost and their effectiveness, as well as the role of those benefits in the American economy.

of retirement, health, and other benefits has itself become a major enterprise within companies that often diverts their focus from competitive business challenges.

Because the benefit security needs of all Americans is a troubling issue of increasing importance to employers and to society as a whole, we created a design that took the best of the current system and developed an entirely new platform that would maximize the opportunity for life security for all Americans.

The following is a brief description:

1. Benefits Administrators would manage benefit plans, competing for business and customers on the basis of product quality, service, and cost.

2. Retirement, short-terms savings plans and medical plans would be included. Other benefits such as life insurance and disability could be added at a later date. We believe that integrating retirement, savings, and health coverage is critical.

3. A uniform national regulatory structure would be established to ensure that there is effective and fair competition among administrators and that there is total transparency for consumers. The structure could be developed by the Federal government or a federally enabled non-governmental entity.

4. Employers would have the option of continuing in the current system, purchasing benefits for their employees from a regional Benefit Administrator, or providing "benefit funding" to their employees who could purchase benefits from the Administrator of their choice.

5. Individuals would be guaranteed the opportunity to purchase benefits directly from Benefit Administrators on the same basis as those accessing benefits through employers.

6. Benefits would be portable among Benefit Administrators.

7. Employers and individuals would share in funding; the tax treatment of qualified lifetime security benefits would be uniform for all Americans.

8. Benefit Administrators would provide financial planning services through salaried financial planners to optimize the potential for retirement security.

9. All individuals would be required to establish a retirement savings account apart from Social Security. We would support a subsidy for low-income savers.

10.Many of the ideas of other stakeholders could be incorporated in a New Benefit Platform.

Thus, the new system combines a market-based structure with individual choice and enhanced group risk sharing, ensuring the voluntary continuation and expansion of the employers' role. It leaves employers to do what they do best and administration to those that do it best.

In summary, ERIC's proposal significantly simplifies and rationalizes the current retirement system by:

- Expanding opportunities for individuals and consumers to participate in retirement plans;
- Enhancing competition by leveling the playing field and providing better tools and improved information to consumers;
- Providing simple, clear, and easy—to-understand choices for employers and consumers;
- Establishing equity and fairness in the tax structure that supports the benefits system.

We recognize that our proposal is controversial and exceeds the breadth of proposals that would simply create additional burdens or build upon components of the current system. ERIC's proposal is designed to spark new thinking about replacing such limiting silos with more creative options. It permits us all to do what Americans do best: create and innovate.

This is an urgent debate. The life security of millions of Americans and the vitality of many American businesses depends on the outcome.

Thank you, Mr. Chairman and members of the Committee.

Chairman ANDREWS. Mr. Stapley, thank you very much for your very succinct and comprehensive statement. Thank you.

Mr. Stein, welcome back. Good to have you with us.

Mr. STEIN. Well, thank you.

I am owed 12 seconds from 2 weeks ago when I testified before the House Ways & Means Committee. So——

Chairman ANDREWS. You just used them. [Laughter.]

STATEMENT OF NORMAN STEIN, PROFESSOR, UNIVERSITY OF ALABAMA SCHOOL OF LAW

Mr. STEIN. Mr. Andrews, Mr. Kline, members of the subcommittee, I am Norman Stein, a law professor at the University of Alabama. I am testifying today about and on behalf of the Conversation on Coverage, an unprecedented public policy initiative to increase pension coverage rates for American workers, particularly those with low and moderate incomes.

Convened by the Pension Rights Center, the Conversation on Coverage brought to the table experts from widely varying perspectives who shared a common goal: to push pension coverage rates upward from the roughly 50 percent level at which they have been stalled for the past 40 years.

The Conversation's viewpoint diversity is illustrated by its generous financial backers: the Ford Foundation, the Annie Casey Foundation, Atlantic Philanthropies, AARP, MetLife, Nationwide, Motorola, Fidelity Investments, ASPA, the Chamber of Commerce, the AFL-CIO, Prudential, EBRI, the International Association of Machinists, CWA, TIAA-CREF, the National Committee to Preserve Social Security, SCI, Vanguard, the Retirement Security Project, the American Academy of Actuaries, the American Benefits Council and the American Council of Life Insurers.

That probably took 30 seconds of my time.

The Conversation had three working groups, and, today, I will briefly discuss their proposals, whose richness of detail is more fully described in our report, Covering the Uncovered. The proposals were each designed to work in complementary fashion rather than in competition with the existing voluntary system. Let me describe the proposals.

Working Group I developed two new types of plans with defined benefit-type features designed for small-and medium-size firms.

The first plan is the Plain Old Pension Plan, or POPP The POPP is a bare-bones version of the traditional employer-sponsored pension plan. The POPP is easy for employers to adopt, fund and administer. The POPP's basic features include: first, a basic benefit for all employees equal to at least 1 percent of career average pay multiplied by years of service; second, the possibility of bonus benefits which an employer could fund in good financial years; and, third, annual contributions that the employer calculates by referencing standardized conservative funding tables published by the Department of Treasury which show the year's contribution for each employee based on the employee's age in that year and the benefit accrued for that year.

The second plan is the Guaranteed Account Plan, or the GAP. The GAP is a hybrid plan combining features of defined benefit and individual account plans. The GAP's key features include: first, an account for each employee, which is annually credited with a pay-based contribution and a guaranteed rate of return; second, a simple funding method with contributions based on standardized conservative funding assumptions; and, third, an innovative sidecar trust which an employee can use to increase funding flexibility and benefit security.

Working Group II's mission was to encourage individuals without access to traditional employer plans to save for retirement, and this is similar to the proposals that Mike and Mark proposed.

To do this, the Working Group developed the Retirement Investment Account plan, or RIA. RIA's key features are: first, the opportunity for employees not covered by a traditional employer plan to contribute to a RIA account through automatic payroll deduction; and, second, the investment of contributions through a central clearinghouse which would offer private-sector investment finds similar to the Federal Thrift Savings Plan.

Working Group III designed the Model T plan. The Model T is a multiple-employer arrangement that is designed to be a basic, no-frills, low-cost savings plan, much like Henry Ford's famous car was designed to be a basic, no-frills, low-cost automobile.

The key features of the Model T are: first, it is a basic individual account plan with standardized features that would make it attractive for financial institutions to market to small employers; second, the financial institution would relieve employers from most of the administrative responsibility for the plan; and, fourth, employers would be encouraged to contribute by providing a higher overall contribution limit for plans where the employer makes contributions.

At the moment, the Conversation is in the process of creating task forces to help implement the proposals, perhaps initially as regional demonstration projects. We are working with an economist at the Employee Benefits Research Institute to survey employers to estimate the probable take-up rate for GAP and POPP.

We truly believe that these proposals have substantial potential to expand retirement plan coverage and, thereby, help more Americans create the financial security to which a lifetime of hard work and productive labor should entitle us all.

We look forward to working with the subcommittee and others to move these proposals from the drafting table to the brick and mortar of the real world.

Thank you. I look forward to your questions.

[The statement of Mr. Stein follows:]

Prepared Statement of Norman P. Stein, on Behalf of the Conversation on Coverage

Mr. Chairman, Members of the Subcommittee, thank you for giving me the opportunity to testify. I am Norman Stein, a professor at the University of Alabama School of Law, where I am privileged to hold the Douglas Arant Professorship. This semester, I am a visiting professor at Catholic University's Columbus School of Law here in Washington, D.C. Today I am testifying on behalf of and about the Conversation on Coverage, an unprecedented six-year national public policy initiative to develop innovative and detailed proposals to increase pensions and retirement savings—particularly among low- and moderate-income wage-earners.

The Conversation is unlike any other initiative in the retirement arena in its composition, duration, focus and accomplishments. The Conversation on Coverage, convened by the Pension Rights Center, brought together experts from widely varying perspectives—from businesses and from organized labor, from financial institutions and from consumer organizations, from consulting firms and from retiree groups, from academics and from think tanks, from women's organizations and trade groups. These experts came together with a common goal and a common cause: to push pension rates upward from the 50% rate at which they have been stalled for the past quarter-century. The animating focus was to put our creative elbows to the wheel and create common ground solutions for the common good.

The supporters of the Conversation on Coverage have included the Ford Foundation, the Annie E. Casey Foundation, the Atlantic Philanthropies, AARP, MetLife, Nationwide, Fidelity Investments, the U.S. Chamber of Commerce, the AFL-CIO, the Communication Workers of America, and many other organizations that are listed in the Conversation on Coverage's final report, Covering the Uncovered—which I respectfully request be submitted into the record of this hearing.

Today I will discuss the four detailed and innovative recommendations that were developed by the Conversation's three Working Groups whose approximately 50 spent collectively hundreds of hours in intensive discussions and whose final recommendations are detailed in Covering the Uncovered. The proposals include two new types of guaranteed pension plans; a proposal for a new clearinghouse structure to administer individual accounts; and a new proposal aimed at increasing coverage in the small business sector. Each Working Group worked to develop achievable short-term solutions that are consistent with and complementary to the voluntary pension system, ensuring that the plans would not directly compete with already-existing pension plans.

Now, let me describe the four recommendations of the Conversation on Coverage.

Working Group I

Working Group I, which I co-chaired with Melissa Kahn, Vice President of Government and Industry Relations for MetLife, developed new approaches to encourage small and medium-sized businesses to adopt plans that have features of defined benefit plans—that is, plans that are employer funded and professionally invested, and which provide a guaranteed stream of benefits to employees and their spouses. The results of our collaboration were two model plans: the Plain Old Pension Plan (POPP) and the Guaranteed Account Plan (GAP)..

In a nutshell, POPP, or Plain Old Pension Plan, is a simplified version of a traditional employer-sponsored defined benefit pension plan that is easy for companies to create, fund and administer, and which should shield employers from cash flow issues that reflect the volatility of the Internal Revenue Code's minimum funding standards..

• Employers who set up a POPP can pay employees and themselves a pension based on a percentage of their career average salaries, which can be as low as one percent multiplied by years of service.

• Employer contributions will be easy for employers to determine and budget for because they would be based on conservative tables published by the government and would allow a seven-year period to fund any shortfalls that did occur.

• POPP allows for a special "bonus benefit" meaning that employers can increase benefits in years when they have good financial performance and then go back to providing the plan's basic benefit in other years, without having to formally amend the plan and without the risk that the IRS would make the amendment permanent.

• Employers can provide generous past service credit, which will make the plan attractive to many small firms.

• All benefits are paid as an annuity for employees and their spouses, except for very small benefits GAP is a hybrid pension plan that combines some of the features of traditional pension and 401(k) plans. The GAP can be looked at as a cash balance plan in reverse. Rather than start with a defined benefit plan that has notional accounts, the GAP adds employer guarantees to the regulatory framework of an individual account money purchase pension. Some of the GAP's key features include:

• Each participant's guaranteed account is credited with an annual contribution that is based on a percentage of pay.

• The GAP credits each employee's account with a guaranteed annual rate of return, which can be a fixed interest rate or a variable rate of return.

• Employers who sponsor a GAP will employ professional asset managers to invest plan assets.

• Employer contributions will be based on standardized conservative funding assumptions.

• The GAP can be designed to allow employees to invest additional pre-tax contributions in either the GAP or a traditional individual account plan.

• The normal form of benefit in a GAP is a joint and survivor annuity.

• The GAP permits employers to establish a unique side-car trust to increase funding flexibility and ensure security for the promised benefit.

• The GAP permits employers to use flexible non-discrimination testing methods in exchange for a gateway contribution of 6.5% for all employees.

• The GAP will be subject to a lower PBGC premium than other defined benefit plans because of the requirement that the employer fund the GAP on the basis of mandated conservative assumptions.

Both the GAP and POPP incorporate conservative funding rules that should substantially reduce the year-to-year fluctuation in the employer's annual contribution. From a marketing perspective, this should make both plans more attractive than those that are currently available.

Working Group II

Working Group II's mission was to encourage more individuals to save. To accomplish this goal, the Working Group developed a proposal for an all-new portable Retirement Investment Account plan (RIA), which would be administered by a new national government-authorized clearinghouse.

The key features of the RIA plan are:

• A Central Clearinghouse that would contract out the investment of funds to the private sector. This is similar to the approach used by the Federal Thrift Savings Plan.

• All workers—whether full-time, part-time or self-employed—could contribute to their accounts through payroll deduction.

• Employers are required to provide access to the RIA to all employees who are not covered by an employer-sponsored savings plan.

• Individuals who don't have access to payroll deduction from their employer can contribute directly to the plan when they file their quarterly income taxes.

• Individuals can contribute more than they could in an Individual Retirement Account—with the annual contribution limit set somewhere between $6,000 and $10,000 annually.

• Contributions would be automatically placed in an appropriate default investment unless employees choose another of three investments. These investments include a bond index fund, Treasury Inflation-Protected Securities, and at least one investment choice that is low risk and preserves the principal.

• The broad contours of a tax credit were designed by the Group and could be added to the RIA to provide incentives for low- and moderate-income wage earners.

Working Group III

Working Group III designed the Model T—named after Henry Ford's basic, yet functional, car, which was designed for a mass audience. The Model T is a low-cost, simplified multiple employer plan that would be sold by financial institutions to small employers. Because it was designed as a multiple employer plan, it would be an efficient way of reaching numerous businesses at once.

Our hope is that if the Model T were effectively marketed, potentially in a demonstration project in a particular region of the country, it could help to significantly increase coverage among small businesses and their employees.

Key features of the Model T include:

• The Model T is a simplified plan that would be marketed by financial institutions to small employers.

• The Model T is a souped-up SIMPLE IRA with a few additional elements from the 401(k) world.

• The administrative features of the plan are simple and handled mostly by financial institutions.

• All employees—full-time and part-time—can participate. Self-employed individuals will also be able to contribute.

• Employee contributions are made through payroll deduction.

• While employer contributions are voluntary, the Group designed a unique two-tiered contribution scheme that encourages employers to contribute on behalf of employees.

• Funds are placed in simplified investment options that are consistent with the U.S. Department of Labor's default investment regulations.

• The Model T features a recommended "Standardized Performance Report," that will be produced by the financial institutions offering the plan. This report will help employers compare fees, services and investment performance of the plan on an apples-to-apples basis.

Conclusion

The Conversation on Coverage has created innovative and workable proposals. However, these recommendations should be viewed as "living proposals," an array of well-developed detailed proposals that hold the promise of truly increasing coverage but that still have room to grow in the public policy process. The proposals are substantive and well-conceived, and, by virtue of the fact they were created in a compromise process, they are good approaches—not necessarily perfect products. In addition, the Conversation on Coverage proposals were developed separately by each Working Group and are meant to significantly increase coverage, but not achieve universal coverage. However, because these proposals were created in a

common ground process, they already have the input and stamp of approval of more than 45 individuals from all sides of the issue.

The Conversation on Coverage is now forming Implementation Task Forces that we hope will be able to move all the proposals forward. For example, we are preparing surveys of pension plan advisors on the potential appeal of both the GAP and POPP. The survey is being conducted by the Employee Benefit Research Institute and will be sent to the membership of the American Society of Pension Professionals and Actuaries. The results of this survey will help determine whether employers have an interest in the GAP and POPP and what the likely impact on both coverage and eventual retirement income would be if these plans were introduced in the marketplace. We look forward to sharing the results of this survey with this Subcommittee.

As the surveys are completed, the Conversation on Coverage and Working Group members will seek to promote GAP and POPP, which have features that are not available under current law. In addition the Conversation on Coverage will continue to promote the Retirement Investment Account framework. We are closely monitoring how RIA-type plans are being adopted by states. These states can serve as laboratories to test how clearinghouse approaches for individual accounts might work.

With the Model T plan, our hope is to partner with a financial institution to launch a demonstration project, marketing the plan to employers in a specific regional market.

We look forward to working with the Subcommittee in further developing these proposals, in whole or in part. And we are hoping to explore ways of potentially enabling the Conversation on Coverage to test some of its ideas by establishing permanent demonstration projects—possibly for POPP, the GAP and the Model T—which would allow us to evaluate how these proposals might expand coverage for employers and their employees.

Thank you. I look forward to your comments and questions.

Chairman ANDREWS. Thank you very much.

Certainly, our optimism about the quality of the panel was thoroughly validated, both by the written statements and by the oral ones. Thank each of you very, very much.

There is good news and bad news about the schedule. The bad news is a vote on the floor is imminent, but the good news is it is only one vote. So, when the buzzer rings, we will very briefly adjourn, I will come back immediately, and the members are welcome to do so as well so we can get to questions.

It appears to me that the issues that the panel raises fall into two categories, and the first is: Should we consider options in the more traditional defined benefit world to help the individuals that I talked about at the beginning of the hearing?

And Mr. Stein talked about two of the proposals from his organization, and Ms. Dudley had some comments about hybrid plans, and I think we need to keep both of those comments under consideration.

I did want to focus on the second set of issues, though, which is how we might construct a defined contribution model that would reach as many of the people we are trying to reach as possible, and it strikes me, within that discussion, we have heard three different main issues.

The first is: What should the infrastructure be? And I think there is a pretty broad consensus that there should be a shared infrastructure. Whether it is, you know, a contracted for-profit organization, a nonprofit, a government entity, there is some dispute about that, but there should be a shared infrastructure that the employers and employees operate under.

The second issue is: To what extent participation should be voluntary or involuntary? And I think the Heritage-Brookings re-

quires the employer to at least offer participation. It does not require the employer to pay for anything in terms of a contribution, as I understand it.

And I think, Mr. Stapley, the proposal you talked about required employer participation, although, again, it is more in the offering nature, not in a mandatory contribution. I think I heard you say that. Was that right?

Mr. STAPLEY. It requires employee participation.

Chairman ANDREWS. Employee. So it is an individual mandate rather than an employer mandate.

The others appear to be saying it is a voluntary participation by employers. Did I hear that correctly? Did everybody else say that there——

Mr. STEIN. We have two proposals that deal with that kind of structure, and one required employers to use automatic payroll deduction.

Chairman ANDREWS. That is the RIA proposal?

Mr. STEIN. Yes.

Chairman ANDREWS. Okay. So you would be required——

Mr. STEIN. Close to——

Chairman ANDREWS. Okay. More like the Heritage-Brookings approach on this.

Mr. STEIN. Yes, yes.

Mr. CALABRESE. And that is also what I said as well.

Chairman ANDREWS. Gotcha. Okay.

Mr. STAPLEY. And that could be incorporated into our proposal very easily.

Chairman ANDREWS. Okay. So there is some real common ground on that.

I think where there is the broadest departure is on the question of whether there should be subsidies or not from the public treasury, and I have heard sort of three positions on that. One is maybe or no. The second is a significant public subsidy. Dr. Perun's position, I think, costs out to $42 million over 10 years, according to her testimony.

And I would tell you, Dr. Perun, I share your sense that an IRA with no money in it is not a great value, and I also share your implicit assumption that without significant subsidies, there will not be a whole lot of money in people's IRAs.

And then I was curios——

Ms. PERUN. Mr. Chairman?

Chairman ANDREWS. Yes?

Ms. PERUN. I would just like to say that Aspen IFS does not support the shared infrastructure idea——

Chairman ANDREWS. Okay.

Ms. PERUN [continuing]. That we are purely a private-sector individual connection——

Chairman ANDREWS. Gotcha.

Ms. PERUN [continuing]. And we would rather see government dollars going into accounts and to building a separate program.

Chairman ANDREWS. So you prefer a thoroughly private infrastructure that is in part contributed to by public subsidy dollars?

Ms. PERUN. Yes.

Chairman ANDREWS. Okay. I misstated that.

Now in the Heritage-Brookings proposal—I want to ask either Mr. Iwry or Mr. John this question—you use the number $250 million a year. How many people do you think that would induce to enroll, and what is that cost based on? What are we buying for that $250 million?

Mr. JOHN. We estimate that our proposal, out of the 60-plus million workers, would affect somewhere in the neighborhood of the high 30 million.

Chairman ANDREWS. Well, that is a lot of people.

Mr. JOHN. So it depends, of course, on what proportion actually participate in that. The assumption that we are making is $250 million roughly a year, and it could be less. They are scoring people. The Urban-Brookings Tax Policy Center is actually still working on that.

Chairman ANDREWS. But is that exclusive of any public subsidy contribution in that?

Mr. JOHN. Yes, it is exclusive of any public subsidy.

Chairman ANDREWS. Okay. That is simply the cost of setting up the infrastructure to get this done.

Mr. JOHN. Actually, it is more in the form of forgone taxes on——

Chairman ANDREWS. Okay. So your assumption would be voluntary contributions that are, therefore, sheltered from taxes deprive the Treasury of revenue. That is what the $250 million is based on?

Mr. JOHN. Yes, that is where we are.

Chairman ANDREWS. But that does not assume any public match?

Mr. JOHN. It does not at this point.

Mr. IWRY. The Retirement Security Project, Mr. Chairman, has separate initiatives, and there is separate proposed legislation too and the saver's credit. You and I have talked about this in past years.

Chairman ANDREWS. We have.

Mr. IWRY. And, in essence, that does bring this very much in the same zone in terms of ideas, as a number of the other proposals, that these IRAs with even the current law saver's credit would have some public subsidy for people earning up to a certain amount, but we have advocated that the saver's credit be refundable, be a 50 percent credit across the board, extend more into the middle-class, et cetera. So a substantial tax credit for all the savings.

Chairman ANDREWS. Gotcha. I want to make sure there is time for my friend if he wants to ask questions before the vote. I will leave it up to him.

Mr. KLINE. Either way. What do you think will be smoothest?

Chairman ANDREWS. I think it is smoothest if we came back, to be honest with you, so as to not rush the people's answers.

I would just ask Mr. Iwry and Mr. John to supplement my questions with one. If the annual tax avoidance cost is $250 million, the deprived revenue, I would assume that that would assume roughly that about $1.25 billion would be contributed to these accounts because people in this bracket are round the 15 percent, 20 percent bracket. So you would multiply that number by five or six?

Mr. IWRY. Mr. Chairman, there are a number of other factors. You are going down, I think, the right road, but the tax brackets are, in many cases, lower. We are dealing with the uncovered population. So many of them have a 0 percent bracket.

Chairman ANDREWS. Okay. All right. Because of the EITC and others.

Mr. IWRY. Exactly.

Chairman ANDREWS. I just want to try to reconcile, if you could for me in writing, the amount of money you think people would voluntarily put into these accounts and the tax revenue avoidance number. Because it seems to me that that number is so low—$250 million a year is almost nothing here because it would not, you know, it is not given the scope of things.

Mr. IWRY. It is a low number, yes.

Chairman ANDREWS. Yes. Okay. I hope it is right, but I——

Mr. IWRY. In many cases——

Chairman ANDREWS. I guess what I would like to see is a separate written analysis of where that $250 million comes from. That is all.

Mr. IWRY. We would be happy to do that, and the Roth IRA versus the deductible IRA accounts for a huge difference in the numbers.

Chairman ANDREWS. Okay.

Mr. IWRY. We are assuming that most people would end up going with the Roth, not all of them, and that shows a much smaller revenue cost.

Chairman ANDREWS. All right.

We are going to go vote, and I am going to come right back, and members that would like to come back and ask their questions, thank you. I assume it will be about 10 minutes.

Thank you.

[Recess.]

Chairman ANDREWS. Ladies and gentlemen, we will reconvene. We thank you for your patience.

And at this time, I will yield for questions to the ranking member, Mr. Kline.

Mr. KLINE. Thank you, Mr. Chairman.

I want to say again what the chairman has said and what I indicated at the beginning of the hearing. This truly is a panel of experts. Taking nothing away from other panels we have had in other hearings and perhaps other committees, sometimes we do not get such a distinguished group, and so it is a real pleasure to have you here.

I am also limited by the clock. So let me sort of cut to the chase on a couple of things.

Mr. Stapley, your proposal differs significantly from some of the others, and it is a change from the status quo, which is what we are looking for. So I can better understand who this would apply to, can you give me some idea of what sorts of employers or employees would find this new benefit platform more palatable, better than the existing? What are we talking about here? Who would this apply to?

Mr. STAPLEY. I will get this right. I think it potentially applies to any employer. I mean, I have talked to large employers. When

you look at the issues associated with the sponsorship of employment benefits, they are looking for a way out, and the foundation for that is—it is like I said in my testimony—I have to have more expertise in the administration of sponsorship of benefits than I have in my core industry.

So I think you have seen a change over the last several years where employers are saying, you know, you really need to have entities, like these benefit administrators, that their core expertise is the administration of benefits.

If you look at small employers, I talked just the other day to a small employer that has got about 300 employees. I had him read this, and I just asked him, "From your standpoint as this small employer, how does this sound to you?" and he said, "If this were available, I would take it tomorrow."

Mr. KLINE. If I could interrupt for just a second, thinking of smaller employers—and 300 is not a mom-and-pop operation, but it is a smaller operation than say 3M or something from Minnesota—are you focusing this on the smaller employer, or are you considering the very large employers as preferring this as well?

Mr. STAPLEY. My sense is this has potential application for employers of any size the way that it is structured. Now some employers, large employers, may want to continue the sponsorship and administration of their own benefits, but it certainly has the potential to apply to their circumstances as well.

Mr. KLINE. Okay. Thank you.

I wanted to pursue some safeguards issues, but perhaps someone else will bring those up.

I want to now follow up on what the chairman was getting at when he was sort of trying to compare the different proposals.

It looks like, Mr. Calabrese, that your proposal and the one brought forward by Mr. Iwry and Mr. John are very similar. We will start. We will see if we have time to go both ways. There is a potential difference in matching funds, but, other than that, can you point out the distinct difference between your proposal and the Brookings-Heritage proposal?

Mr. CALABRESE. Well, it is very compatible. I am looking at what would be the entire system, and so looking at both, you know, proposing the matching tax credits, requiring, you know, automatic defaults, and then, you know, the payroll deduction and clearinghouse as the infrastructure. And so really what I think Brookings and Heritage have done here is they have focused in on the automatic payroll deduction, you know, and a basic account clearinghouse. So that is one component.

But on that component, on that infrastructure piece, I think that is the critical first step we need to take and, you know, I am in almost complete agreement with what they have proposed. I think the only major difference that I point out in my testimony is, particularly, you know, with the bill that has been introduced by Congressmen Neal and English, that I would set the limits higher.

The Conversation on Coverage also had a consensus that the limit should not be as low as today's IRA because most middle-income people cannot achieve an adequate replacement rate for retirement by saving, you know, $4,000 or only $5,000 a year, particularly in the second half of their career, and I think if we put

that limit somewhere between today's IRA and a SIMPLE, which is $10,500, around, say, $8,000, that that would not threaten employers, for example, dropping their 401(k)s for this.

Mr. KLINE. But it would presumably cost more when you look at the avoidance tax deferral piece of it. It would cost more to the Treasury.

Even if I were to steal Mr. Stein's 12 seconds, I see that I am out of time. So I will yield back, Mr. Chairman. Thank you.

Chairman ANDREWS. Thank you very much, Mr. Kline.

Mrs. McCarthy is recognized for 5 minutes.

Mrs. MCCARTHY. Thank you, Mr. Chairman. Thank you for holding this hearing.

You know, listening to all the proposals. I also happen to sit on Financial Services, and one of the things that we have been noticing—I remember your testimony going back to the year 2000. I did not remember the year, but I knew that you were in front of us once before.

What I find interesting is that I have been trying to push those interested parties from the Financial Services people that we need to do more financial literacy, and they say they are. Now I am watching everything. I am in schools. I am asking if they have programs in the schools for financial literacy. I am asking just about anybody. If we do not educate our young people—and, yes, when I say young, I am talking from 18-to the 30-year-old group—to get them to start saving, we are going to be in big trouble when they start reaching towards 65.

Those that are baby boomers that are retiring today did save, and they prepared, and they happen to be in a very good economy, so most of them have done all right.

But, Dr. Perun, when you were talking about someone saving $50 a month and, at the age of 65, they would have $165,000 in their IRA, most likely, they will probably still be working after 65. Actually, Social Security will probably be 67, 69 possibly. So he would probably still live to 85, 90 most likely. That is not counting any health care costs. No one can survive on that. I mean, they are not going to be able to survive on that.

So what I am looking for is—you know, we talk about how much you should save, but I go back to the financial literacy. How are we going to say, "By the time you are, say, 67, this is the amount of money you are going to need to live on or need to have. Some costs in your life will go down, but this is how much you are going to need," without scaring them, saying, "Well, I am not going to be able to do that so I am not going to save for it."

Do you have an answer to that?

Ms. DUDLEY. Well, I have a couple of thoughts. The first is I agree with you wholeheartedly. As part of Safe and Sound, a cornerstone of our proposal is to advance the number of people who actually understand the amount that they need to save. We think that is the fundamental first step in financial literacy, teaching people how much they are going to need in retirement, and, therefore, how much they need to save in order to meet that goal, and I think in doing that, I think there are a couple of different ways that you can approach it.

The typical way that it is looked at is to look at how much replacement income you will need, and one of a newer kind of concept is to look at how much you will spend in retirement and to work from those ultimate goals back to how much you need to save.

But the problem with that is a lot of times people do not really have an appreciation for that until they are much older in their careers, and so you really have to go all the way back to even elementary school and high school to teach them about the concept of compounding interest, about the concept of debt. One of the big problems is understanding debt versus investment and how to balance the two as you go through your life.

Mrs. MCCARTHY. I know the banks are basically doing a better job today. When I was young, we saved every week. People had a couple of pennies, and you put it. But when the banks started charging an account that might have $5 in it, they actually ended up charging more than what was in the account, so they all pulled away. They are turning that around now, thank goodness.

But, again, what I will say—you know, we have thrift savings here, and I have a couple of young people that started with me when I started here 11 years ago. They were in their very early 20s, and I sat down with them and I said, you know, "You need to do this." The excuse was they did not have the money. I said, "What does a hamburger and a beer cost you 1 day a week?"

And, anyway, they all joined, and that is why I am one of those that you can opt out, but as soon as you start a job, a certain percentage should be taken out because if you do not see in the beginning, you are going to—and, by the way, all those young people today are very, very happy that they got into the program. Some have been able to buy a house or at least put down a down payment anyhow.

So we have a long way to go.

Ms. DUDLEY. We do actually think that automatic enrollment and the automatic increase that you all thoughtfully included in the Pension Protection Act are ways that help employees, when they first get into a job, to start saving and to start being part of the program and to gradually increase the amount that they save, and as they get into the plan, we find that very few people pull back out.

Mrs. MCCARTHY. Oh, no. It is like volunteerism. Once you start it, you get used to it and will continue. That is the challenge that I think we all face.

With that, I yield back.

Chairman ANDREWS. Thank you very much, Mrs. McCarthy.

Mr. Courtney is recognized for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Chairman.

I want to thank the witnesses also, and I also want to thank Mr. Kline and Mr. Andrews for helping.

When I got this testimony last night, I was reading through it. It reminded me going to IHOP and getting one of these menus where you are trying to figure out, you know, which combination is the right one, and then sorting through, as Mr. Andrews did, in terms of the common elements and the separating ones is something I needed certainly in the testimony.

And, Mr. Stein, in your written testimony, you indicated that the Conversation will seek to promote GAP and POPP which have features not available under current law and will continue to promote retirement investment account framework. I mean, it sounds like you are sort of taking the agnostic approach as much as possible—or the group is—in terms of trying to get a wide array out there for employers. I mean, is that an accurate statement?

Mr. STEIN. Well, there were three working groups, and they each had sort of different missions, and one of the working groups, the one that developed POPP and GAP, had a mission of trying to encourage new coverage through defined benefit plans, and that group sort of had a split focus because, on the one hand, they wanted to increase coverage, on the other hand, they thought defined benefit framework offers certain advantages to employees that individual saving account approaches do not.

The other two groups were focused more on defined contribution plans, and one of the things that I want to note—one reason our Group II proposal sounds so similar to the Heritage-Brookings proposal and Mike Calabrese's proposal is because they were on that work group and, in fact, I think 71.4 percent of this panel were participants in the Conversation on Coverage.

I mean, I think our idea was, you know, almost shotgun, if we had lots of different ideas and, you know, each of them hit a different kind of segment of the workforce, that would yield better dividends than just focusing on one type of proposal.

But the RIA proposal, I think, is very promising, and it is very, very, very similar to what you have heard from Brookings and Heritage and from Mike.

Mr. COURTNEY. Right. I mean, I am new. A year ago, I was a small employer with a 401(k) plan, administering it. And, you know, one of the things is we would have our annual get together to go through the portfolio with all the staff, but you really as a—and I think this is true of small business, which is, at some point, you just want to practice law or medicine or run your machine shop, and you really do not want to get into the business of running, you know, benefits as a big chunk of your day, and that is the only concern I have about sort of just throwing too much out there in terms of businesses because at some point——

Mr. STEIN. Well, the Model T plan, which is more like existing pension plans, except that the ideas to let the employer say, "I want to sponsor this" and try and relieve the employer of a lot of the administrative burdens and a lot of the fiduciary responsibility and to shift that to a financial institution which would market these plans to small employers.

Mr. COURTNEY. Right. And I guess the Brookings-Heritage group, I mean, what is your reaction to the POPP and GAP proposals?

Mr. IWRY. Mr. Courtney, as Professor Stein said, I was a member of that Conversation on Coverage effort and shared the pride that many of us have, I think, that overall the effort has been just terrific and unique. I think there is a lot to be said for those proposals, as well as for the one that is almost identical to the automatic IRA that we have been talking about and similar to the New America one.

I think it is striking, and I hope you are encouraged, to see the convergence of themes here. Automatic enrollment, the power of enlisting inertia in the cause of saving is, obviously, one of those common ground themes. The power of a progressive matching contribution, some kind of deposit saver's credit expansion is the way most people have put it. We have got right now a tax credit for folks that helps people in the lower brackets, not just people in the top bracket, and expanding that in some fashion is, I think, something a lot of us have been talking about as well.

Mr. Chairman, apropos to Mr. Courtney's question, the cost issue really ties into those themes, and I think for all of us perhaps the cost is not as great as one might think in the case of the infrastructure and the revenue cost of increased saving. The greater cost comes if you add a matching deposit and expanded saver's credit, but I bet that everyone on the panel would agree, and I invite them to disagree if they do, that it is well worth it.

But even if there are many billions of dollars of cost associated with a separate matching deposit, a tax credit that induces people to save and puts more in the accounts, it is well worth it, that the benefits to the nation to prepare for retirement and to the economy to increase our abysmally low national saving rate, and thereby increase national productivity and the gross domestic product, make it a good investment.

Chairman ANDREWS. Thank you, Mr. Courtney.

With the consent of the ranking member, he and I may ask another question or two. I will ask one.

I do want to go to Mr. Iwry's point about cost because I do think there is significant conversion—convergence on other issues—maybe some conversion, too—but there are some questions about cost. I want to understand this. I hear three elements of cost that we would be talking about here.

One is the administrative cost of administering the common platform, whether it is in the private sector, the nonprofit sector, the public sector. Someone has to bear the cost.

The second is the lost revenue to the Treasury because more people would be making tax-deductible contributions.

And then the third would be the cost of any credits that would be extended to employers, employees or both.

So I have that framework correct? Are there any other costs that we failed to identify?

Mr. IWRY. No, the credits are potentially the hugest part, if there are matching credits to individuals.

Chairman ANDREWS. And really in response, again, to Dr. Perun's earlier testimony, I think that a $42 billion outlay over 10 years is a small fraction of the benefit that we would get over time because of less political pressure on Social Security, more consumer spending, healthier people. I think it is a very, very good investment. I agree with that.

I want to ask a slightly different question to Mr. Iwry and Mr. John about the crowding-out problem.

You know, I think there would be a consensus on both sides of the podium up here that there is sympathy for public expenditures, whether it be for tax avoidance or subsidiaries, that would provide pensions for those who would not otherwise have it, but we would

want to avoid the unwelcome outcome of simply shifting people who are getting pensions now with a modest public subsidy to one that would get pensions with a great public subsidy.

Your claim is that your proposal avoids that crowding-out problem. How does it do it?

Mr. IWRY. Very simply, Mr. Chairman. We have two goals. One is to promote universal coverage, cover the people who are not covered, that 69 million, 75 million, 78 million. The other goal is to promote more qualified employer plans.

We actually believe that by keeping the limits low on the new vehicle—and the new vehicle in our case is the old vehicle, the existing familiar IRA—whose limits, $5,000 starting next year, are nowhere near even the limits of the SIMPLE plan, much less the 401(k) and other qualified plans. So the employer does not have an incentive. It is not only the employee contribution limits, but the employer contribution. We would not allow the employer to match in the IRA because we want them to graduate to a 401(k).

Chairman ANDREWS. So your argument essentially is that an employer who is already providing this benefit would be disadvantaged in the labor marketplace because he or she would be stepping backward to such a great extent, it would be such a cut in employee benefits, they would not do it because they would not want to lose valued employees?

Mr. IWRY. Absolutely.

Chairman ANDREWS. Okay.

And let me ask the other side of the coin then. Are the benefits generous enough that they would be meaningful to help the people who would be newly having a pension? I mean, the contribution limits are so low, would they be so low that they would not produce a significant benefit to the employee?

Mr. IWRY. Our rough estimate is that about $15 billion of additional deposits, contributions to IRAs, would likely be generated by this kind of proposal. It could well be a lot more.

Chairman ANDREWS. Per year? Per year?

Mr. IWRY. Per year. Per year. And so over a 10-year period, we are looking at something like $150 billion or maybe $100 billion as it ramps up.

Chairman ANDREWS. Okay.

Mr. IWRY. That could easily be a lower bound. We are trying not to be unrealistic.

Chairman ANDREWS. That sort of goes to the question I know you are going to answer for us in the supplemented, the record, which is that you must be implicitly assuming that a huge percentage of those contributors are people that pay no federal income tax or get the EITC, right?

Mr. IWRY. We think that something like approaching two-thirds——

Chairman ANDREWS. See, that would be good. I mean, that is——

Mr. IWRY [continuing]. Have 0 percent federal income tax liability, are in the 0 bracket, and so that the average bracket, when you take into account the 10 percent bracket and 15 percent bracket people who comprise most of the rest of that group, is going to be probably in single digits.

Chairman ANDREWS. Well, if you take into the account the EITC, it may be a negative rate of taxation.

Mr. IWRY. That is right. There is interaction there.

Chairman ANDREWS. In fact, it is a good thing because that is the target population which we are trying to help.

Mr. IWRY. Exactly. And when you add in the automatic enrollment as an incentive or as a vehicle, it gets people actually saving.

Chairman ANDREWS. Could I just pose one quick question? Is there anyone here who opposes automatic enrollment as the default position? Is there anyone who thinks that is a bad idea? Okay.

Mr. Kline?

Mr. KLINE. Thank you, Mr. Chairman.

I think there is universal agreement even up here on the dais that that is a good idea.

I just want to ask one question continuing on our sort of sorting out the differences. We see that there is a great deal of commonality, automatic enrollment certainly being one of them. In one or two sentences, because we are going to quickly run out of time, I would like to ask each of you what is the single most important feature of your proposal that you would like us to keep in mind as we are looking at this. What is really the defining or the most important or the distinguishing feature of your proposal that you would like us to take away?

And we will just work right down the line if we could. I know that is hard, but——

Mr. CALABRESE. Yes, it is. It is hard because I think they need to work in combination, but I would say, again, the most important first step, you know, the fulcrum for this, is to give every worker automatic payroll deduction to a clearinghouse, you know, to a platform where they can at least have a low-cost default account that is managed for them.

Mr. KLINE. Okay. Thank you.

Ms. Dudley?

Ms. DUDLEY. I think the one takeaway for the American Benefits Council is the importance of educating the public and employers about personal financial security and the importance of saving and participating in some sort of retirement plan coverage.

Mr. KLINE. Thank you.

Mr. JOHN. Yes. For the Retirement Security Project, we would say it is simple, it is very low cost and, therefore, it is something that can be enacted quickly and easily, and it can make a difference very quickly.

Mr. KLINE. Yes. Thank you.

Dr. Perun?

Ms. PERUN. Yes. Our goal is to have all Americans included in a first-class saving system in the private sector, and we view America's IRA as a way of connecting millions of Americans to the financial mainstream who currently have no attachment to it.

Mr. KLINE. Okay. Thank you.

Mr. Stapley?

Mr. STAPLEY. I think from our perspective, it would be to extend the significant advantages of the employment-based system into a structure where every single American and every single employer

could access the same thing that larger employers get in today's market.

Just very quickly for example, we provide to our plan participants an S&P 500 index fund at 3 basis points. If you go to the marketplace, a financial planner, and you get yourself an IRA, you are probably going to pay around 50 basis points, and there are some financial planners that are selling them for 500 basis points.

I would simply ask the question: Why do we have this disparity? Why does it make sense? Why shouldn't every individual American have the capacity to purchase an IRA on the same basis?

Chairman ANDREWS. If the gentleman would just yield for a second.

Mr. KLINE. Happy to yield.

Chairman ANDREWS. You would be happy?

I think the committee's looking very closely at exactly those questions. There are some discussions of the ways we should regulate disclosure for 401(k) fees, and the committee is very actively looking at those questions.

Mr. KLINE. Mr. Stein?

Mr. STEIN. We have three proposals, so I will need three to six sentences.

Mr. KLINE. You get your 12 seconds back.

Mr. STEIN. Working Group I was, I think, most concerned with increasing coverage but providing employees with the features of a guaranteed pension. Group II, I think, very similar to a number of the other proposals, looked to create a framework that people who do not have access to employee plans could use to save. And Group III, I think, was interested in creating a very simple version of an employer plan that financial institutions would then have an incentive to market to employers that do not now have plans.

Mr. KLINE. Okay. Thank you very much.

I yield back, Mr. Chairman.

Chairman ANDREWS. Thank you, Mr. Kline.

I do notice that two of our colleagues have joined us, and I would first recognize Mr. Wu for 5 minutes for questioning.

Welcome.

Mr. WU. Thank you very much, Mr. Chairman, and I apologize for—well, we just have multiple things going on, and that is not unique to us, and, you know, you all do, too, and thank you very much for being here.

I think that this automatic opt-in proposal is something, I mean, that is just commons sense, and I fully, fully support it.

But I am concerned about one other matter—and if it has been covered earlier, you know, just let me know how you covered it—and that is with the mobility of our workforce, I am deeply concerned about vesting periods. And we had to make this decision for our own law firm before I came to Congress, and, you know, this is not the first time that I have admitted it in public, so I am happy to say it again.

I thought that we should have a vesting period of a year or 2, and it was my Republican law partner who actually said, having an employee hang around to vest is the worst thing in the world. We want someone who wants to be here and who wants to work hard and who is enthusiastic about it, so, you know, any benefit

plans or employer match ought to vest immediately, and, you know, people stay because they want to stay, not because they want to vest.

I would like any of you all who want to comment on that to comment.

Mr. IWRY. Mr. Wu, I very much agree with you, and when I was at the Treasury Department overseeing the regulation of the nation's private pension system and policy in this area, we initiated the movement of vesting from a 5-year to a 3-year period in our nation's 401(k) and defined contribution plans. We have also suggested that defined benefit plans perhaps move to a faster vesting, but we need to be cautious about discouraging defined benefit plans, of which we have done too much already, and so I very much agree with you. We did not propose 3 because we thought that was necessarily the ultimate long-term answer, but because we wanted to do something that would be politically realistic and enactable as it was.

Mr. WU. Well, the then-chairman and now minority leader, I think, proposed 3-year vesting when this committee considered it in the last Congress. I believe I then tried to push him to 1 year, not because I believed in 1 year but because it was pushing the envelope far enough, but I would like to see the fastest vesting——

Mr. IWRY. Well, if I could just add, Mr. Wu, that our proposal here today, the automatic IRA, has faster vesting than what you are aspiring to. There is 100 percent immediate vesting. That is also true of a number of the other proposals.

Chairman ANDREWS. Yeah, I want to be clear on that, that the proposal is that the minute you put a dollar in that account, it is yours.

Mr. IWRY. Correct.

Chairman ANDREWS. Period.

Mr. STEIN. That is the rule today for 401(k) plans with your money.

Chairman ANDREWS. Yes.

Mr. STEIN. And the other thing that I think is interesting in response to this point is when ERISA was enacted there a number of people who testified that we should have immediate vesting. Even back in 1974, there were people advocating for that.

Ms. DUDLEY. If I could just add one thought, that you have to be very sensitive to the cost for small employers. In fact, if you make the vesting requirement too low, you can actually result in fewer matching contributions. Some small employers in particular may not even be able to afford it, so they just will not add a matching contribution whereas if the vesting schedule is something more like 3 years or 2 years or 5 years, they are much more likely to have a matching contribution, and where employees do typically stay that length of time, then people will end up with more money.

Chairman ANDREWS. The gentleman's time has expired.

I want to make sure we get to Mr. Tierney for his questions, and then we will adjourn the hearing.

But Mr. Tierney is recognized for 5 minutes.

Mr. TIERNEY. Good morning.

Chairman ANDREWS. Is that your knee, John? [Laughter.]

Mr. TIERNEY. Pretty much at this age.

Thank you, Mr. Chairman, for having the hearing. As well, I really do not want to take too long.

Did any of you in these plans, which I have not had a great deal of time to go over yet, deal with any type of universal thrift savings plan, anything comparable to what we had? All of them did something on that basis? Does somebody just want to address the thought on that, and then I will call it a day on that?

Mr. John, did you want to address it?

Mr. JOHN. Well, our proposal does include something like a TSP2 to make sure that we have a universal platform that is available for everyone, and that would especially be true of people who live in a central city location without major financial services presence or in some of the rural areas where they do not have quite the same availability of products.

Likewise, however, it could also be handled by a nonprofit consortium somewhat similar to a corporate central credit union or something along that line. It could be handled by a for-profit consortium or any variation in there, but the key to us is to make sure that it is set up so that every worker who wants to have an account does have the account and at a price that makes it reasonable to have.

Mr. CALABRESE. The universal 401(k) plan, you know, that I described also relies on a clearinghouse, and one reason I just want to add is that, you know, we see that also as a way of reducing the burden on employers because if you are going to ask every employer to forward, you know, the payroll-deducted saving of the workers who are not, you know, otherwise in retirement plans, it is much easier, you know, if it is all going to the same place and out from there, you know, and there could be behind that clearinghouse a number of different platforms, whether they are, you know, like TSP, a contracted investment management. You know, that administration could be contracted or there could be several different options, but we would like to make the burden on the employer as simple and straightforward for the employer as possible.

Mr. TIERNEY. Okay. Well, thank you all very much.

Thank you, Mr. Chairman.

I appreciate that, and we appreciate your materials as well which we will read.

Chairman ANDREWS. I thank my colleagues.

I thank the panel for very thoughtful, very comprehensive testimony.

My intention from here is to take the good work that you have done, probably ask more questions about it. I think it is very encouraging that we have the convergence of views that we do. Obviously, some of the issues that arise are outside the committee's jurisdiction, within that of the Ways & Means Committee, but the fact that Mr. Neal and Mr. English are already thinking along these lines is very encouraging.

You know, the best pension policy in this country has been made with very broad bipartisan support. The Portman-Cardin efforts of the last 10 years, the Retirement Act of 2006 were very broadly supported. That is the template that I would like to try to follow here, that we could build a very broad consensus between the two parties, between the House and the Senate, and try to get some-

thing done that would address the needs of the people we have talked about here this morning.

Your contribution has been very, very important, and we appreciate it very much.

Mr. Kline, did you have any closing comments?

Mr. KLINE. Thank you.

Chairman ANDREWS. We thank the witnesses.

I do have to read. As previously ordered, members will have 14 days to submit additional materials for the hearing record. Any member who wishes to submit follow-up questions in writing to witnesses should coordinate with the majority staff within 7 days.

Without objection, the hearing is adjourned. Thank you.

[Statement of the U.S. Chamber of Commerce submitted by Mr. Andrews follows:]

Statement of the U.S. Chamber of Commerce

ON: **HEARING ON "SECURING RETIREMENT COVERAGE FOR FUTURE GENERATIONS"**

TO: **HONORABLE ROBERT ANDREWS OF SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR & PENSIONS**

BY: **RANDEL K. JOHNSON, VICE PRESIDENT OF LABOR, IMMIGRATION, & EMPLOYEE BENEFITS; AND ALIYA WONG, DIRECTOR OF PENSION POLICY, U.S. CHAMBER OF COMMERCE**

DATE: **NOVEMBER 8, 2007**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

Chairman Andrews, Ranking Member Kline, and Members of the Subcommittee, the U.S. Chamber of Commerce thanks you for holding this hearing on "Securing Retirement Coverage for Future Generations" and for providing us the opportunity to comment on this important issue. We ask that this statement be included in the record of the hearing.

The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large. Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business – manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states. Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Introduction

In order to secure retirement coverage for the future, it is necessary to remember that there are several components to the retirement "stool." While this has often been referred to as a 3-legged stool consisting of Social Security, individual savings, and employer-provided pensions, we believe that there may be a potential fourth leg – phased retirement. For a variety of reasons, many Americans are remaining in the workforce beyond what was traditionally thought of as retirement age. Thus, phased retirement should also be considered when discussing retirement security. The Chamber believes that all of these legs must be secure and available. Our comments below address each of these legs, and the issues that we believe must be addressed to ensure retirement security for future generations.

Phased Retirement

The Chamber is concerned not just about current retirement systems, but also ensuring that these systems continue to be valuable retirement tools in the future. Encouraging the implementation of phased retirement programs is vital to this goal. Laws that were put into place 30 years ago may not be adequate to address changes in the current economy. There are a number of demographic and economic factors that are changing the way that Americans think of retirement. Increased life expectancy, changing lifestyles, workforce needs, and the desire to increase income in retirement all

contribute to a need for phased retirement programs. Workers are looking to stay employed beyond traditional retirement ages from a desire to remain engaged in society, to continue earning income, or for other reasons. At the same time, employers who are looking at an impending labor shortage and possible "brain drain" want to keep their experienced and skilled workers in order to remain competitive.

The barriers to phased retirement are many and include legal, fiscal, policy, and practical issues. There are legal restrictions on when benefits can be paid out, there are fiscal concerns surrounding the costs associated with employing older workers, such as increased pension payments and higher health care coverage, and there are policy and practical concerns about how accruals should be calculated during phased retirement or how to apportion the payout. A primary issue for the Chamber, however, is exclusivity because employers want to maintain discretion over the employees that are able to participate in phased retirement programs. In order to maximize skills and expertise, many employers feel that not all employees should be eligible for phased retirement just by reason of having met an age or service requirement.

Phased retirement programs could be advantageous to employers, workers, and the overall economy. It would be injudicious for statutory and regulatory burdens to restrict what could otherwise be a beneficial situation for all parties. Rather, statutes and regulations should encourage employers to implement phased retirement programs that provide attractive benefits and incentives for workers to stay with their employer.

Employer-Provided Pension System

The employer-provided pension system is a critical piece of retirement security for many Americans. Defined benefit retirement plans cover 44.1 million workers and defined contribution plans cover 64 million workers.[1] In addition, employers spend over one billion dollars annually on employee benefits.[2] The Chamber believes that the key element to the private retirement system is the voluntary nature of the system. For employers that choose to implement retirement programs, flexibility and choice are key considerations. The mix of types of benefit plans in the future will be diverse – defined benefit, defined contribution, multiemployer plans, cash balance plans, and hybrid plans. In addition, demographic and competitive needs will spur the creation of plan designs that we have not even begun to contemplate. Consequently, it is increasingly important to ensure that there are no statutory, practical, or political barriers to innovation that would discourage participation in the private retirement system.

In addition to the general principles stated above, there are several particular areas in the private system where attention is required to ensure the continuation and growth of the employer-provided system.

[1] BLS Abstract of 2004 form 5500 published in March 2007.
[2] EBRI Databook on Employee Benefits.

ERISA Preemption. Employee Retirement Income Security Act preemption is an important public policy. ERISA allows employers to achieve greater bargaining power, economies of scale, and administrative efficiencies when designing retirement and health benefits plans for their employees who reside and work in multiple states. Weakening the preemption provisions will weaken the ability of employers to provide both retirement and health care benefits. Employers depend on ERISA preemption to ensure that coverage can be offered uniformly across the country and administered relatively efficiently. ERISA preemption also gives each employer the flexibility to design the terms of retirement and health plans to meet the changing needs of their unique workforce. The Chamber sincerely hopes that Congress will continue to recognize the vital role ERISA plays in the employer-provided benefits system and protect any attempts to diminish the national framework it provides.[3]

Cash Balance and Hybrid Plans. In order to secure future retirement security, plan sponsors must be encouraged to maintain plans that fit the needs of their workers. Unfortunately, sponsors of cash balance and hybrid plans have not received such encouragement and some cash balance plans continue to deal with unexpected and onerous hurdles. With the passage of the Pension Protection Act of 2006 ("PPA"), the Chamber believes that Congress has signaled its intent to confirm the legality of hybrid plans – including hybrid plans converted from a traditional benefit plan. However, certain cash balance plans continue to be plagued with legal difficulties.

Officials in the Internal Revenue Service ("IRS") have indicated that certain hybrid plan conversions are possibly at risk of violating the tax qualification rules. In particular, these officials maintain that hybrid plans that provided plan participants with the greater of the benefits under the old (traditional) pension plan or the benefit under the new hybrid plan violate the anti-backloading rules in ERISA. In response to pressure from Congress, the business community and other interested parties such as AARP,[4] the Treasury Department and the IRS have agreed to provide further guidance on this issue and have also agreed not to issue any negative guidance before the end of the year. We hope that Congress remains engaged in this issue and, depending on the outcome of the guidance, will work to ensure that the intent and spirit of the PPA is maintained and that plan sponsors are finally able to sponsor cash balance plans without fear of future unforeseen liabilities.

Small Business. According to the U.S. Small Business Administration, small businesses (less than 500 employees) represent 99.9% of the total firms and over

[3] On May 22 of this year, this subcommittee held a hearing entitled, "Health Care Reform: Recommendations to Improve Coordination of Federal and State Initiatives." The Chamber submitted detailed comments for the record on ERISA preemption. The remarks here are a summary of those comments.

[4] Copies of letters sent to Treasury and IRS by various industry groups can be found at http://benefitslink.com/index.html.

half of the workforce in the United States.[5] Clearly, ensuring adequate retirement security for all Americans means encouraging small businesses to participate in the private retirement system. Small businesses, in general, face significant hurdles and may view retirement plans as yet another potential obstacle and therefore, choose not to establish them. Thus, there have been tremendous efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.[6] As a result, small businesses with less than 100 employees cover more than 19 million American workers.[7] In order to maintain and expand this success, it is necessary that Congress remain sensitive to small business plan issues and minimize the administrative and financial hurdles that they face.

Investment Advice. Defined contribution plans, which largely did not exist when ERISA was enacted in 1974, require greater employee participation than traditional defined benefit plans, in which the employer pays for the entire benefit and takes on investment risk. Clearly, the need for education and advice on how to invest that money is an important complement to the defined contribution retirement model. While the PPA took a step in the right direction, we believe that there is additional work that can be done. The Chamber supports changes to current law that would allow employers to provide employees access to investment advice from regulated professionals as long as there are adequate disclosures concerning fees and any potential conflicts of interest.

FASB Accounting Rules. Last year, the Financial Accounting Standards Board ("FASB") undertook a project to reconsider the method by which pensions and other benefits are reported in financial statements. On Sept. 29, 2006, FASB completed Phase I of this project.[8] In Phase II, FASB will evaluate and propose changes to the accounting standards for measuring pension costs, obligations and assets. Indications are that FASB intends to remove smoothing periods from the measure of liabilities. As you are aware from debates during the PPA, smoothing techniques are extremely important to the defined benefit system because they provide predictability and consistency. Consequently, we expect that Phase II

[5]U.S. Small Business Administration Office of Advocacy estimates based on data from the U.S. Dept. of Commerce, Bureau of the Census, and U.S. Dept. of Labor, Employment and Training Administration.
[6] Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that was made permanent by the Pension Protection Act of 2006 small businesses may claim a tax credit for establishing a retirement plan equal to 50% of qualifying costs up to $500 per year for the first three years. In addition, the PPA instituted a number of additional positive reforms including the creation of the Roth 401(k), simplification of a number of complex administrative requirements, and the creation of the DB(k) for small businesses.
[7]Patrick J. Purcell, Congressional Research Service (CRS) Report for Congress, Social Security Individual Accounts and Employer-Sponsored Pensions, February 3, 2005, Table 2. Employee Characteristics by Employer Retirement Plan Sponsorship, 2003 at CRS-5.
[8] Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (FAS 158). This statement requires companies to report the net financial status of pension and other benefits on the company's balance sheet rather than in the footnotes. In addition, plan assets and benefit obligations must be measured as of the date of the employer's fiscal year end and employers must use the projected benefit obligation measure of liabilities

will have significant negative consequences for employers with defined benefit pension plans. We urge Congress to weigh in to express concern about any such accounting rules and their potential to discourage the maintenance and expansion of the defined benefit system.

Individual Savings

No one financial product is best suited to address all of the financial risks that individuals can potentially face in retirement. Thus, any tax incentive or other policy initiative designed to encourage prudent distribution of retirement assets should be broad-based, take into account the wide array of challenges that arise during one's retirement years, and provide incentives that encourage individuals to make appropriate retirement decisions based on their particular financial circumstances and individual needs.

The Chamber has been particularly supportive of legislation that would encourage taxpayers to convert individual savings into lifetime income annuities.[9] These products provide steady payments for the remainder of the purchaser's life and help reduce the risk of losing one's investments in a market downturn or outliving one's nest egg. With more U.S. workers participating in defined contribution programs, this legislation would provide retirees with a guaranteed source of monthly income that could not be outlived. As Americans of the baby-boom generation near retirement, it is critical that public policy encourage retirees to manage and draw upon their retirement savings in a manner that appropriately addresses their individual needs and circumstances.

Also impacting individual savings are several proposals that attempt to expand retirement coverage through the use of payroll IRAs.[10] The Chamber has not taken a position on these proposals because we would like further details concerning the administration and investment of such accounts. However, we very much applaud the intent of these proposals to increase retirement savings coverage. To this end, we have supported automatic enrollment provisions and the permanent expansion of the qualified savings limits. We are, however, concerned about the mandatory nature of these proposals. Mandatory choice or any other mandatory benefit imposition is inconsistent with the voluntary nature of ERISA and employer-provided retirement programs. Therefore, we urge extreme caution in the consideration of legislation that would impose a mandate upon employers.

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[9] S. 1010, the "Retirement Security for Life Act of 2007"would provide a 50 percent deduction on up to $20,000 of taxable income from a lifetime income annuity.

[10] S.1141, Automatic IRA Act of 2007; H.R.2167, Automatic IRA Act of 2007; S.1288, Women's Retirement Security Act of 2007; J. Mark Iwry and David C. John, Pursuing Universal Retirement Security Through Automatic IRAs (Draft), *White Paper #02122006* (February 12, 2006) http://www.heritage.org/Research/SocialSecurity/wp20060212.cfm.

Social Security

An important component of retirement for many Americans is Social Security and the Chamber has been involved in much of the reform effort. The chief objective of Social Security should be to provide a basic floor of economic protection upon retirement which the individual can enhance through private retirement programs and personal savings. The only permanent way to strengthen Social Security is to transform the system.

We understand that such transformation will require extensive study, debate, and working through of details. The Chamber has several principles that we believe are necessary to strengthen our current system. Reform should not unduly burden future generations to pay for current benefits. Workers of current and future generations must receive a fair market return on what they pay into the system. In addition, we must consider advance funding, at least partially, of future promised benefits through private capital markets. This should include, for example, allowing younger workers to invest a portion of their tax contributions in individually managed accounts. And, finally, as economic and social conditions change, there will be a continuing need for Congress to review periodically all aspects of Social Security including objectives, financing, benefits and eligibility.

Conclusion

Individuals, employers, and the government all have a shared role in ensuring retirement income security for current and future generations. Therefore, Congress should work toward encouraging savings and retirement planning among all of these avenues and, at the very least, should not establish barriers and roadblocks.

We appreciate the opportunity to share our thoughts and concerns with you and look forward to future discussion on this issue.

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[Whereupon, at 11:44 a.m., the subcommittee was adjourned.]

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