FULL COMMITTEE HEARING ON DROP IN RETIREMENT SAVINGS: THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

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FULL COMMITTEE HEARING ON DROP IN RETIREMENT SAVINGS: THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

Wednesday, February 25, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360, Rayburn House Office Building, Hon. Nydia M. Velázquez [Chair of the Committee] presiding.

Present: Representatives Velázquez, Moore, Dahlkemper, Schrader, Bean, Clarke, Sestak, Bright, Halvorson, Graves, Buchanan, Luetkemeyer, Schock, Thompson, and Coffman.

Chairwoman VELÁZQUEZ. I call this hearing of the Committee to order.

If we have learned anything from the current financial crisis, it is that for better or worse, Main Street's economy is tied to the markets on Wall Street. As a result, the recent decline in the stock market has touched every corner of our lives and the fallout is everywhere. But while much has been made over indicators like tightened credit and reduced consumer spending, there are other troubling consequences. One of the most overlooked effects of the stock market slide has been the impact on small business retirement plans. It has been estimated that in the last 18 months, over $2 trillion in retirement savings has been lost from retirement plans, primarily due to the stock market's decline. Just in the last year, 401(k) account balances for workers between 35 and 65 have shed over 20 percent of their value.

For small businesses and their employees, these problems are compounded. Unlike Wall Street executives, small firms do not have golden parachutes to fall back on. For many of these men and women, pensions and 401(k) plans are their only form of savings. So when the volatility in the stock market impacts their accounts, entrepreneurs are hit particularly hard. As the economic downturn hits retirement funds, small businesses that provide these benefits are finding it even harder to stay afloat. Employers that try to do the right thing and offer a secure retirement to their workers are being hit the hardest. For example, when the value of pensions drop, many small business owners still find themselves on the hook for paying out benefits.

With credit almost impossible to access, consumer spending near an all-time low, and sales devastated, small firms simply lack the revenue to fund retirement plans. In some cases, this means entrepreneurs do not have the ability to meet their legal obligations. In other instances, small businesses are scaling back or ending their contributions. Overall, too many small businesses are finding that continuing to fund their retirement plans would put their entire business in jeopardy.

In today's hearing we will explore ways to help small businesses that have offered retirement plans but are now in a difficult position because of poor decisions made on Wall Street.

One way to assist small business owners might be to cap the amount of losses that they are responsible for paying during market downturns. This could help keep solvent many firms with defined benefit plans. Another approach would allow small firms to look further ahead for pension values when calculating how much they must pay into employees' retirements.

Other proposals would encourage small employers to offer retirement plans by making it easier to borrow against them during difficult economic periods.

These and other ideas merit further discussion. But while a number of approaches can be taken, one thing is clear: We must act soon to help small businesses struggling with retirement fund obligations.

A secure retirement has long been part of the American social contract. Now, too many small employers are suffering for simply trying to live up to their side of the bargain.

Chairwoman VELÁZQUEZ. I welcome our witnesses and now I yield to Mr. Graves for an opening statement.

Mr. GRAVES. Thank you Madam Chair. And I want to thank you for calling this hearing to examine the difficulty that small businesses are having in maintaining and offering retirement plans in the current economic climate. America's economy is suffering a very difficult downturn. Right now consumer confidence is declining, the housing slump endures, layoffs continue, well-known enterprises are closing their doors or declaring bankruptcy, and credit simply is not flowing to the small firms as quickly as we had hoped.

Saving for retirement has always been a challenge for Americans. In 2008 the Employee Benefit Research Institute reported that almost half of workers who are saving for retirement said they had less than $25,000 in total savings and investments, excluding the value of their home and defined benefit plans. That number is probably lower today. And that is the savings level for workers who report that they save. Many simply do not or cannot.

According to the Small Business Administration, small companies represent over 99 percent of all employers. Yet a National Federation of Independent Business Survey reports that just 30 percent of small firms offer pension plans. These companies face numerous barriers to offering retirement savings such as the cost and complexity of administering a plan. As the workforce ages, retirement savings is becoming even more important.

In the current economic climate, the financial performance of pension and retirement savings plans has been uneven, and many

employees and business owners are concerned. Increasingly, large and small companies are mindful of how these plans affect their earnings and their balance sheet. Some believe that plans have over-relied on investments in the stock market. Given the recent performance in the market, individuals and business owners are concerned about the viability of their retirement investments.

We have a very distinguished panel of witnesses today here, and I look forward to hearing all of your thoughts and appreciate you all coming in for this hearing.

Thank you Madam Chair. I yield back.

Chairwoman VELÁZQUEZ. Thank you Mr. Graves.

Chairwoman VELÁZQUEZ. I welcome Mr. Stephen L. Dobrow. He is the President of Primark Benefits located in San Francisco, California. Mr. Dobrow entered the retirement field over 30 years ago and has led Primark Benefits since 1990. Primark Benefits provides consultant, administration and actuarial services for qualified retirement plans. He is testifying on behalf of the American Society of Pension Professionals and Actuaries. He represents career retirement plan professionals.

Welcome and you have 5 minutes to make your testimony.

STATEMENT OF STEPHEN DOBROW, QPA, APA, CPC, CEO, PRIMARK BENEFITS, BURLINGAME, CALIFORNIA; ON BEHALF OF AMERICAN SOCIETY OF PENSION PROFESSIONALS AND ACTUARIES (ASPPA)

Mr. DOBROW. Chairwoman Velázquez and Ranking Member Graves, the American Society of Pension Professionals and Actuaries, ASPPA, appreciates this opportunity to testify before you today on the challenges small businesses face in funding and maintaining their retirement plans in a struggling economy.

I am Stephen L. Dobrow, the current President of ASPPA, and president of Primark Benefits, a San Francisco-based employee benefits firm that provides administration and actuarial services for retirement plans.

ASPPA is a national organization of more than 6,500 retirement professionals of all disciplines, who provide services for qualified retirement plans covering millions of American workers. ASPPA members are united by a common dedication to the private retirement plan system, with a particular focus on the issues faced by small- to medium-sized employers.

The current economic crisis is weighing heavily on the heart of the American economy, our small businesses. Many small companies are struggling to stay afloat as sales drop off. And it is harder to come by loans. Many small businesses sponsor a retirement plan and want to continue to do so. However, plan sponsors are facing unprecedented pressures because of the current economic conditions.

I would like to focus today on two important areas where relief is critically needed: defined benefit pension plan funding relief; and 401(k) safe harbor plan relief. If the relief is not provided, many employers will be forced to freeze or terminate their retirement plans.

In a defined benefit plan, the employer takes on all the investment risks and contributes whatever it takes to pay for promised

benefits. Employers that have been willing to take on this risk are now being slammed by the market downturn and desperately need your help.

As a real-life example I want to tell you about one of my defined benefit clients, a fruit importer with 15 employees. Because of how pension plan rules work, as well as a drop in the market value of the plan's assets, the minimum contribution rose from $177,000 in 2008 to $474,000 in 2009. There is no way that this employer can afford the nearly $300,000 increase. Profits are down because of the economy. The sponsor cannot go to a bank to borrow the money in this financial environment. They may be forced to pay an excise tax this year because of the inability to contribute the increased amount, and plan termination will likely result unless adequate relief is offered.

There are a variety of proposals for providing funding relief. The ideal solution would be to provide options to sponsors. These options would include basing the current year's contribution upon the amount paid in the prior year, better use of a tool called ″asset smoothing,″ and allowing for interest-only payments on the investment losses. The employer I described earlier would receive substantial funding relief from either the lookback or the interest-only approaches.

In general, 401(k) plans must satisfy a certain amount of discrimination requirements. Under the popular 3 percent 401(k) safe harbor plan design, an employer commits before the year begins to contributing 3 percent of compensation to all eligible employees. Treasury regulations do not permit an employer to change his or her mind once making the commitment, except by terminating the plan.

One of my clients, Cyclonix, a Silicon Valley company with 60 employees that does branding and trade show work, last year they contributed $69,000 to their safe harbor plan for 2009 and became obligated to contribute about $72,000 to the plan. They contacted us last month to discuss their options because their financial picture had changed, and they no longer could afford all of the required contribution. And unfortunately under the current rules, none of the options are good. They are now considering terminating their 401(k) plan or possibly laying off some employees.

To help Cyclonix and other small businesses maintain their 401(k) plans, ASPPA has asked the IRS to promptly issue guidance to permitting employers to suspend safe harbor contributions prospectively while still protecting the rights of employees. Further, a new safe harbor should be created that allows employers to adopt a wait-and-see attitude in meeting the safe harbor.

Small employers are the heart of the American economy. As a small business owner who provides services to other small business owners, I can tell you that we want to do the right thing by our employees. We just need your help. We are not looking for a bailout, only for a life jacket to keep our heads above water during these troubled times. Regulatory relief for safe harbor 401(k)s and funding relief for pension plans are straightforward ways to help small businesses meet cash demands without resorting to plan termination and, in some cases, dumping liability on the PBGC or laying off more workers.

Thank you for the opportunity to speak to you today.

Chairwoman VELÁZQUEZ. Thank you Mr. Dobrow.

[The statement of Mr. Dobrow is included in the appendix at page 29.]

Chairwoman VELÁZQUEZ. And now the Chair recognizes the Gentlelady from Illinois, Ms. Bean, for the purpose of introducing the next witness.

Ms. BEAN. Thank you, Madam Chairwoman. First of all, let me thank all of our witnesses who are here to testify and share your experiences and your subject matter expertise on this important issue of trying to make sure that our small businesses can maintain their pension coverage. I am delighted to welcome our next witness, Jason Speer, whom I know personally and have had the pleasure of working with and visiting his business. He is the vice president and general manager of Quality Float Works based in Schaumburg, Illinois, in the beautiful Eighth District that I am honored to represent.

Quality Float Works is a manufacturing company with 24 employees that produces premier metal float balls. He is testifying today on behalf of the U.S. Chamber of Commerce, the world's largest business federation, representing 3 million businesses as well as State and local chambers and industry associations.

Today Quality Float Works exports to such international locations as Belgium, Canada, China, Germany, Indonesia, Ireland, Mexico, Singapore, Vietnam and throughout the U. K. This international growth is one of the reasons why Quality Float Works was recently named one of the fastest growing companies in America.

By harnessing his passion for manufacturing, Jason has turned a virtually unknown family business on the verge of financial collapse into an industry leader. He has also shared his experiences with other businesses in my Eighth District. I often invite various parts of the Federal Government to talk about their programs, and I have had the Commerce Department come out and talk about the gold key program and the value of trade and exports to small businesses. And Jason was kind enough to back that up, because when government says we are here to help, businesses don't always believe it. But when we have other businesses who have participated in these programs successfully and can share that, they really establish a model. So I thank you for encouraging others to follow your lead.

Thank you for participating today. And I am glad to welcome you to Washington.

Mr. GRAVES. Madam Chair, may I ask what a metal float ball is?

Mr. SPEER. They are hollow metal balls, you see them on top of flagpoles, weather vanes, kind of like a toilet float; also for industrial uses, a wide range of different applications.

Chairwoman VELÁZQUEZ. The gentleman is recognized for 5 minutes.

STATEMENT OF JASON SPEER, QUALITY FLOAT WORKS, INC., SCHAUMBURG, ILLINOIS; ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

Mr. SPEER. Thank you, Chairwoman Velázquez and Ranking Member Graves and members of the Committee for this oppor-

tunity to appear before you today to discuss challenges facing small business in a struggling economy. My name is Jason Speer, vice president and general manager of Quality Float Works Incorporated based in Schaumburg, Illinois.

I am pleased to be able to testify today on behalf of the U.S. Chamber of Commerce where I am a member of its Small Business Council. The Chamber is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector and region. Over 96 percent of the Chamber members are small businesses with fewer than 100 employees.

Quality Float Works is a family-owned and -operated company that manufactures premier metal float balls. We are globally engaged and have grown our sales in the international marketplace. Quality Float Works has 24 employees and did approximately $2.7 million in revenue for 2008. We offer employees a 401(k) plan and provide up to a 4 percent match. The Quality Float Works plan enables employees to choose funds, change contribution rates at any time and work with an adviser to seek guidance. We encourage all employees to participate, as they are like family, and we want them to be prepared for their retirement.

I am the administrator of the plan, and in that capacity it is my responsibility to assist with enrollment, ensure that contributions are transferred to the facilitator, and direct questions to the appropriate person.

We are all aware of the current economic situation. The equities markets have fallen an average between 30 and 50 percent, and this decline is reflected both in defined benefit plan balances and the accounts of participants in 401(k) plans. For Quality Float Works specifically, we are facing slowing sales due to the economic climate even though our company is diversified.

Quality Float Works has weathered many ups and downs in the past 94 years, and recent additions for our product line led record sales in 2008. However, due to the recent global economic crisis, we predict that 2009 will be a difficult year and we are unsure of how our sales will be in 2009, and will potentially look at reducing expenses if sales decrease.

In that context, the challenges facing small business can be particularly challenging. Quality Float Works established its 401(k) plan in 2005. Prior to that we had an IRA, and we stopped that in 2001 after another similar decrease in sales. When we started the 401(k) plan, 12 employees enrolled. In 2008, five stopped participating, due to concerns about the market, and several others have expressed similar concern in recent months. If too many participants drop out of the plan, we risk not meeting our minimum contribution requirements that are required in the contract with our facilitator. Thus, even though we would like to continue to maintain our 401(k) plan, we may be not able to do so if our employees do not stay in the plan.

In addition, due to the financial crisis, small business plan sponsors are acutely aware of administrative costs. One result of participant concern is that there is an increase in demand for distributions, both hardship withdrawals and loans. Moreover, participants may increase their request to make changes to their investments. These events increase administrative costs unexpectedly and take

a significant toll on small businesses already experiencing financial strain.

In December, Congress passed the Worker Retiree Employer Recovery Act of 2008 which includes important changes for retirement plans. We very much appreciate the work that Congress did on this bill. However, there are some issues that require additional attention. The law did not change 2008 distributions; therefore, beneficiaries who turn 70-1/2 in 2008 still have to take delayed distributions by April 1, 2009. However, there are still some exceptions to the suspension of the RMD rules that participants and plan sponsors may not be fully aware of. For small business owners, communicating these issues and ensuring that plan participants understand these issues can be challenging. Many employees do not understand the changes to the rules and look to me as the plan administrator for advice. Thus, additional clarification of the changes to the rules would help plan sponsors administrate these rules effectively.

Moreover, defined benefit plans need additional help. Their support show that the pension funding ratios have fallen significantly over past 3 months and it is unlikely that these markets will recover in the immediate future. Without further legislative action, these unexpected funding requirements will continue to require that companies choose between funding their pension plans and laying off workers, closing plants and postponing capital investments. This will result in increased unemployment and slower economic recovery.

Finally, I believe it is important to highlight one specific recommendation. The current challenges highlight how small businesses continue to often need additional consideration. To this end, the Chamber is encouraging Congress to consider adding a small business representative to the ERISA Advisory Council. The challenges facing small business plan sponsors in the current economic downturn are substantial. In the current economic environment it is more important than ever that Congress focus on encouraging the implementation and maintenance of retirement plans by small businesses.

I thank you on behalf of myself and the Chamber for the opportunity to testify today and look forward to any questions you might have.

Chairwoman VELÁZQUEZ. Thank you Mr. Speer.

[The statement of Mr. Speer is included in the appendix at page 35.]

Chairwoman VELÁZQUEZ. Our next witness is Mr. Andrew Keeler. He is a partner and founding firm member of Everhart Financial Group. Everhart Financial Group helps individuals with personal financial planning, investments and mortgages and also serves mid- to large-sized corporations with flexible customized retirement, 401(k) and profit sharing plans. He is testifying on behalf of Financial Planning Association. FPA is an organization that helps practitioners succeed as financial planners. Welcome.

STATEMENT OF ANDREW KEELER, CFP, EVERHART FINANCIAL GROUP, DUBLIN, OHIO; ON BEHALF OF THE FINANCIAL PLANNING ASSOCIATION (FPA)

Mr. KEELER. Thank you, Chairwoman Velázquez, Ranking Member Graves, and other Members of the Committee for inviting me to talk to you about the challenges facing small businesses trying to provide retirement plans for their employees during these difficult economic times. I am Andy Keeler, a certified financial planner practitioner and partner with the Everhart Financial Group in Dublin, Ohio. I am honored to be here today on behalf of the Financial Planning Association to address your concerns about how the current economic environment is affecting employees of small businesses' ability to save for retirement and, more importantly, how it is affecting their ability to achieve a positive financial outcome with respect to retirement.

Our firm assists its corporate clients in establishing and maintaining customized retirement plan solutions. The most critical part of this process is face-to-face meetings where we learn more about the participants as individuals and their needs and expectations, and hoping those participants understand the importance of saving for retirement and the determinants of wealth.

As you might imagine, the largest determinant of wealth is the amount of money that is being saved by or for a retirement plan participant. Savings rates are the key factor followed by market performance and security selection. As you all are well aware, this country has seen a major shift of responsibility for retirement planning from the employer to the employee. Yet we as a society have neglected to explain to America's workers how this shift of roles and responsibilities affects their retirement income down the road.

Under the traditional defined benefit plan, retirees would receive around 60 percent of pre-retirement income until death. Worries about the stock market were nonexistent. Participants didn't see a retirement plan balance or dollar value, nor were they beat over the head with negative financial news. All the participant had to do is simply count on a monthly income stream in retirement. To finance this retirement liability, employers had to contribute roughly 25 to 30 percent of the employee's income into the defined benefit trust each and every year.

As employers faded out the defined benefit plan and implemented the defined contribution plan, we failed to inform employees that they would need to receive annual additions of between 25 and 30 percent of their income each year for the next 30 years. Today, we are finding that employees either choose to save nothing or they contribute up to the employer match, which is often between 3 and 6 percent of pay. We find that the lower the match, the lower the contribution rate for the employee.

Not only are participants not saving enough, but they must direct their own investments and make their own investment decisions. This is a responsibility that the average American is ill-prepared to do, or do well. Most people, once properly informed and educated, understand that over long periods of time, the stock market has historically provided the greatest return.

However, now we are faced with the worst bear market since the Great Depression and employees are losing faith in our securities

markets and questioning the fundamental premise of investing over the long term. I often hear participants say, ″I can't afford to lose everything,″ or ″Should I stop contributing to the plan until the market goes back up?″

While most lay people are initially willing to take risk over long periods. When they actually see losses on their statements, their risk tolerance will shift and they will look for more conservative options; options that reduce the chance of a positive financial outcome. In addition, we have employees that are laying off their workforce. No paycheck means no savings.

Obviously, at the heart of the recession are businesses big and small that are having a hard time staying in business. The 401(k) match is the first thing to go. If eliminating the match is not enough, a more drastic measure is to terminate the plan. Start-up fees, ongoing record keeping fees and administrative fees can be easy targets for a CFO looking to cut cost in difficult times. One incentive would be to enhance the current tax credit that is being used to offset the start-up cost and the cost of educating employees about the plan. This credit should be broadened to include any employer with less than 500 employees and it should also be broadened to offset employer contributions to a retirement plan. The credit would work like the current tax credit for low-income and middle-income consumers, which is detailed in my written testimony.

The best way to help participants from making poor financial decisions is to improve financial literacy for consumers, as we heard from the President yesterday. Public service announcements could cover a lot of ground towards this end. The Financial Planning Association and numerous independent non-profits can offer stimulating and compelling research that reinforces the value of saving and investing prudently.

FPA, for example, maintains a partnership with Junior Achievement in which personal financial literacy is taught to students by certified financial practitioners. But that is not enough. According to the Jump Start Coalition, a national financial literacy group, only three States require at least a one-semester course dedicated to personal finance while another 17 allow it to be integrated into another curriculum, usually math.

Madam Chairman, Ranking Member Graves, ladies and gentlemen, we are at a very important time in which Americans are losing faith in the financial system and frustration is building. Retirement assets have shrunk by roughly 40 percent with the paper losses in the trillions of dollars. The investing public is questioning the value of saving for retirement. There have been many times over the past 200 years that Americans came together and rallied for a common cause. Sense of entitlement, jealousy and resentment often take the back seat when times get rough or a situation is approached properly. This is our problem. Participants may surprise you. If they are made aware of the problem and armed with the knowledge to make sound financial decisions, we will be impressed by the outcome.

I am happy to respond to any questions.

Chairwoman VELÁZQUEZ. Thank you Mr. Keeler.

[The statement of Mr. Keeler is included in the appendix at page 43.]

Chairwoman VELÁZQUEZ. Our next witness is Ms. Catherine Collinson, senior vice president of strategic planning in Transamerica Retirement Services in Los Angeles, California. In this post she is responsible for developing and implementing short- and long-term strategic business plans. The Transamerica Center for Retirement Studies conducts studies of retirement trends and issues facing the American workforce. Welcome. You have 5 minutes.

STATEMENT OF CATHERINE COLLINSON, PRESIDENT, TRANSAMERICA, CENTER FOR RETIREMENT STUDIES, LOS ANGELES, CALIFORNIA

Ms. COLLINSON. Thank you for this opportunity. Again, my name is Catherine Collinson and today I am actually testifying in the capacity of the Transamerica Center for Retirement Studies, and I am very pleased to share with you some of our recent research.

Employer-sponsored retirement plans in small business play a critical role in facilitating savings for American workers. The Transamerica Center for Retirement Studies just completed the tenth annual Transamerica retirement survey of 3,466 full-time and part-time workers across the country, over half of whom work for companies employing between 10 and 499 persons. That is what we are calling small business.

The survey found that 76 percent of workers who have access to workplace defined contribution retirement plans participate in them. Equally significant, workers who are offered a company-sponsored retirement plan are more likely to save for retirement outside of work—67 percent—than those who are not offered a plan—52 percent.

Regarding retirement planning coverage and small business, 75 percent of full-time workers are offered a plan by their employers compared to only 24 percent of part-time workers. Because only 9 percent of the workers surveyed indicated that they are offered a company-funded defined benefit plan, this testimony will focus on defined contribution plans.

The economic downturn has already started taking its toll on small business. Among the worker survey respondents, the survey found that their employers had implemented the following measures over the last 12 months: layoffs or downsizing, 32 percent; frozen salaries, 20 percent; eliminated bonuses, 18 percent; reduced or eliminated non-retirement benefits, 9 percent; and reduced or eliminated retirement benefits, 10 percent.

Of those indicating that their retirement benefits had been reduced or eliminated, these were their responses. Company match on 401(k) or similar was reduced or eliminated, 72 percent. 401(k) or similar plan was discontinued, 14 percent. Pension plan was frozen or discontinued, 20 percent.

Fifty-six percent of the workers surveyed say they are less confident in their ability to achieve a financially secure retirement than they were 12 months ago and 29 percent expect to work longer and retire at an older age. Forty percent of the respondents indicated they plan to work past the age of 70, including 17 percent

who do not plan to retire. Yet despite this gloomy outlook, workers are staying committed and continuing to save in their company's retirement plans.

Ninety percent of workers still value a 401(k) plan as an important benefit. Participation at 76 percent and median salary contribution rate, 7 percent, remain stable. Even more compelling, 18 percent indicated they have increased their contributions over the last 12 months. Eleven percent have said they have taken a loan and only 4 percent have taken a hardship withdrawal.

The survey also found opportunities for improvement, as evidenced by the 69 percent of workers who agree they don't know as much as they should about retirement investing.

And now for recommendations:

First, preserving and improving upon the existing system. While defined contribution plans are proving to be a highly effective solution, the system is not without risk. More work can be done to help workers navigate through this economic downturn and equip them with tools to do so, including access to affordable financial advice.

Second, funding and maintaining retirement plans in the struggling economy. A key to avoiding any potential further reductions in benefits will be to help alleviate the cost to the employer. Possible solutions include tax credit for small business employers who sponsor and make employer contributions to a plan, and further simplification of nondiscrimination in testing worlds.

In addition, plan coverage rates could be increased by the following: additional tax incentives and safe harbors to encourage plan sponsors to expand coverage to part-time employees; increase the amount available and number of years for the current start-up tax credit for small businesses to establish a plan; and for small businesses in which a stand-alone plan is not feasible, enable and provide incentives to join a multiple employer or group plan. Lastly, increasing savings of low- to middle-income workers.

The Transamerica survey found that 40 percent of low- to middle-income workers reported less than $5,000 in total household savings. The savers' credit offers a meaningful incentive for them to save. However, only 18 percent are aware of it. Recommendations include adding it to the 1040 easy form and/or ensuring that online free file programs are designed to catch the savers' credit if they are unaware. The IRS should promote it, as well as consider increasing the eligible income limits and making it refundable.

Thank you for this opportunity.

Chairwoman VELÁZQUEZ. Thank you, Ms. Collinson.

[The statement of Ms. Collinson is included in the appendix at page 52.]

Chairwoman VELÁZQUEZ. And now I recognize Mr. Edward Ferrigno. He is the vice president of Washington Affairs for the Profit Sharing/401k Council of America. Mr. Ferrigno has extensive experience in human resource management and government relations. The Profit Sharing/401(k) Council of America is an association of businesses which believe in the success of profit sharing, 401(k) and related savings and incentive programs. Welcome.

STATEMENT OF EDWARD FERRIGNO, VICE PRESIDENT, WASHINGTON AFFAIRS PROFIT SHARING/401(K) COUNCIL OF AMERICA

Mr. FERRIGNO. Thank you, Chairwoman Velázquez, Ranking Member Graves and members of the Committee for the opportunity to appear before you today. The Committee has asked how the economic crisis affects small business retirement plans. My initial response is the same as for large businesses, only worse. After some thought, I identified two special ways in which a small business retirement plan is impacted differently than a large plan.

But first I would like to address the market crisis. 401(k) plan participants working in partnership with employers can successfully manage normal market risks and cycles and accumulate ample assets for retirement; however, they cannot succeed without sufficient and transparent capital markets. The drop in 401(k) account balances was not caused by a defective 401(k) system or by ignorant participants. These plans are caught in the same financial crisis that has paralyzed business and financial organizations throughout the world. We urge the Committee and Congress to direct their efforts to ensure a similar market collapse never occurs again.

Contrary to several published reports, real current data indicates that 401(k) participants are remaining resolute. They are not stopping contributions or increasing loan activity. And I certainly recognize Mr. Speer's situation. Hardship withdrawals have increased slightly, but the percentage of participants taking the hardship distribution remains well below 2 percent.

The cost-benefit analysis for micro-plans changes in an economic downturn. In very small business, the owner's personal financial situation is a major factor in deciding to offer a plan to employees. For the benefit of personally saving in a tax-qualified plan, the owner must be willing to pay the expenses of offering a retirement plan to employees. This equation changes in an economic downturn. The benefit of a tax deferral is diminished by the owner's reduced income from the business.

On the cost side, plan service providers might increase their fees because plan assets that drive asset-based fees are lower, and participating activities resulting from the market collapse is increasing. The owner may decide to terminate or not offer a plan and contribute to an IRA. Another option is a low-cost variable annuity with no contribution limits, in which investment earnings are deferred the same as if in a qualified plan. These products are available for as little as 25 basis points over normal investment fees. If the owner has no current tax liability, this option is probably significantly more attractive than offering a plan.

Second, the top-heavy rules are more onerous in an economic downturn. They provide that if 60 percent of a plan's assets are in the accounts of the highly compensated or key employees, the company must contribute 3 percent of pay for full-time employees over the age of 21 with 1 year of service. As you know, this onerous rule affects only small plans because there is virtually no turnover of highly compensated employees, and turnover among young employees is high. This is exacerbated during an economic downturn. The top-heavy rules should be repealed.

And to build on Mr. Dobrow's testimony, a 401(k) safe harbor plan is not subject to the top-heavy rules. If we fix, if we provide relief for the safe harbor plans, some are going to go from the pot to the frying pan because they are going to be top-heavy.

As Congress considers fee disclosure and other reforms, it is critical that small plan issues be represented. Small businesses do not have the resources of a large business to meet their duties under ERISA. For example, small businesses rely on service providers to tell them about plan fees. However under ERISA, they, not the service provider, have the responsibility to ensure that plan fees are reasonable. PSCA supports legislation that shifts the burden from plan sponsors to try to determine plan fees to service providers being required to furnish this information.

Many small businesses prefer reviewing costs in an aggregate or bundled manner. As long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable, without being required to analyze each fee on an itemized basis.

Finally, legislation should preserve this option.

In the 110th Congress legislation was introduced to create mandatory payroll IRAs in which a business of 10 or more employees that doesn't offer a retirement plan must offer a payroll IRA plan. Employees age 18 or older must be automatically enrolled at 3 percent of comp. A small credit is intended to offset employer cost. President Obama supported this proposal during his candidacy, and I expect it to be included in the budget tomorrow.

Because a default investment is required, the plans are subject to ERISA. The default investment must be prudently selected and fees must be reasonable. This duty normally entails significant cost, time and liability exposure to plan sponsors. Last year's legislation includes a TSP-type board as an alternative to managed investment. PSCA is concerned about any mandatory benefit program. Additionally, the potential for significant costs for small businesses when they can least afford them has to be considered when this proposal is reintroduced. Thank you.

Chairwoman VELÁZQUEZ. Thank you.

[The statement of Mr. Ferrigno is included in the appendix at page 59.]

Ms. VELÁZQUEZ. And the House is taking a vote so the Committee stands in recess until the next 20 minutes at least.

[Recess.]

Chairwoman VELÁZQUEZ. I would like to address my first question to Mr. Speer. You mentioned that employees had recently dropped out of the company's retirement plan, which threatens your ability to continue offering your plan. In your view, is fear of losing money in the market your employees' number one concern, or are there other factors making them pull back?

Mr. SPEER. Based on my experience and speaking with employees, I think it is a combination. Some employees have been fearful of seeing their money just disappear and keep dwindling, and one or two employees have had some hardship issues with housing and such, that they just needed the extra money that was taken out of their paycheck.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Dobrow, given the state the market, you suggest allowing employees to suspend or delay safe harbor contributions. This makes sense if such contributions force employers to drop their plans or, even worse, go out of business. However, all employers do not need this type of relief.

Is there a way to fix this while also ensuring unscrupulous employers do not abuse the system?

Mr. DOBROW. Absolutely, because what would happen is that after you suspend the safe harbor, then the regular rules apply, and the regular nondiscrimination rules prevent abuse and prevent everything from going awry. So we are just saying that instead of waiting until December 31st to end the safe harbor, let's end the safe harbor as of March 31st or whatever notice period is available.

Chairwoman VELÁZQUEZ. Do you want to comment, Mr. Ferrigno?

Mr. FERRIGNO. I agree that there won't be an opportunity for abuse at all. And I did mention it in my oral testimony that for some plans they would then be subject to the top-heavy rules which would require the 3 percent nonelective. That is the problem that they are trying to get out from under with the safe harbor.

Chairwoman VELÁZQUEZ. Mr. Keeler, you mentioned that many employees are simply not saving enough for retirement— we all know that—and the severe dip in stock values that made this problem worse now. So, first, how can we get more workers thinking about the importance of adequate savings; and, two, how can we make it easier for small businesses to offer retirement plans?

Mr. KEELER. I think the first way is educating the employees how the old model worked, the model that their parents or grandparents were accustomed to, whereby they worked for a company for 30 years, they retired from that company, had 60 percent of their income replaced by the pension, another 20 percent replaced by Social Security. Their parents didn't need to save. Their parents, because they didn't need to save, it didn't matter what the stock market did. They could put their money in a jar in the backyard or in the freezer, for all it mattered, because any wealth that their parents accumulated would have been passed to future generations. It wasn't needed for retirement because they relied on Social Security and pensions.

No one has gone to the investment public participants now and said, the game has changed, and if you can still rely on Social Security for that 20 percent, if you needed 70 to 80 percent, how are you going to fund that liability? Your employer is only going to kick in 3 to 6 percent. How much do you need to save over the next 30 years if you stay employed that long to make the math work? And my numbers show somewhere around 19 to 25 percent is what most people should be saving for a 30-year period.

So educating employees that, you know—what happens when an employee starts working at 25, the first question they will ask is, Is there an employer match? Yes, it is 3 percent. Okay, well I am going to put in at least 3 percent. Well, is that enough? They don't know that it is not enough. So I would say that is the first part.

As far as relief for employers contributing more, as I laid out in my written testimony, there could be some sort of credit for employer contributions. There is a credit for start-up costs. There is

a credit for costs of educating employees. That could be broadened or increased and it could also be broadened to include a credit against employer contributions, whether it is profit sharing, match, some sort of tax credit, dollar-for-dollar tax credit. If there is not money in the budget to allow that now, and then it could be something that is phased in over time, or it could be a situation where those credits build, you know, on the tax return, those credits build and the employer can take the credits down the road.

Chairwoman VELÁZQUEZ. Thanks.

Ms. Collinson, individuals are trying to avoid pulling out funds to rebound from record losses. Would you be in favor of suspending distribution for accounts that have been particularly hard hit? Can you discuss how this could keep Americans from jeopardizing their long-term retirement security?

Ms. COLLINSON. Yes. Many Americans may face the very difficult decision of taking a loan or a hardship withdrawal from their plan. One area of particular concern is when a participant has taken a loan and they fully intend to repay that loan in 5 years, and then they lose their job. And many plans require that loan be repaid in full, within a certain period of time, or it simply becomes a taxable event. Well, chances are if that participant had the funds in the first place, they wouldn't have taken out the loan.

So especially for individuals who find themselves in a job loss situation, it is worthy of consideration to give them some relief, at least on the penalties, on the 10 percent penalties.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Dobrow, you mentioned widening the 10 percent corridor to help companies during the market downturn. However, there is concern that this could lead companies to sharply undervalue their pension liabilities.

First, how far would you widen the corridor? And more importantly, how can you ensure that companies will not undervalue their plans?

Mr. DOBROW. Well, the proposal so far has been to basically temporarily change the corridor to a 20 percent corridor instead of a 10 percent corridor. And the thing behind it here is that if you have a 30-year time horizon for your assets, why do we need to pay close attention to valuating them on only a 12-month basis? And so this smoothing stuff spreads it out over a number of years.

And the thing about actuarial science is what relief you get granted today, you have to pay for later. And so what happens is in the rules, it makes sure that future contributions are higher to make up for the contributions that don't come in now. And by allowing this smoothing to occur, I think the plan won't freeze and won't terminate.

Chairwoman VELÁZQUEZ. So can you talk to us about the consequences of when a plan is deemed under-funded?

Mr. DOBROW. Well, when a plan gets underfunded, there are lots of things that kick in that aren't necessarily good. First of all, if it is very underfunded, participants cannot receive receive lump sum distributions. Secondly, the benefits freeze at some point when the benefit becomes underfunded.

Chairwoman VELÁZQUEZ. Thank you.

I recognize the Ranking Member now.

Mr. GRAVES. Thank you, Madam Chair. A question for Mr. Dobrow. You mentioned smoothing assets in your testimony. Could you expand on that just a little bit?

Mr. DOBROW. Okay. As I said before, you know, if you are looking for a 30-year time horizon on having enough money in there for folks who retire, it is kind of artificial that we decide on a 12-month basis that we are going to value those assets. And bear markets occur and assets fluctuate in value. They go up, they go down. If you recognize all of the losses all at once, it doesn't give you any anticipation that the assets are ever going to come back, which is a normal part of the economic ebb and flow. And so by widening out the amount of time you are looking at those assets, you get to take into account some of the flow, instead of all ebb.

Mr. GRAVES. I never heard the term ″asset smoothing″ before.

Mr. DOBROW. It is an actuarial kind of term to determine—you know, to not recognize all of the gains or all the losses all at once.

Chairwoman VELÁZQUEZ. Mr. Schrader.

Mr. SCHRADER. Thank you, Madam Chair. I am a small businessman. I have been doing that for about 30 years. And the underlying tone of the panel has been that our goal is to provide for our own and our employees' retirement fully and completely, in addition to Social Security, with whatever plan our firm or business has. I guess I have never assumed that as a small business person. To me that has always been totally unaffordable.

I am a veterinarian. I have a small small business. To me, given the current debacle that has gone on in our market and the—in my opinion, and I would be curious about yours—the extreme unlikelihood we will ever see a 14,000 Dow in our lifetime, there will be a permanent correction as a result of this debacle. But I am a small businessman, I want to attract employees. I am going to go with the defined contribution plan and put in as little or as much as I think I can afford to do for myself and my employees, just to make my business grow, and go. And if they want to put a little more money aside or if I want to put a little more money aside, I will have to do it differently.

That is real small business thinking here. That is not grandiose. It is not like I am trying to save the world. I am just trying to get by and help myself and my employees out. Convince me that I should do differently is what I am asking.

Mr. FERRIGNO. I don't think you should do anything different. Indeed, a little bit different perspective on Mr. Keeler's statement that he recommend people saving 19 percent of pay. We would scare away at least half of our workers if we told them that they had to save 19 percent of their pay.

The good news is the Congressional Research Service says if you save 10 percent pay for 30 years, you are going to have 53 percent income replacement. And bear in mind that 10 percent will include an employer match, which frequently is 3 percent of pay. For the median-income replacement, Social Security today is 42 percent of income. So if we are shooting for 70 to 80 percent replacement rate, then the burden for the 401(k) plan for the median worker is in the 30 to 40 percent.

Mr. SCHRADER. I just don't think that is very real.

Mr. FERRIGNO. It is. We just had testimony here which is consistent with what we know, that the average worker defers 6 or 7 percent of pay. And there is ample, ample evidence that level, particularly when accompanied by an employer match is exceedingly likely to occur, is going to produce retirement assets adequate for retirement.

Mr. SCHRADER. Other comments?

Mr. DOBROW. I have about 700 clients just like you, people who come to me late in their career and say, I have this number of employees who I really want to take care of and I haven't saved any money for my retirement, and you know, our system works really well; we are providing coverage, because when you get the retirement plan for your retirement, you are going to scoop in all of your employees at the same time, and it has been working. We are getting more and more employees getting benefits from their employer, because it benefits everybody overall, and taking advantage of the tax break. And if we didn't have this kind of thing, we would not have coverage of employees. And I can show you a plan designed for your business that would be attractive.

Chairwoman VELÁZQUEZ. Mr. Coffman.

Mr. COFFMAN. Thank you, Madam Chairwoman. First of all, if a small business has a defined benefit plan, and that firm is dissolved, then what happens to the assets of the defined benefit plan as to the employees that were covered under the plan?

Mr. DOBROW. I can take that one. A company is not allowed to dissolve until its defined benefit plan is taken care of. And what usually happens in the real world of small business is that all the employees get paid out 100 percent of their benefit, and the owner gets then their benefit if there is money left for them.

Now in some distressed situations, the plan might be turned over to the Pension Benefit Guaranty Corporation, PBGC. But we don't see that very often in the small business environment. Mostly it is larger employers that do that.

So what happens is the employees get the money and get to roll it into their new employer's plan, get to roll it in a IRA or, in some cases, actually take the money and spend it, and we call that leakage. But we think that part of it is well taken care of.

Mr. COFFMAN. The following question to you. Let's say you have 20 employees in a small business, and it is a defined benefit plan. Do they, in and of themselves, form that investment pool? Or do you throw them in with a bigger defined benefit pool? How is that done? Because it seems like 20 employees, maybe you can tell me what the actual rate of return would be and what the asset allocation would be in terms of equities versus fixed income, because that seems like a pretty perilous path for a small business.

Mr. DOBROW. Because small businesses are unique, all the plans are unique. And virtually every small business person has a financial adviser they are relying on. Defined benefit plans are invested in the pool, and the pool has certain aspects to it under ERISA that make it be conservative. And what I tell my client is, please invest this money conservatively with your adviser and make sure that it doesn't take too much risk, because in any given year you really don't want to lose money. In a normal market, that works great. You also don't want to get high spikes, a lot of volatility. If you get

too much it will cut down your contribution. So being conservative is the perfect answer.

Mr. COFFMAN. Equity versus fixed income, what is allocation?

Mr. DOBROW. The smart ones were 30 to 40 percent in equities leading up to this, and we see a lot of people have 80 percent.

Mr. COFFMAN. It seems that it is not a good deal for employees because they come in and then the employer tells them, we have this great plan here. We are going to give you a lesser salary because we have this wonderful plan. But, of course, now then we go down the road, then they are in a distressed situation, so they have underfunded the plan, and then if it goes into this guaranteed pool, they get pennies on the dollar. So I just fail to see why that is a rational decision for a small business.

Mr. DOBROW. First of all, it is just the really highly paid people that get pennies on the dollar, because the normal rank-and-file worker gets 100 percent guarantee.

Secondly, they are always paid out first. And I know when I am doing my distributions to terminate participants and giving them a check which sometimes is Hundreds of thousands of dollars, they say this is more money than I have ever seen in my whole life; thank you so much.

Mr. COFFMAN. What is 100 percent? Give me an income scenario.

Mr. DOBROW. It is about $49,000 a year and PBGC sets that every year.

Mr. COFFMAN. So $49,000, and below they are going to get 100 percent of what they were promised in their defined pension plan?

Mr. DOBROW. That is the maximum benefit they would get, so they might be making more than that.

Mr. COFFMAN. I think it is a bad bet for small business, and certainly I do believe this Committee ought to look at incentives for a defined contribution and how to make sure that they are appropriate, so that those plans are retained.

Thank you, Madam Chairwoman, I yield the balance of my time.

Chairwoman VELÁZQUEZ. Ms. Clarke.

Ms. CLARKE. Thank you, Madam Chairwoman, and to Ranking Member Graves, thank you both for holding this very timely and important hearing today. I want to also thank all of our witnesses for testifying before this Committee.

I would just like to raise a few questions with the panel and I would like to start with Ms. Collinson. Federal law mandates a 5 percent government wide procurement goal for women-owned small businesses. However, just 3.3 percent of Federal contract dollars went to women-owned firms in fiscal year 2005. In addition, only 34 out of 81 Federal departments, agencies and commissions recorded by the FPDS met or exceeded the goal in fiscal year 2005.

Increasing procurement from 3 to 5 percent may help to fund retirement benefits. How can procurement for women-owned businesses be improved?

Ms. COLLINSON. I am going to have to defer. That is really beyond my expertise. However, I will say the Transamerica Center for Retirement Studies has done extensive research on women, and women planning and saving for retirement. And a lot of the data and trends is very unsettling in that there continues to be a wide

gap in both real retirement confidence as well as actual retirement savings between men and women in the workplace.

Ms. CLARKE. It would seem to me that certainly, a lot of it has to do with some of the inequities in terms of how the businesses are built and the access to the growth and development and expansion of business. So I guess that is something we would have to look further into, Madam Chair.

To Mr. Keeler, women-owned businesses invest billions on benefits for their employees. Health benefits comprise a larger share of benefit expenditures, with 2004 spending estimated at about $38 billion. Estimated spending on retirement benefits, life insurance and disability insurance comprise more than $16 billion, for a total of $54 billion in benefit expenditures. These benefits are some of the first to be cut in economic downturn.

What options do these firms have to fund employee benefits at a time when the stock market has declined by over 30 percent in the last year and sales have dropped considerably.

Mr. KEELER. Well, I think your assessment is accurate. A lot of money spent on benefits, the first benefit to go is usually the 401(k). Health benefits are the last to go because they are the ones that employers use to attract and retain employees. So I can't really speak to what kind of relief could be given to that, and I don't know that relief needs to be given. I think obviously there is a major problem with the health care system overall. But that is a topic for another day.

With respect to relief for retirement plan costs, as I said, there could be credits that would offer tax credits to employers based on the amount of money that is contributed. Whether it is a profit sharing contribution or an employer match, the employer would receive a tax credit. In addition to that, broadening or increasing the tax credit for start-up fees, plan start-up fees, ongoing maintenance fees for the first, say, 3 to 5 years, I think now it is 3 years, and the costs for educating participants, again, you have probably picked up already.

I think there needs to be an emphasis on education because in general, the investing public lacks the knowledge that they need to make smart financial decisions. And whether guaranteeing a positive financial outcome is the employer's responsibility or not, giving the employee the fighting chance to have a positive financial outcome and have the retirement income that they need starts with educating and helping them understand how to invest, where to invest, when to invest, how much to invest and so on.

Ms. CLARKE. Well, thank you very much. I yield back the balance of my time, Madam Chairwoman.

Chairwoman VELÁZQUEZ. Mr. Thompson.

Mr. THOMPSON. Thank you, Madam Chairwoman. The first question I will just throw out to the whole panel regarding the savers' credit, I know when the IRS drafted that it was very confusing. So my question is of your opinions on what the status is it actually being used? And, what can be done to encourage more use of that?

Ms. COLLINSON. I would like to respond to that. First of all, the Transamerica Center for Retirement Studies commends the IRS for making changes to better promote the savers' credit. When it was first implemented, it was legislated and everybody on the Hill

called it the savers' credit. Yet when the tax forms were printed, it was referred to by a number of different names including things like the credit for qualified retirement savings contributions, sort of rather a complicated version, and it was not real consistently described through the forms and publications. And looking at the income eligibility requirements, individuals who are likely to qualify for the savers' credit are also likely to complete the 1040 EZ form.

Well, since the 401(k) contribution comes out pretax dollars, the 1040 EZ wasn't even contemplating that question. So the IRS, while they did not add it to the form itself, they at least added it to the instructions, so that if somebody read the instructions and knew that they contributed to a retirement plan, then they would know to use a different form in order to claim the credit. So that goes a long way.

However, given our survey reports, only 18 percent are aware of it. There is a big risk that there are 401(k) savers—in fact, 50 percent of our survey respondents in that income demographic said they participate in the plan—there are a large number of survey respondents and savers who may very well qualify for the credit, they just don't know about it. And then there is also the issue that, given that it is not refundable, those without a tax liability obviously don't receive it right now. So more can be done.

Mr. FERRIGNO. If I can just comment, PSCA was very instrumental in drafting the savers' credit and it is not by accident that there is no obligation whatsoever for the employer to administer that. We promoted heavily to our organization with our members who are plan sponsors.

Ms. Collinson mentioned the fact that it is not refundable, and you could, if you wanted to, go even one more. At some point there are people who cannot afford to substitute consumption for savings. The savers' credit even could exceed the contribution it has made and actually replace the cash that is saved. It is a matter of what you want to do and how much of a tool you want it to be. But the fact that it is not refundable is certainly a problem.

Mr. THOMPSON. Well, Mr. Ferrigno, while I have your attention, I have a question specifically for you, please. Some have encouraged mandatory payroll deductions for IRAs. I still have some concerns about this, since there will likely be administrative or, frankly, other burdens; and that mandatory IRAs could dissuade employers from offering benefits as a part of their package for attracting and retaining experienced employees, specifically such as health insurance. What are your views on that?

Mr. FERRIGNO. First, the issue would mean that through payroll that it is mandatory, and so in a world where employee benefits are voluntary, it is disturbing for us that they are talking about a mandate to provide a benefit. There is definitely an element of substitution and, frankly, poor substitution.

One thing we know is that when a small plan adopts a plan, they are terrific champions. They have higher-than-normal participation rates because the owner has personal contact with all the participants. That would not exist in a mandatory program where basically there would be a form. Actually this would be a default,, but you wouldn't have the support of the business owner; it would be something that would be forced on them.

And, again, what is looming out there that isn't talked about nearly enough is it is being portrayed as having minimal or no impact on the small plan that is going to be required to offer this. And as I mentioned in my oral testimony, if you look at the legislation as introduced last year, these are ERISA plans, and so there has to be a fiduciary that has to select a default investment and has to determine that the fees are reasonable. It can't be the IRA; the IRA provider cannot do that. That is not allowed under ERISA.

So I urge this Committee when this issue is raised—and again I think it is going to be in the budget tomorrow— to take a look at it from the small business perspective.

Mr. THOMPSON. Thank you sir. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Sure. Mrs. Dahlkemper.

Mrs. DAHLKEMPER. Thank you, Madam Chairwoman.

Mr. Keeler, currently the ERISA rules limit the amount of pre-funding a plan can undertake. Someone suggested increasing or removing the limits so employers can save as much as they can during the good years.

What are the concerns with allowing businesses to make these larger contributions? And do you believe that pre-funding would ease some of the challenges caused during downturns in the economy such as we are experiencing right now.

Mr. KEELER. Are you speaking about defined contribution plans—

Mrs. DAHLKEMPER. Yes.

Mr. KEELER.—or defined benefit? Allowing employees to put more than, say, 25 percent of covered payroll in, I don't see any reason to limit it to 25 percent. So I don't see a disadvantage to that. I think it would be a good thing. I don't know how many employers, especially right now, would do that or could afford to do that. But by all means, I think it is a great, great idea.

Mrs. DAHLKEMPER. During the good times—obviously these are not those times—but as we look forward to the future. Would anyone else like to comment?

Mr. DOBROW. I would. The Pension Protection Act for defined benefit plans actually allows you to pre-fund a little bit more than you would before, and it has had a great effect. The only downside I see to allowing defined contribution plans to do it is the loss of revenue.

Mrs. DAHLKEMPER. Okay, thank you. I yield back my time now.

Chairwoman VELÁZQUEZ. Mrs. Halvorson.

Mrs. HALVORSON. Thank you, Madam Chairwoman.

I am going to start with Mr. Speer, basically because we are both fellow Illinoisans, and then if anybody else would like to touch this one. My husband and I have two small businesses and many people in my district are all small business. And because of the economic downturn, they are finding it very difficult to borrow and meet the capital needs of the business expenses of their costs. So one of the proposals that has been put forward to us and to a lot of other people are to use the funds from their SEP IRAs.

Now can you tell me, in your view, what are some of the potential downsides of doing this?

And Mr. Speer, if you would like to start, and if anybody else would like to talk about that.

Mr. SPEER. Sure. I can just give you my personal views on that. Again I am not an expert on this, but, you know, we being a small business try to encourage people to save money long term and you never want people to take their money out for the short term. So we try to do our best, we treat our employees like family, like most small businesses do, and try to do whatever we can to have them think, to educate them for the long term. And so I would probably try and discourage our employees from taking out short term and think long term.

Mrs. HALVORSON. Not so much employees we are talking— my husband and I own the business, we have to make ends meet, we have to make payroll. And if the banks are not loaning there has to be a way. And when somebody says, well, you can borrow against this—and that might be some people's only way to do it—you can say you need to save or discourage it, but there has to be something.

Mr. SPEER. I would agree with that, when people come to desperate measures there are certain things that are happening now and people might result in desperate actions. But it is hard to dissuade people from doing that.

Mrs. HALVORSON. Anybody else want to answer that?

Mr. FERRIGNO. My only caution is that the IRS might be interested in these transactions. There are limits on what you can do and what you can't do. And I am not an expert.

Mrs. HALVORSON. Why are accountants suggesting it then?

You can't always trust your accountant? Okay.

Mr. FERRIGNO. I am not a tax attorney.

Mr. KEELER. I would just comment that most defined contribution plans, not simple IRAs or SEP IRAs, could have them in provision and it would be perfectly legal for you or your husband to take a loan. Plan costs have come down a lot in the last 5 to 10 years, so for a small business with 5 or 10 employees to have a 401(k) plan, it wouldn't be cost prohibitive in any way, shape, or form. You simply check a box saying you want to have a loan provision, and you are able to borrow against that balance, up to 50 percent of the balance in the account.

Now, there are other types of plans where loans to owners are prohibited, and for good reason, you know; there could be fraudulent activities, and the Department of Labor doesn't want to allow any employer to be able to access employee funds in a pooled retirement account. But in the case of a modern-day 401(k), you would be allowed to do that.

Mrs. HALVORSON. Lucky for us we don't have to. But a lot of the other employers that come to us, they are like, what do we do? We can't even get another loan, the banks aren't loaning. So it is a huge concern. And so when that is brought up to them, they are trying to figure out ways to figure out what is going to be in their best interest.

Mr. DOBROW. I will give you my business card. I think I can take care of that for you.

Mrs. HALVORSON. I got it. Thank you.

Chairwoman VELÁZQUEZ. Mr. Sestak.

Mr. SESTAK. Thank you, Madam Chairwoman. I am sorry I wasn't here earlier. If you answered these, I apologize.

I will ask you three quick questions. In the tough environment we are in, would it help us to go back to the pre-PPA corridor of 80—I think it was 80 to 120 percent of market value—rather than the present 90 to 110 to do that now? Would that help?

Mr. DOBROW. Yes, it would help. You know, that is one of the proposals that has been offered forth.

Mr. SESTAK. And I guess you had it in your testimony. I am sorry I missed. Before, when you evaluated your interest rate, you used to be able to do it—I think it was corporate bonds if I am not mistaken—over 30 years. We might not even want to change that to this three-segment type. Should we go back, at least temporarily, to the old pre-PPA era, straight valuation?

Mr. DOBROW. A lot of compromises get made. I think that a lot of people were happy with the three-segment rates. And I am not sure that changing them backward would be all that great an idea.

Mr. SESTAK. Because of the compromises?

Mr. DOBROW. The Treasury and what they are trying to accomplish.

Mr. SESTAK. How about amortizing unfunded liabilities? It used to be 3 years. Would you extend that at this time?

Mr. DOBROW. We are asking for a temporary, like 1 or 2 years, just the interest on it for 2 years and then amortize it over 7. That would give the asset some time to probably come back a little bit and help make it less onerous.

Mr. SESTAK. I don't know if this is yours or not, and I apologize for popping in here late. Some 401s are supposed to take care of investor risk. I am not sure they do. I think that is a little challenge, but I don't think we do longevity risk very well, which is annuities. Should we move towards that almost as a ″you must opt out″ type of an approach to take care of the longevity risk?

Mr. FERRIGNO. Recently I think that way. But first of all, as far as managing investment risk in almost any 401(k) plan in America, if you want to, you can invest in a government securities bond or a stable value product or a money market fund.

Mr. SESTAK. Should we make it mandatory that everybody offers an index fund, for example?

Mr. FERRIGNO. No, no; 75 percent of the plans that are surveyed do offer an index fund. I think that a plan sponsor has to consider an index fund. But when we get into mandating various planned investments it is a very slippery slope.

Mr. SESTAK. Slippery towards what?

Mr. FERRIGNO. Well, there is talk about socially targeted investments. In State government plans there are politically directed investments. So we have some concern in that area.

On the subject of annuities, and I was present yesterday at Ed and Labor, you have to understand that 20 percent of 401(k)-type plans offer an annuity option. Nobody selects it. Nobody selects it. There is no demand for it. And in a defined benefit plan, some defined benefit plans let you have a lump sum distribution. A defaulted defined benefit plan is an annuity payout. About half of the defined benefit plans offer a lump sum. In order to get that lump sum you have to, if you are married, you have to get a waiver of the joint annuity. You have to go and find a notary and waive your right to get a lump sum. Ninety to 95 percent of folks do that.

So the bottom line is there is no demand for annuity product at retirement because what you are saying is, I haven't even retired yet, I am going to retire, and you want me to make a decision now about what to do with my money for the rest of my life. What we have found is that after people are retired for a period of time, they do consider annuities. You have to remember the role of Social Security, that Social Security provides more than half of the income for most retirees. That is in the form of an annuity. So maybe they are making the rationale decision—

Mr. SESTAK. Would it help—if I could ask one last question—would it help people make a rational decision, if we can, to post trading activity; how many transaction costs, how many transactions there are each year in your 401 or your mutual fund?

Mr. FERRIGNO. Yes. There is a debate about that and plan sponsors are responsible for reviewing fees. Transaction costs are a fee. And we had taken a public position that transaction costs should be provided.

Mr. SESTAK. Should be provided also.

Mr. FERRIGNO. Yes, that is our position. And they can be very material.

Chairwoman VELÁZQUEZ.. Mr. Moore.

Mr. MOORE. Thank you. I would like to pose a question to anybody on the panel who cares to respond. I would like to ask a question about the state of our Nation's retirement system, the need to consider more comprehensive proposals for reform. Data shows that many members of the baby-boom generation don't have sufficient resources to maintain their standard of living in retirement, a situation that has been made worse by the decline in housing values and economic downturn recently in the past year.

Now, the lack of retirement plan coverage is an issue for small business owners and employees. Not only do small businesses often not have the resources available to offer retirement plans, but the movement towards low-cost defined contribution retirement plans has increased the volatility of plan assets, as they are invested heavily in equities.

What types of comprehensive reform efforts are needed to help ensure that a larger number of people have safe and stable ways to save for retirement? For example, a gentleman by the name of Dean Baker, an economist for the Center for Economic and Policy Resources, suggests the creation of a voluntary federally run pension program that would offer participants a modest but guaranteed rate of return.

Any thoughts about that or other plans?

Mr. KEELER. I would just say, to expand on a key issue that you have pointed out and Mr. Coffman pointed out before he left, I think the emphasis needs to be on defined contribution plans more so than defined benefit plans, because defined contributions are more prevalent.

Possibly differing from Mr. Ferrigno's testimony, I find that about only 56 percent of people participate in a 401(k) plan. That is nationwide; 56 percent participate and only 15 to 20 percent of small businesses have 401(k).

So, to your point regarding—was it Mr. Dean's testimony earlier this morning—there is a broad, very broad problem. Is it a small

business owner's responsibility to guarantee a positive financial outcome for every employee that they have? Probably not. It is not feasible to do that. But, again, when the statistics may say that Social Security provides 50 percent of people's retirement benefits and that if somebody saves 6 to 7 percent and the employer matches 3 they get 10 percent they are going to be fine,.

I am seeing a lot of people that are 55 that have 35- to $50,000 saved for retirement. The statistics show, if you want to talk statistics, the average account balance of people in their fifties is about $50,000. That is not enough to provide a positive financial outcome. So we can look at who is saving and who isn't and what the statistics are, but I am seeing on the ground that the numbers don't add up.

How the government steps in to mandate a plan or provide a plan that people can opt into, again, I come back to education. Everybody wants a silver bullet. They think that if Social Security is reformed, that they are going to be fine in retirement. Social Security was never intended to be the only means of retirement income. There is a three-legged stool most of you probably learned about back in home economics class: savings, pensions, and Social Security. Well, Social Security is at risk. Savings is at an all-time low. The stock market we are, you know, down 40 percent. People are questioning the validity of long-term savings. So I don't know what needs to be done, but something needs to be done.

Ms. COLLINSON.. I would like to add to his response. Our research at the Transamerica Center for Retirement Studies has found that—corroborates everything that we have heard. Baby boomers aren't saving enough and haven't saved enough and are now facing a real crisis. But our research has also found that there are a lot of things baby boomers can and should be doing for themselves in order to help better their situation in terms of learning more about saving and investing, actually calculating a retirement savings goal versus guessing at the amount which nearly half say they have guessed. Very few have a written plan. They don't know how they are going to bridge their savings gap. And the common solution is a very large percentage plan to work beyond the age of 70. Well, reality is sometimes life dictates otherwise. Something could force somebody out of the workforce.

So as we think about ways to help the baby boomers, I think it is really important to think of ways that we can help them help themselves. Because by the time you reach 50 years old, no two situations are alike. People have different facts and circumstances, expenses, families, commitments, levels of savings. So to help educate people and get them the advice that they need or at least access to advice so that they can make informed decisions and put together a more rational plan.

Chairwoman VELÁZQUEZ. Would the gentleman yield?

Mr. MOORE. Certainly.

Chairwoman VELÁZQUEZ. Ms. Collinson, at what point, how can we address the issue of educating people, young people, at what level? Whose responsibility? Because it is just amazing that they go to college, graduate, and still don't know the value of saving and thinking ahead of terms of retirement.

Ms. COLLINSON. Well, one of our research questions which I found really interesting and compelling, we are still sorting through the data, but directionally there is a real high level of interest in terms of what the government can do, and that is to start Americans early in terms of educating about financial literacy, and that could be junior high school. You know, first and foremost, we want kids to graduate from high school with basic math skills so that they can balance a checkbook or understand compounding investments or compounding interest. However, starting early financial literacy in schools can help prepare kids. And where we are at right now in terms of education, the extent to which parents are helping their kids with their homework, there could be some residual benefit for grown-ups as well.

Mr. KEELER. About 2 years ago, a college professor asked me to fill in for one of his undergraduate classes, and it was the second day of class. And he warned me, he said most of the students haven't gotten their textbooks yet. They had a reading assignment but most of them don't have their text, so they won't have read it. We have some jocks in there, they will fall asleep. So I am warning you up front.

So I go in and I covered the two or three chapters that they were supposed to have read. Then I just started covering stuff that I thought was important, like what is a mutual fund? How do you choose between a mutual fund? And why would you buy a house instead of renting an apartment? How do you buy a house? Why would you do it? And I can tell you, there weren't any jocks sleeping. They were all, they were hanging on every word I was saying to them. They were soaking it up like sponges. And at the end, this doctoral candidate said to me, Mr. Keeler, I have been in school almost my whole life and no one has ever taught me this stuff. Why am I just now learning this? And I am not even learning it out of a textbook. I am learning it because you are ad-libbing and shooting from the hip because you didn't want to pace the class and go through the chapters.

FPA and a lot of other nonprofits are already geared to try to provide this kind of literacy. There is a program called Junior Achievement, where financial planners go out to schools and teach this kind of thing. It just needs to be mandated. As I shared in my oral testimony, only three States require at least one semester course dedicated to personal finance. And in another 17, it is integrated into math. So it is kind of lost in the process.

So I think that is where it starts. And even public service announcements or TV ads that show modern-day plan participants, not kids in high school, why you don't try to time the market, statistical data that shows market timing doesn't work, that shows that if you are not in the market every day you are not going to have a fighting chance to get market returns, and that you are just shooting yourself in the foot.

Mr. FERRIGNO. We are having a big problem in that we are making value judgments about the 401(k) system based on 60-year-olds. The first 401(k)s came in around the mid-eighties but were relatively unheard of until the nineties, and they took off in the mid-nineties. So we are judging the system based on the experience of someone that may, if they are lucky, have had probably 10 years

in the plan. There is data available, a huge database about half the 401(k) participants in the country, and they looked at people who have been in the plan since between 1999 and 2006. They found that people in their sixties that had been with an employer for 30 years but hadn't been in the plan for 30 years averaged $193,000 in their final balance. So it is a great concern to me.

And you referenced Mr. Baker, that judgments are being made on a system without saying what is it going to do when it is mature? And the good news is that these people did have this opportunity, because the bottom line is the defined benefit system provided benefits to very, very few people.

So your question about what can we do, what we have seen in the system, which is terrific, is by design 401(k) plans are very flexible and the government has cooperated in that. And by turning things around in the marketplace, we came back with automatic enrollment, we came up with target date funds, we made advances in education and advice. So what we need from the government is to be the referee, but let us play the game.

Chairwoman VELÁZQUEZ. Thank you. Mr. Graves.

Mr. GRAVES. Just a point of clarification. You mentioned, Mr. Ferrigno, you mentioned the average person. What, 6 or 7 percent; is that what you said?

Mr. FERRIGNO. Yes.

Mr. GRAVES. And you mentioned 19 percent would be optimum. Does that include the employer?

Mr. FERRIGNO. No. The 6 or 7 percent does not include—that is a good range of what we are getting for deferral. And the most common employee match is 50 percent of the first 6, is 3 percent going on in there. And what I cited was government work from the Congressional Research Service that says if you do contribute that level, you are going to have very adequate income replacement. We have to fix this market crisis. We can't do anything if the markets don't work.

Chairwoman VELÁZQUEZ. I would like to ask a question, to all the members at least, any of you who might want to answer; but, in light of the Committee here, focusing on providing some type of retirement relief, given the current economic conditions and the fact that so many workers reaching retirement age have suffered staggering losses in their investment accounts, would you be in favor of raising the required minimum distribution age from 70-1/2 as a way to provide temporary relief for these workers?

Mr. KEELER. I would. And I commend Congress for doing that for 2009. I think it is pretty likely that it should be done again for 2010. But, by all means, I think it should be raised. I don't think it should be a requirement. Let's face it, based on what I am saying, a lot of people need that money anyway, because they have they haven't sufficiently saved for retirement. So whether it is required or not, they have probably been taking it since they were 65. But for those that are fortunate enough to be in a position where they don't need to, they shouldn't be forced to, especially in a down market.

Mr. FERRIGNO. These are tax policies. They should be repealed permanently.

Mr. DOBROW. We agree.

Chairwoman VELÁZQUEZ. And given that older workers have been more adversely affected than younger ones, should we consider allowing older workers, ones over 55, the ability to make larger catch-up contributions?

Mr. FERRIGNO. Absolutely.

Mr. KEELER. Sure. Why not?

Chairwoman VELÁZQUEZ. If there is anything in your data—and I would like to ask this question to Ms. Collinson— indicating older workers will make those larger contributions, given the decreased confidence in the financial market?

Ms. COLLINSON. What I can share from our data is there is an opportunity to further increase awareness of catch-up contributions of what we have right now. Many of the workers surveyed indicated they do have the opportunity through their company-sponsored plan. And I believe about 25 percent, I would have to recheck the number, are taking advantage. And those who aren't we asked why, and it is, by and large, because right now they can't afford to.

Chairwoman VELÁZQUEZ. Okay. Well, let me take this opportunity to thank all of you. This is a very important issue. And we are going to continue to look at any regulatory relief in ways of distribution and contribution that could be made by the IRS administratively, talk to them and see what can be done. And also, we are going to be having discussions with the Committee on Ed and Labor regarding some of the issues and concerns that you have raised.

I ask unanimous consent that members will have 5 days to submit a statement and supporting materials for the Record. Without objection, so ordered. This hearing is now adjourned.

[Whereupon, at 3:00 p.m., the committee was adjourned.]

Statement by Stephen L. Dobrow,
CEO of Primark Benefits,
on behalf of ASPPA

Comments Presented to the
Committee on Small Business
United States House of Representatives

Drop in Retirement Savings: The Challenges Small Businesses Face Funding and Maintaining Retirement Plans in a Struggling Economy

February 25, 2009

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to testify before the House Small Business Committee on the important issue of the challenges small businesses face in funding and maintaining their retirement plans in a struggling economy.

I am Stephen L. Dobrow, the current President of ASPPA and President of Primark Benefits, a growing San Francisco based employee benefits firm that provides consulting, recordkeeping, administration and actuarial services for retirement and flexible benefit plans. Primark Benefits was founded in 1971 and has 26 employees and a payroll of $2.4 million. As an employer, we sponsor both a defined benefit pension plan as well as a safe harbor 401(k) plan.

ASPPA is a national organization of more than 6,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. ASPPA's large and broad-based membership gives ASPPA unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

Need for Relief for Small Business Retirement Plans

The current economic and financial markets crisis is weighing heavily on the heart of the American economy – our small businesses. Many of these companies are struggling to stay in business as sales drop off and businesses find it harder to come by loans. The

National Federation of Independent Business recently reported that their Index of Small Business Optimism fell 1.1 points to 84.1 in January. This is the second-lowest reading in the 35-year history of the survey.[1]

In 2007, about 11.7 million employees worked for a small employer (fewer than 100 employees) that sponsored a retirement plan.[2] These small business plan sponsors are concerned about the retirement security of their employees and want to continue to provide retirement benefits. However, plan sponsors are facing unprecedented pressures on their employee benefit programs due to the current economic conditions – and this is making it difficult for these employers to continue their plans. I would like to focus today on two important areas where relief is critically needed: defined benefit pension plan funding relief and 401(k) safe harbor plan relief. If relief in these two areas is not provided, many small businesses will be forced to freeze or terminate their retirement plans.

Defined Benefit Pension Plan Funding Relief

There are two basic varieties of retirement plans – defined benefit and defined contribution. Most workers who have an employer-sponsored plan now have only a defined contribution plan, typically a 401(k) plan. One key difference between defined benefit and defined contribution plans is who assumes the risk of market downturns. In a 401(k) plan, it is the plan participants who see the value of their benefit plummet when the market plummets. For a defined benefit plan, the employer takes on the investment risk. A worker covered by a defined benefit plan has not lost a penny of his or her accrued benefit even though plan assets have declined dramatically. That is because the employer has agreed to contribute whatever it takes to pay for promised benefits. Fewer and fewer employees have a pension promise because fewer and fewer employers are willing to take on investment risk. Employers that have been willing to take on risk in order to promise a secure retirement to workers are now being slammed by this market downturn. Help is desperately needed.

The market downturn is the root of the problem, but there are two aspects of the Pension Protection Act of 2006 (PPA) funding rules that are key to understanding both the problem and proposed solutions:

- The Worker, Retiree and Employer Recovery Act of 2008 (WRERA) amended PPA to permit plans to use "smoothed" asset values, averaged over a two-year period. In theory, the smoothing helps to reduce volatility. However, PPA also has a requirement that the resulting smoothed value cannot be greater than 110% of the fair market value of assets. Most plans cannot take advantage of smoothing because this corridor is too restrictive for current market conditions. Historically, most smaller plans use fair market value without any smoothing, so this has not been a concern. However, in this environment, more small plans might take advantage of smoothing if it were meaningful.

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[1] National Federation of Independent Business, "February SBET: Small Business Optimism Index Dips Closer to All-Time Low," February 10, 2009, available at http://www.nfib.com/object/IO_39979.html.
[2] Purcell, Patrick, Congressional Research Service, "Pension Sponsorship and Participation: Summary of Recent Trends," September 8, 2008.

- PPA requires that any unfunded target liability (liability for benefits already earned under the plan) be amortized over seven years. This means a plan's minimum required contribution increases $19 or $20 for every $100 of investment loss. This adds up to serious dollars pretty quickly. Plans that were well funded before the market decline had no amortization payment due at all, and suddenly being saddled with substantial payments on substantial losses will be devastating.

There are many, many small employers in this situation. I want to tell you about one of my clients who is a real life example of an employer that has done the right thing – provided a defined benefit pension plan for employees – and now finds himself in serious trouble. The employer is an importer and distributor of fruit in the San Francisco area. They have 15 employees and payroll totals $1.4 million. They have a generous retirement program which includes a profit sharing plan and a defined benefit plan. Their defined benefit contribution in 2007 was $302,000 and in 2008 it was $177,000. Because of how the PPA rules work as well as a change in the market value of the plan's assets, the minimum 2009 contribution is $474,000.

There is no way that the employer can afford the nearly $300,000 increase. Profits are down because of the economy. The sponsor cannot go to a bank to borrow the money in this financial environment. They may be forced to pay an excise tax[3] this year because of the inability to contribute the increased amount, and plan termination will be the likely result unless adequate relief is offered.

There are a variety of proposals for providing funding relief. Because plans and employers that sponsor them vary widely, the ideal solution would provide options, and allow the employer to choose the one that best fits the situation. Options that would provide relief would include:

- Cap the increase in contributions that a company has to recognize due to the 2008 investment losses by allowing the company to "look-back" to the previous year's contribution requirement. The required contributions for the year the loss is recognized would be limited to 105% of the previous year's required minimum contribution, then 110% in the following year. In the third year, regular rules would apply.

- Temporarily widen the 10% corridor around market value to help companies that smooth asset values to manage the extreme unexpected losses experienced during the market downturn.

- Allow employers to pay interest only on their plans' 2008 losses for two years, then begin seven-year amortization of those losses in the third year. Under this proposal, the loss is recognized and contained – that is, interest on the loss is paid so that the loss does not grow. However, employers have two years to recover and plan before having to pay dramatically increased contributions. The extra time

[3] Plan sponsors must pay an excise tax of 10% on required contributions not deposited within 8 ½ months after the end of the plan year. Contributions not paid by the end of the following year can be subject to a 100% excise tax.

might also allow the plan investments to rebound as we come out of the current bear market, making the problem less onerous.

The employer I described earlier would receive substantial funding relief from either the look-back or the interest-only approaches. However, neither approach to funding relief would address another problem that arises from PPA requirements. PPA imposes restrictions on lump sum payments if a plan is less than 80% funded. PPA also prohibited additional benefit accruals when a plan falls below 60% funding, but WRERA provided relief for this restriction on accruals by providing a look-back to the prior year strictly for purposes of this 60% test. Congress should consider coupling funding relief with the same look-back for the restriction on lump sum payments that kicks in when funding falls below 80% as WRERA provided for the restriction on benefit accruals.

401(k) Safe Harbor Plan Relief

In general, 401(k) plans must satisfy certain non-discrimination requirements. These rules were enacted to ensure that contributions and benefits under the plan do not favor highly compensated employees over low and moderate income employees. These non-discrimination requirements can be onerous. However, in 1996, Congress passed the Small Business Job Protection of Act which provided 401(k) plans with alternative safe harbor methods of meeting the non-discrimination requirements by providing certain minimum employer contributions. The safe harbor 401(k) plan design has become quite popular with small businesses.

Under the safe harbor, a 401(k) plan is deemed to satisfy the non-discrimination rules if the plan satisfies one of two contribution requirements and satisfies a notice requirement. Under the contribution requirement, a plan must either (1) make a nonelective contribution to a defined contribution plan of at least three percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the plan or (2) satisfy a matching contribution requirement.[4]

Under current Treasury Regulations, plan sponsors that choose to use the three percent nonelective safe harbor contribution are generally required to decide whether to implement or continue the safe harbor contributions prior to the beginning of their next plan year (*e.g.*, December 1, 2008 for a 2009 calendar year plan). Many plan sponsors elected in good faith to implement or continue the safe harbor provision for the 2009 plan year without knowing the severity of the current economic crisis or the full impact on their individual businesses.

Treasury Regulation §1.401(k)-3(e) generally requires that a plan satisfy the safe harbor requirements for the entire plan year, and failure to do so could result in disqualification of the plan. The Regulations provide two key exceptions to the plan year requirement.

- A safe harbor plan may be terminated mid-year, subject to certain conditions such as providing participants with advance notice and making the safe harbor contribution up to 30 days after the notice is provided; and

[4] Internal Revenue Code §401(k)(12).

- A plan that satisfies the matching contribution safe harbor may reduce or suspend safe harbor matching contributions during a plan year with the same notice and contribution requirements that apply when a plan is terminated mid-year. There is no similar exception in the Regulations that would permit plans that satisfy the three percent nonelective safe harbor to suspend contributions during the year.

Therefore, the only recourse for an employer that cannot afford to continue the three percent nonelective contributions for the entire year is to terminate the plan.

A significant number of small businesses, including one of my clients, Cyclonix, have found themselves in the difficult position of considering terminating their 401(k) plans because they cannot afford this year's safe harbor nonelective contribution. Cyclonix is a Silicon Valley company with approximately 60 employees and annual payroll of approximately $2.4 million. Cyclonix does branding and trade show work for local companies.

Cyclonix has sponsored a safe harbor 401(k) plan since 2007. Last year they contributed approximately $69,000 to their plan. In November 2008, Cyclonix complied with the safe harbor notice requirement and notified their eligible employees that they would be making a three percent nonelective contribution to their 401(k) plan in 2009. Therefore, this year Cyclonix will be required to contribute approximately $72,000 to the plan.

However, Cyclonix contacted us last month to determine what their options were because their financial picture had changed and they no longer could afford the required contribution. And unfortunately, under the current rules, none of the options are good. Cyclonix is now considering terminating their 401(k) plan or possibly laying off some employees. Ideally they'd like to borrow the money to make the contribution but with the current banking situation, Cyclonix – like most small businesses – have lost the ability to expand their line of credit.

To help Cyclonix and other small businesses maintain their 401(k) plans, ASPPA has asked the IRS to promptly issue guidance permitting employers to suspend safe harbor nonelective contributions during a plan year. We suggested that certain notice requirements and other protections be incorporated into this guidance, including notification on when such a suspension would occur, a timely amendment made to the plan, notification provided to affected employees, and a provision that the three percent nonelective contribution be made for compensation earned prior to the effective date of the suspension. These requirements are consistent with Internal Revenue Code §401(k)(12) and the existing exception for plans that satisfy the matching contribution safe harbor, and would ensure that the suspension of nonelective contributions will not result in discriminatory deferrals for highly compensated employees.

We are hopeful that the IRS will respond and allow employers to suspend safe harbor contributions without terminating the 401(k) plan. However, we are concerned that having to suspend the contribution will make employers gun shy about adopting a safe harbor in the future. To address this concern, we recommend a statutory change to the 401(k) non-elective safe harbor that would allow employers to adopt the safe harbor later in the year, even after the end of the year, when the employer knows it is affordable. In

exchange for permitting more time to elect the safe harbor, the required contribution would be increased from 3% to 4% of pay.

Summary

Small employers are the heart of the American economy. As a small business owner who provides services to other small business owners, I can tell you that we want to do the right thing by our employees. Small businesses that provide retirement plans for their workers want to continue to provide retirement benefits. We just need your help in navigating the challenges we all are facing now. We are not looking for a bailout – only for a life jacket to keep our heads above water during these troubled times. Regulatory relief for non-elective safe harbor 401(k) plans, and funding relief for defined benefit pension plans, are straightforward ways to help small businesses meet cash demands without terminating plans (and in some cases dumping liability on the PBGC) or laying off more workers.

Statement of the U.S. Chamber of Commerce

ON: **TESTIMONY ON THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY**

TO: **THE COMMITTEE ON SMALL BUSINESS OF THE UNITED STATES HOUSE OF REPRESENTATIVES**

BY: **JASON SPEER**

DATE: **FEBRUARY 25, 2009**

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.

TESTIMONY BEFORE

THE COMMITTEE ON SMALL BUSINESS

OF THE UNITED STATES HOUSE OF REPRESENTATIVES,

ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

ON

THE DROP IN RETIREMENT SAVINGS: THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

BY

JASON SPEER

WEDNESDAY, FEBRUARY 25, 2009

Thank you, Chairwoman Velázquez, Ranking Member Graves, and members of the Committee for the opportunity to appear before you today to discuss challenges facing small business in a struggling economy. My name is Jason Speer, Vice President and General Manager of Quality Float Works, Inc., based in Schaumburg, Illinois. I am pleased to be able to testify today on behalf of the U.S. Chamber of Commerce where I am a member of its Small Business Council. The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. Over ninety-six percent of the Chamber members are small businesses with fewer than 100 employees.

Quality Float Works, Inc (QFW) is a family owned and operated company that manufactures premier metal float balls. We are globally engaged and have grown our sales in the international marketplace. QFW has 24 employees and did approximately $2.7 million in revenue in 2008. We offer employees a 401(k) plan and provide up to a 4% match. The QFW plan enables employees to choose funds, change contribution rates at any time, and work with an advisor to seek guidance. We encourage all employees to participate, as they are like family and we want them to be prepared for retirement. I am the administrator of the plan and in that capacity, it is my responsibility to assist with enrollment, ensure that contributions are transferred to the facilitator, and direct questions to the appropriate person.

Introduction

According to the U.S. Small Business Administration, small businesses (less than 500 employees) represent 99.9% of the total firms and over half of the workforce in the United States.[1] 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.[2] Thus, there have been tremendous efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.[3] Despite the obstacles, and due to certain incentives, small businesses are having success in the retirement plan arena. Small businesses with less than 100 employees cover more than 19 million American workers.[4] Most of these small business employees enjoy generous annual retirement plan contributions from their employers, often in the range of 3 to 10 percent of compensation. Nonetheless, the current economic environment raises entirely new challenges and obstacles for small business owners.

As you are aware, due to the unprecedented downturn in virtually all investment markets, pension funding ratios have fallen significantly over the past year and it is unlikely that the markets will recover sufficiently in the short term. In addition, corporate bond interest rates fell dramatically during December of 2008, triggering a significant increase in pension liabilities. According to Watson Wyatt, the global pensions balance sheet deteriorated by nearly 29% in 2008, reflecting the combined effects of poor performing assets and lower government bond yields.[5] While there is no specific data for small business plans, these plans are obviously facing similar declines. For QFW specifically we are facing slowing sales due to the economic climate even though our company is diversified. QFW has weathered many ups and downs in the past 94 years and recent additions to our product line led to record sales in 2008. However, due to the current global economic crisis, we predict that 2009 will be a difficult year and are looking at ways to cut costs as sales decline.

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[1]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.

[2] Part of the reason why small business lags behind in retirement coverage is that the first 4 years of a small businesses' existence, they are generally fighting for their lives. Across all sectors, nearly 40 percent of new establishments fail after two years and over 50 percent fail after 4 years. Survival and longevity in the Business Employment Dynamics Data, Amy E. Knaup, http://www.bls.gov/opub/mlr/2005/05/ressum.pdf.

[3] Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that was made permanent by the Pension Protection Act of 2006 ("PPA") 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.

[4]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.

[5] Watson Wyatt *Global Pension Assets Study 2009*, http://www.watsonwyatt.com/europe/research/resrender.asp?id=200901-GPAS&page=1.

Defined Contribution Plans

Forty percent of small employers offering an employee retirement plan offer a 401(k) plan.[6] Therefore, declining balances and administrative costs associated with these plans are a big issue for small business plan sponsors. During 2008, the S&P 500 Index lost 37.0 percent for the year, which translated into corresponding losses in 401(k) retirement plan assets.[7] Due to the transparency of these plans, participants are acutely aware of these declines and as the economic situation remains uncertain, more and more participants are concerned about retirement assets. Plan sponsors must deal with the concerns of their participants. In the small business context, this can become particularly challenging due to an environment with fewer employees. For example, QFW had 12 employees enroll when we introduced this a few years ago. In 2008, 5 stopped participation due to concerns about the market, and several others have expressed similar concern in recent months. If too many participants drop out of the plan, we risk not meeting our minimum contribution requirements that are required in the contract with our facilitator. Thus, even though we would like to continue to maintain our 401(k) plan, we may not be able to do so if our employees do not stay in the plan.

In addition, due to the financial crisis, small business plan sponsors are acutely aware of administrative costs. One result of participant concern is that there is an increase in demand for distributions – both hardship withdrawals and loans. Moreover, participants may increase their requests for changes to their investments. These events increase administrative costs unexpectedly and can take a significant toll on a small business already experiencing financial strain.

Another area undergoing financial review is the employer match. In a Mercer survey, 83 percent of plan sponsor respondents did not expect their company to reduce the level of employer contributions. However, this means that 17 percent are considering this drastic action.[8] While it is not an action that an employer wants to take, it is sometimes a necessary consideration in these challenging times.

Required Minimum Distribution Rules

There are several concerns with the required minimum distribution (RMD) rules. The changes made in the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) did not impact 2008 distributions; therefore, beneficiaries who turned 70 and ½ in 2008 still have to take a delayed distribution by April 1, 2009. Moreover, it was not a complete suspension of all RMD rules. There are still some exceptions to the suspension of the RMD rules that participants and plans sponsors may not be fully aware of. For small business owners, communicating these issues and ensuring that plan participants understand these issues can be challenging. Many employees do not understand the changes to the rules and look to me, as the plan administrator,

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[6] NFIB, 411 Small Business Facts. http://www.411sbfacts.com/sbpoll-tables-res.php?POLLID=0044&QID=00000001273&KT_back=1.

[7] EBRI Issue Brief, "The Impact of the Recent Financial Crisis on 401(k) Account Balances" February 2009 • No. 326 by Jack VanDerhei. http://www.ebri.org/pdf/briefspdf/EBRI_IB_2-2009_Crisis-Impct.pdf.

[8] Mercer Global Survey "*Leading Through Unprecedented Times*" November 2008, www.mercer.com/unprecedentedtimes.

for advice. Thus, additional clarification of the changes to the rules would help plan sponsors administer these rules effectively.

Furthermore, WRERA did not address one issue under the RMD rules that particularly penalizes small businesses owners. Under the RMD rules, a five percent owner must take a distribution at age 70 and ½ even if she continues to work, although there is an exception for non-owners who continue to work.[9] Thus, small business owners are forced to receive retirement distributions even if they do not need them. Consequently, Congress should consider a permanent change to this rule that would provide small business owners the same treatment under the RMD rules as non-owners.

Defined Benefit Plans

The Worker, Retiree, and Employer Recovery Act of 2008 provided much-needed technical corrections and certain relief provisions particularly for small business plans.[10] Nonetheless, plan sponsors are currently facing even greater economic hurdles than they were last year. Various reports show that pension funding ratios have fallen significantly over the past three months, and it is unlikely that the markets will recover in the immediate future. Without further legislative action, these unexpected funding requirements will continue to require that companies choose between funding their pension plans (which are long-term obligations) and laying off workers, closing plants, and postponing capital investments. This could result in increased unemployment and a slower economic recovery.

Because of the importance of this issue to workers' retirement security and the overall U.S. economy, the Chamber urges Congress to adopt follow-up, temporary provisions that will ease cash flow constraints and make contributions more predictable and manageable in 2009 and 2010. Specifically, the Chamber encourages Congress to enact the following provisions:

Contribution Assistance – While the general impact of the current economic situation is widespread, the particular situations of individual companies are varied and, therefore, a fix that works for one company may not work for another. Consequently, we request that Congress enact the following three alternate proposals. Individual plan sponsors would then elect to use the provision that is best suited to its situation.

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[9] IRC section 401(a)(9)(C)(ii).

[10] WRERA included the following changes for small business defined benefit plans: Flexibility in Code Section 415 Interest Rate Assumption - Small defined benefit plans would be required to determine the value of lump sum distributions not in excess of the Code section 415 limit using a fixed 5.5% interest rate, instead of the greater of the 5.5% rate or 105% of the corporate bond yield curve rate; and Clarification of the Valuation Date for Small Plans - The Secretary of Treasury is given authority to prescribe special rules for small defined benefit plans that have a valuation date other than the first day of the plan year for purposes of, among others, quarterly contributions and determining the application of the benefit restriction rules.

Option 1 - Provide a "look back." The look-back would allow companies for 2009 and 2010 to make contributions to their pension funds based on 105% and 110% of their 2008 required contribution.

Option 2 - Widen the funding corridor. Under current law, companies can "smooth" market losses over a period of time. However, the amount of losses that can be smoothed is restricted to 10 percent (this is referred to as the funding or smoothing corridor). However, the 2008 market losses were far beyond 10 percent, leaving many plans with losses that exceeded 30 percent. Temporarily widening the funding corridor to 30 percent would help companies manage the extreme unexpected losses experienced during the market downturn.

Option 3 - Amortization of 2008 losses. We propose that for 2009 and 2010, employers shall pay interest on their plans' 2008 losses to prevent the plans' shortfall from growing, but seven-year amortization of those losses would not commence until 2011. Moreover, companies electing to use this special amortization rule must, for 2009, contribute at least 105% of the amount required to be contributed for 2008. For 2010, this would be increased to 110% of the amount required to be contributed for 2008.

Protection of Employees and Employers – We propose that for 2009 and 2010, all benefit restrictions would apply based on a plan's funded status for 2008. Similarly, a plan's funded status for 2008 shall be deemed to remain in effect for 2009 and 2010 for purposes of determining whether the plan sponsor may use its prefunding balance or funding standard carryover balance in the next year.

Critical Guidance Items – In addition to the above proposals, there are items that need modification or clarification. These items impact plan funding and are critical in addressing the current funding crisis.

Ensuring Transition Relief Applies to All Plans. WRERA generally amended the Pension Protection Act of 2006 (PPA) transition rule to provide that for purposes of determining a plan sponsor's funding shortfall, the plan's funding target is 94% of liabilities for 2009, 96% for 2010, and 100% thereafter. However, certain plans were left out of this provision—new plans and plans that were subject to the deficit reduction contribution ("DRC") regime in 2007. The law should be amended to measure the funding targets for all plans by reference to the phased-in targets of 94% for 2009 and 96% for 2010.

Clarification of Target Normal Cost. In the technical corrections portion of WRERA, the definition of target normal cost was amended to include "plan-related expenses." The law has never required plan investment expenses to be included in normal cost, so the interpretation of a technical correction to make a major policy change would not be appropriate. The law should be clarified by changing the term used to "plan-related administrative expenses."

Use of the Spot Yield Curve. Consistent with the statutory language, it should be clarified that the spot yield curve for any plan year may be the spot yield curve for any "applicable month" with respect to such year, which generally can be the first month of the plan year or any of the four preceding months.

Application of the Contribution Assistance Proposals to Certain Fiscal Year Plans. For purposes of the above proposals, in the case of plans with plan years beginning after October 31, but before January 1, and for plans with end-of-year valuation dates, the relief would apply to plan years beginning in 2008 and 2009 rather than in 2009 and 2010.

Chamber Recommendations

There are no easy or complete solutions to the challenges facing small business plan sponsors. Moreover, the current challenges only highlight how small business issues often need additional consideration. To this end, the Chamber believes that it is important to increase small business representation in as many areas as possible. Specifically, it would be important to have a small business representative included on the ERISA Advisory Council. The ERISA Advisory Council advises the Secretary of Labor on ERISA issues pertaining to pension and health care issues. Having a voice dedicated to small business ERISA issues would add a critical component to that group.

In addition to the short-term provisions for defined benefit plans described above, we have several long-term recommendations that we believe would encourage small businesses to establish and maintain retirement plans. It is important to note that the Chamber opposes the mandate of benefits or benefit plans. Rather than mandating participation by either employers or employees, the Chamber recommends provisions that would incentivize participation in the qualified plan system. Thus, we recommend the following provisions:

Encourage greater pre-funding of defined benefit plans – Given today's financial climate – the substantial drop in equity values and rock bottom interest rates – had we allowed plans to save as much as they could during the "good" years, there would be less of a strain during the "bad" years and our defined benefit pension funding rules would be less of a problem for small businesses and might have a very positive effect on all sizes of defined benefit plans. Currently, ERISA limits the amount of pre-funding.[11] The Chamber recommends that Congress allow for unlimited pre-funding up to the amount of projected future benefits in the plan. In addition, we recommend the elimination of the tax penalty for the reversion of assets in a pension plan after all promised benefits have been paid out to participants. These changes would encourage small business plan sponsors to make larger contributions when they could afford them without fear of being penalized at a later date.

Eliminate administrative complexities and burdens – In general, greater regulation often leads to greater administrative complexities and burdens. Such regulatory burdens can often discourage small business plan sponsors from establishing and maintaining retirement plans. The top-heavy rules under ERISA are an example of extremely complex and burdensome regulations that do not

[11] IRC section 404(a).

offer a corresponding benefit.[12] Thus, we recommend that they be eliminated. There are also burdens in the compliance area that should be eliminated. For example, we recommend an immediate moratorium on the assessment and collection of the IRC Section 6707A penalty until the statute can be thoroughly reviewed and recommendations can be made to carry out the intention of Congress without the disproportionate and probable unconstitutional impact of current law on small businesses and their owners.[13]

Tax distributions at capital gains rate – Much of the success of the private retirement system has been attributed to the tax savings incentive. Thus, taxing distributions from qualified retirement plans at the capital gains rate instead of the income tax rate would create an even larger incentive for small plan sponsors to establish and maintain retirement plans.

Conclusion

The challenges facing small business plan sponsors in the current economic downturn are substantial. In the current economic environment, it is more important than ever that Congress focus on encouraging the implementation and maintenance of retirement plans by small businesses. The Chamber appreciates the opportunity to express our thoughts and looks forward to working with you and other interested parties to help shore up the retirement security of American workers through the provision of retirement plans established and maintained by small businesses.

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[12] IRC section 416.

[13] Section 6707A of the Internal Revenue Code imposes a penalty of $100,000 per individual and $200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a "listed transaction" or "substantially similar" to a listed transaction. The Treasury Department announces on an ad hoc basis what is a listed transaction. There is no regulatory process or public comment period involved in determining what should be a listed transaction. The penalty applies even if the small business and/or the small business owners derived no tax benefit from the transaction. The penalty also applies even if on audit the IRS accepts the derived tax benefit. The penalty is final and must be imposed by the IRS and cannot be rescinded under any circumstances. There is no judicial review allowed. In the case of a small business, the penalties can easily exceed the total earnings of the business and cause bankruptcy – totally out of proportion to any tax advantage that may or may not have been realized. If a transaction is not "listed" at the time the taxpayer files a return but it becomes listed years later, the taxpayer becomes responsible for filing a disclosure statement and will be liable for this penalty for failing to do so. This is true even if the taxpayer has no knowledge that the transaction has been listed.

Testimony of

Andrew Keeler, CFP®
Everhart Financial Group, Inc.
Columbus, Ohio

on

"Drop in Retirement Savings: The Challenges Small Business Face Funding and Maintaining Retirement Plans in a Struggling Economy"

Before the

House Committee on Small Business

February 25, 2009

Thank you, Chairwoman Velazquez, Ranking Member Graves, and other members of the Committee, for inviting me to talk to you about the challenges facing small businesses trying to provide retirement plans for their employees during these difficult economic times.

INTRODUCTION

I am Andy Keeler, a CERTIFIED FINANCIAL PLANNER™ practitioner, and partner with Everhart Financial Group, Inc. in Dublin, Ohio. Our firm is a fee-based financial planning firm that practices in two areas-retirement plan design and implementation for small businesses, and comprehensive financial planning for executives and small business owners. I am honored to be here today on behalf of the Financial Planning Association to address your concerns about how the current economic environment is affecting employees of small businesses ability to save for retirement, and more importantly, how it is affecting their ability to achieve a positive financial outcome with respect to retirement.

Regrettably, only 15-20% of small businesses have retirement plans in a healthy economy. Perhaps this is a discussion for another day. So, I will focus my discussion on those small businesses that offer retirement plans to employees, and offer my insights and observations with respect to how business owners and plan participants are coping with the current economic crisis.

Day in and day out, our firm assists its corporate clients in establishing and maintaining customized retirement plan solutions. The most critical part of this process is face-to-face meetings where we learn more about participants as individuals and their needs and expectations. Part of this education process is also helping participants understand the importance of saving for retirement, and the determinants of wealth. As you might imagine, the largest determinant of wealth is the amount of money that is being saved by, or for, a retirement plan participant. Savings rates are the key factor, followed by market performance and security selection.

OVERVIEW

As you are all well aware, this country has seen a major shift of responsibility for retirement planning from the employer to the employee. This transition from defined benefit "pension" plans to defined contribution plans like 401(k)'s have occurred over the past decade or so. In the process, we as a society have neglected to explain to America's workers how this shift of roles and responsibilities affects their retirement income down the road. There is a great disconnect between the retirement income that an employee would have received under a traditional pension coupled with a solvent Social Security program as compared with where most Americans are heading today. Under the traditional defined benefit plan, retirees would receive around 60% of pre-retirement income until death. Social security would provide an additional 20%, giving retirees of generations past a retirement income replacement of 80%. On average, we find that most retirees need between 70 and 80% of pre-retirement income to make ends meet. Under defined benefit plans, employees were on track to receive 80% without saving a penny of their own money. Worries about the stock market were non-existent. Participants didn't see a retirement plan balance or dollar value, nor were they beat over the head with negative financial news. All the participant had to do was simply count on a monthly income stream in retirement.

To finance this retirement liability, employers had to contribute roughly 25-30% of the employee's income into the defined benefit trust each and every year. As employers phased out the defined benefit plan and implemented the defined contribution plan, we failed to inform that employees that they would need to receive annual additions of between 25 and 30% of their income each year for the next 30 years. With the exception of discretionary employer matching funds or profit-sharing contributions, the responsibility of providing a solid retirement income rests almost entirely on the shoulders of those entering the workforce today. So, today, financial planners are finding that employees either choose to save nothing, or they contribute up to the employer match, which is often between 3 and 6% of pay. We find that the lower the match, the lower the contribution rate for employees. This presents a large unfunded liability for retirees, and high probability that retirement outcomes will not be successful.

Not only are participants not saving enough, but they must direct their own investments and make their own investment decisions. This is a responsibility that the average American is ill-prepared to do, or do well. Most people, once properly informed and educated, understand that over long periods of time the stock market has historically provided the greatest return. However, some have deep-rooted insecurities over the stock market, and these beliefs can often be traced back to their parents or grandparents that chose to invest in "safe" investments like banks or shoved under the proverbial mattress. After all, as I have just shown, years ago retirees didn't really need to save at all, since their retirement needs were fulfilled by their employer's generous pension plan and Social Security. Educating participants today that this model does not work for them can be very difficult, especially in manufacturing or other so-called "blue collar" industries.

Now, we are faced with the worst bear market since the Great Depression, and employees are losing faith in our securities markets, and questioning the fundamental premise for investing over the long-term. I often hear participants

say, "I can't afford to lose everything", or, "Should I stop contributing to the plan until the market goes back up?" or "Every penny I invest in the plan is being lost, so why bother?" While most lay people are initially willing to take risk over long periods, when they actually see losses in their statements, their risk tolerance will shift and they will look for more conservative options.

In addition, we have employers that are laying off their workforce. No paycheck means no savings. It also makes those who are still employed all the more conservative, and not so eager to save as much as they should given uncertainty of employment.

Obviously, at the heart of the recession are businesses, big and small, that are having a hard time staying in business. Financing has dried up, so they can no longer borrow to make payroll. Revenues are down, so after reducing their workforce, the next area to cut is the company match. If there are no profits there is no profit sharing. According to Watson Wyatt, 2% of large businesses have reduced or eliminated their match, and another 4% plan to reduce or eliminate their match within the next 12 months. When you look at small businesses, the problem is amplified since most operate in specialty niches and do not have a diversity of revenue streams. Since medical benefits are crucial in attracting and retaining employees, often the 401(k) match is the first thing to go. If eliminating the match is not enough, a more drastic measure is to terminate the plan. Plan terminations have increased in 2009, but are not yet significant.

With all of these negative factors putting downward pressure on participants eagerness to save and take the risk that is necessary to achieve a positive financial outcome, many participants are now putting their heads in the sand and investing in cash, money market or stable value options within their 401(k). Fortunately, the Pension Protection Act (PPA) gave employers defensible means to make the default investments more than just low yielding investments like stable value funds or money markets. But the risk for the American worker

remains -- that once the bear market ends, if they stay invested only in fixed-income investment products, the value of their retirement savings will eventually be eroded by inflation.

RECOMMENDATIONS

While the cost of implementing and maintaining a retirement plan has decreased significantly over the past decade, when revenues are down, a cost is a cost, and employers can use any help they can get. Start-up fees, on-going recordkeeping fees, and administrative fees can be easy targets for a CFO looking to cut costs. Obviously, the company match and profit sharing contributions, which are generally discretionary, are the first to go. Then the whole plan.

One incentive to encourage small businesses to maintain their plans would be to enhance the current tax credit that is used to offset the startup cost and the cost of educating employees about the new plan. Created under The Economic Growth and Tax Relief and Reconciliation Act (EGTRRA) the credit is available to offset costs paid or incurred in tax years beginning after December 31, 2001, for retirement plans that first become effective after that date. The credit currently equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of $500 per year for each of the first three years of the plan.

This credit is limited to those employers with 100 or fewer employees who received at least $5,000 in compensation for the preceding year; at least one participant must be a non-highly compensated employee.

This credit should be broadened to include any employer with less than 500 employees, and it should also be broadened to offset employer contributions to a retirement plan. This credit could look like the current tax credit for low income & middle income consumers which is detailed in the grid below.

Joint Married	Head of Household	All Other Filers	Saver's Tax Credit
$0 - $30,000	$0-$22,500	$0-$15,000	50% of contribution
$30,001-$32,500	$22,501-$24,375	$15,001-$16,250	20% of contribution
$32,501-$50,000	$24,376-$37,500	$16,251-$25,000	10% of contribution
Over $50,000	Over $37,500	Over $25,000	0% of contribution

This credit could be modified to reward the employer for making an employer contribution. It might look something like this.

Number of Employees	Employers Tax Credit
2-200	50% of contribution
201-350	20% of contribution
351-500	10% of contribution
Over 500	0% of contribution

Given these tough times, perhaps these credits could accrue to be used later once prosperity returns, although that would not stimulate the inflows that these participants need when they need them the most.

The best way to help participants from making poor financial decisions with potentially devastating results is to improve financial literacy for consumers. I believe it is critical that our schools, grades K-12, offer curriculum that helps educate the plan participants of tomorrow about equity markets, the importance of saving, and how saving in the future is so different from that of their

upbringing. Consumers can't simply take the practices of previous generations, implement them today, and expect to have the same outcome.

Two years ago, I was asked to cover a college professor's personal finance class on the second day of classes. He warned me that most of the students would not yet have purchased their texts, so most of them probably had not completed their reading assignment. He also warned me that some of the students fall asleep or talk in class.

I began class on time, covered the chapters that they were supposed to read before coming to class, then spent the rest of the class covering basic financial concepts like how to choose a mutual fund and how and why to purchase a home instead of renting. I can honestly say there were no students sleeping in my class. They listened and hung on every word until finally, a doctoral candidate said, "Mr. Keeler, I have been in school almost my entire life and I am just NOW hearing about this? This is really important stuff; it seems crazy that no one taught us this earlier on!"

Public service announcements could cover a lot of ground towards this end, and serve as "continuing-education" for those lucky enough to have learned about saving, investing and the equity markets years ago. The National Foundation for Financial Education (NEFE), The Financial Planning Association (FPA), and numerous, independent non-profits can offer stimulating and compelling research that reinforces that value of saving and investing prudently. FPA, for example, maintains a partnership with Junior Achievement in which personal financial literacy is taught to students by CERTIFIED FINANCIAL PLANNER™ practitioners, but this is not enough. More needs to be done to encourage states to adopt mandated financial literacy curricula in public schools. According to Jump$tart Coalition, a national financial literacy group, only three states require at least a one-semester course dedicated to personal finance, while another 17 allow it to be integrated in another curriculum, usually math.

With improved financial literacy comes renewed confidence and a more sophisticated understanding of our financial markets. Especially in middle-income families and the underserved, there is a backdrop of mistrust of the companies that the participants invest in. Helping participants understand that the money they invest is theirs, and will always be, is important. It is also very helpful for participants to understand the process that their contributions go through from the paycheck to the 401(k) account.

CONCLUSION

Madam Chairman, Ranking Member Graves, ladies and gentleman, we are at a crossroads. We are at a very important time in which Americans are losing faith in the financial system, and frustration is building. Retirement assets have shrunk by roughly 40%, with paper losses in the trillions of dollars. The investing public is questioning the value of saving for retirement. T they need to be reminded and convinced of its overall importance to meeting their retirement goals. There have been many times over the past 200 years.that Americans came together and rallied for a common cause. Sense of entitlement, jealousy and resentment often take the back seat when times get tough if a situation is approached properly. This is OUR problem. Participants may surprise you -- if they are made aware of the problem, and armed with the knowledge to make sound financial decisions, we will be impressed by the outcome. I thank you for taking the time to address an issue of such critical concern, and I appreciate the opportunity to offer my insights. I am happy to respond to any questions.

Testimony of Catherine Collinson
President, Transamerica Center for Retirement Studies
before
The U.S. House of Representatives
Committee on Small Business

Hearing on
Drop in Retirement Savings: The Challenges Small Businesses Face Funding and Maintaining Retirement Plans in a Struggling Economy

February 25, 2009

The Transamerica Center for Retirement Studies® ("The Center") appreciates the opportunity to provide this written testimony in connection with the hearing of the U.S. House of Representatives Committee on Small Business on the issues related to retirement benefits by small business. The Center commends Committee Chairwoman Velazquez and Ranking Member Graves for focusing on the particular concerns of small business and their employees.

The Center is dedicated to educating the American public on trends, issues, and opportunities relating to saving and planning for retirement and achieving financial security in retirement. Its research focuses on how to educate and effect positive changes among the American workforce towards achieving greater levels of financial security in retirement. It emphasizes savings trends among American workers and segments within the workforce, trends of employer-sponsored retirement plans and their participating employees, and the implications of legislative and regulatory changes.

The Center is a non-profit corporation and private operating foundation. It is funded by contributions from Transamerica Life Insurance Company and its affiliates and may receive funds from unaffiliated third-parties. For more information about The Center, please refer to www.transamericacenter.org.

Pertinent Facts about Small Business

According to the U.S. Census Bureau, small businesses (less than 500 employees) represent 99.7% of the total firms and 50.9% of the workforce in the United States.[1] Further, according to the U.S. Small Business Administration, small businesses have generated 60 to 80% of net new jobs annually over the past decade in the United States and supply more than half of U.S. non-farm private gross domestic product.[2] Given the prominent role that small businesses play in the U.S. economy, it is vital to encourage small business owners to sponsor retirement plans and help the small business workforce adequately prepare for retirement.

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[1] U.S. Census Bureau, 2004 County Business Patterns. For information on confidentiality protection, sampling error, non-sampling error, and definitions, see http://www.census.gov/epcd/susb/introusb.htm
[2] *See* U.S. Small Business Administration, Frequently Asked Questions, at www.sba.gov.

The small business sector is highly dynamic with high start up rates, closure rates, and merger and acquisition activity. Small businesses are represented in all industries and generate a wide range of revenue, earnings, and payroll. As such, at any given time a small business may have unique needs and objectives for sponsoring a retirement plan.

Role of Small Business Employers in Providing Workplace Retirement Benefits

Employer-sponsored retirement savings plans play a critical role in facilitating savings and making the savings process easy and attractive for American workers. With the benefits of saving in an employer-sponsored plan (investment education, the potential for employer contributions, fiduciary oversight), combined with the convenience of automatic payroll deduction, Americans are more likely to save for retirement through participation in employer-sponsored plan versus contributing to an individual.

The Center just completed the Tenth Annual Transamerica Retirement Survey[3] ("Transamerica Survey") of 3,466 full-time and part-time workers, over half of whom work for companies employing between 10 and 499 persons ("small business").

The Transamerica Survey findings underscore the importance of workplace retirement benefits in helping small business workers ("workers") prepare for retirement. Of the worker respondents, 39% expect 401(k), 403(b) accounts, and IRAs to be their primary source of income when they retire. Workers who did not expect savings from an employment-based plan indicated that they expected that role to be filled from Social Security (27%), followed by other savings and investments (18%), company-funded pension plan (6%), inheritance (2%), home equity (2%), other (6%).

The Transamerica Survey found that 76% of workers, who have access to workplace retirement plans offered to them, participate in their company's defined contribution retirement plan. By comparison, the Investment Company Institute found that only 14% of U.S. households contributed to an IRA in 2007.[4]

Equally significant, the Transamerica Survey found that workers who are offered a company-sponsored retirement plan are more likely to save for retirement outside of work (67%) than those who are not offered a plan (52%).

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[3] This survey was conducted online within the United States by Harris Interactive on behalf of the Transamerica Center for Retirement Studies between December 16, 2008 and January 13, 2009 among 3,466 full-time and part-time workers, including 1,714 small company workers (10 to 499 employees) and 1,752 large company workers (500 or more employees) Potential respondents were targeted based on job title and full-time and part-time status. Respondents met the following criteria: All U.S. residents, age 18 or older, full-time workers or part-time workers in for-profit companies, and employer size of 10 or more. Results were weighted as needed for the number of employees at companies in each employee size range. No estimates of theoretical sampling error can be calculated; a full methodology is available. Harris Interactive is a global leader in custom market research. For more information, please visit **www.harrisinteractive.com**.

[4] Investment Company Institute, The Role of IRAs in U.S. Households' Saving for Retirement, 2008, January 2009

The role of employers in providing retirement savings plans to their employees has long been supported by public policy and the work of this and prior congresses in enacting tax incentives both for employers to sponsor retirement plans for their employees and for employees to accumulate long-term savings through those plans. The current tax system also helps to ensure that these savings will be there for retirement by placing restrictions on pre-retirement distributions and imposing tax penalties for most early withdrawals.

Small Business Retirement Plan Coverage

The Transamerica Survey found that 75% of full-time workers are offered a plan by their employers compared to only 24% of part-time workers. Because only 9% of workers indicated that they are offered a company funded defined benefit pension plan, this testimony will focus on defined contribution plans.

A 2007 survey[5] conducted by The Center found that of small business employers who did not sponsor a defined contribution plan, 75% are not likely to offer a 401(k) in the next two years, with the most frequently cited reason being concerns about cost (50%).

Drop in Retirement Savings: Challenges & Opportunities for Small Business

The economic downturn has taken its toll on companies of all sizes. Many small business employers have been or will soon be confronted with difficult decisions regarding employment, compensation, and health and welfare benefits including company-sponsored retirement plans.

Among worker respondents, the Transamerica Survey found that their employers had implemented the following measures over the last 12 months: layoffs or downsizing (32%), frozen salaries (20%), eliminated bonuses (18%), reduced or eliminated non-retirement benefits (9%), and reduced or eliminated retirement benefits (10%).

Of those indicating that their retirement benefits had been reduced or eliminated, these were the responses: company match on 401(k) or similar plan was reduced or eliminated (72%), 401(k) or similar plan was discontinued (14%), pension plan was frozen or discontinued (20%), other (6%).

Workers also face competing financial priorities. When asked about their greatest financial priority right now, the Transamerica Survey yielded the following response rates from workers: just getting by – covering basic living expenses (30%); paying off debt (26%); saving for retirement (20%); paying off mortgage (10%); supporting children and/or parents (5%); paying healthcare expenses (2%); other (7%).

The Transamerica Survey found that 56% of workers are less confident in their ability to achieve a financially secure retirement than twelve months ago and 29% expect to work longer and retire at an older age. To put this in greater perspective, only 10% of workers

[5] The 9th Annual Transamerica Retirement Survey

are now "very confident" in their ability to fully retire with a comfortable lifestyle and 40% expect to work past the age of 70 including 17% who do not plan to retire.

Yet, despite this gloomy outlook, the Transamerica Survey found that workers are staying committed and continuing to save in their companies' 401(k) or similar retirement plans. Participation (76%) and median salary contribution rates (7%) remain stable. Even more compelling, 18% percent indicated that they have increased their salary contributions in the past twelve months compared to those who have decreased contributions (10%) or stopped contributing altogether (4%). Eleven percent indicated that they have taken out a loan from their plan of which 52% did so in the past twelve months. Only 4% have taken a hardship withdrawal in the last twelve months.

The Transamerica Survey also found that workers need to better educate themselves about retirement investing and more effectively manage their savings, as evidenced by those who indicated that they: agree that they don't know as much as they should about retirement investing (69%), guessed at how much they will need to save for retirement (52%), have "a great deal" of knowledge about asset allocation principles (7%), and who are "not sure" how their retirement savings is invested (18%).

Many workers (47%) would prefer to rely on outside experts to monitor and manage their retirement savings yet only (35%) reported using a professional financial advisor.

Recent Accomplishments: Pension Reform in the 2000s

With the large number of Americans employed by small businesses and the particular challenges faced by small businesses in providing retirement plans for their employees, regulatory relief and incentives helped ease the burdens of small businesses in providing retirement savings plans for their employees and creating incentives for employees to participate in these plans.

Many important steps were taken by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and the Pension Protection Act of 2006 ("PPA") (which both made the positive EGTRRA changes permanent and instituted a number of additional positive reforms). Legislators are commended for passing these laws that promote plan sponsorship and participation through provisions including: (1) higher retirement plan and IRA contribution limits, (2) catch-up contributions for individuals who are age 50 or older, (3) establishment of the Saver's Credit to encourage plan or IRA savings for those who meet the income and eligibility requirements, (4) a small business employer tax credit for plan formation, (5) creation of the Roth 401(k), (6) simplification of a number of complex administrative requirements, (7) incentives and safe harbors needed to increase participation in employment-based plans through automatic enrollment, and (8) removal of certain impediments to employers providing participants with investment advice and annuity distribution options to provide lifetime income.

These laws continue to be valuable in increasing both the number of retirement plans offered by employers and the participation of employees in these plans; however, given

the economic downturn, much more can be done to help small business owners with existing retirement plans, expand retirement plan coverage among those who do not offer a plan, and help workers address savings shortfalls.

Recommendations

Preserving and Improving Upon the Existing System

Employer-sponsored defined contribution plans have proven to be a highly effective solution for encouraging workers to save for retirement on a consistent basis. That is not to suggest, however, that savings through the defined contribution system is not without risk. Given the decline in fund balances, many workers have already adjusted their expectations of working longer and retiring later.

Despite these declines in the financial markets, the Transamerica Survey found that 90% of workers value 401(k) or similar retirement plans as an important employee benefit and they are continuing to save. When the markets recover, workers should hopefully benefit from dollar cost averaging and eventually enjoy a rebound in their account values

However, more work can and should be done by the industry, behavioral finance experts, government and policymakers to educate workers, help them navigate through this economic downturn, encourage them to take greater ownership in planning and managing their savings, and equip them with tools to do so. These tools should include access to affordable professional financial advice.

Funding and Maintaining Retirement Plans in a Struggling Economy

The Transamerica Survey found that some workers employed by small businesses (10%) have reported that their employers have reduced or eliminated retirement benefits in the last twelve months. As the economic downturn persists, other employers may follow.

A major driver of any employers' benefits-related decisions is cost. A key to helping avoid any potential further reduction or elimination in benefits will be to help alleviate some of the cost. Possible solutions for consideration include:

1. An annual tax credit for small employers that continue to maintain a plan and that make some level of employer contributions.

2. An annual tax credit for small employers that exceed a set percentage of participation by non-highly compensated employees.

3. Adoption of a tax credit to help small employers finance plan contributions on behalf of their non-highly compensated employees.

4. Nondiscrimination rules, compliance testing, and the cost associated with correcting failures increase the employer's overall cost of sponsoring the

retirement plan. Further simplification of the regulations and administrative requirements may be achieved while preserving this basic spirit of fairness.

Increasing Plan Coverage in the Small Business Sector

Small businesses have a myriad of business circumstances, unique retirement plan-related needs, and concerns about cost. A key to successfully increasing plan coverage rates is to offer a variety of cost-effective solutions, within the context of the existing system and available plan types, to address those needs and concerns.

Possible alternative solutions that are worthy of consideration include:

1. Additional tax incentives to help offset the cost for small employers to establish new retirement savings plans. Increase the available amount and number of years of the start-up tax credit, under EGTRRA, which allows small businesses to claim for establishing a retirement plan.

2. Additional tax incentives and safe harbors from non-discrimination testing to encourage plan sponsors to extend eligibility and coverage to part-time employees when practical.

3. For small businesses in which a stand-alone 401(k) plan is not feasible, consideration should be given to enabling and providing incentives for them to join a multiple employer or group plan to be provided by a financial institution. To be effective, this plan should be simple to administer and should provide safe harbors from fiduciary liability for each employer. In addition, care should be taken to (1) protect employers from any fiduciary liability for the acts or failure to act of other employers participating in the plan, (2) provide tax incentives for employers and employees to encourage participation and (3) provide the means to ensure reasonable compensation for financial institutions for taking on investment and administrative functions. Multiple employer plans would provide very standard plan terms, and therefore, employers that want plan design flexibility, such as by offering a more robust investment menu, would continue to offer their own plans.

4. Increase the attractiveness of SIMPLE 401(k) plans and workplace IRAs, such as the SIMPLE IRA, as an alternative to 401(k) plans. Create a step-up progression in which a small business may start with a more simplistic solution, i.e., SIMPLE IRA, and then graduate up to more robust plan types as their business grows and evolves.

5. Broadly promote any new legislation and regulatory relief.

Increasing Savings of Low- to Middle-Income Workers

The Transamerica Survey found that the participation rate (50%) among low- to middle-income workers, as defined by annual household income of less than $50,000, lags behind higher income households. Forty percent of low- to middle-income workers reported having less than $5,000 in total household retirement savings.

The Saver's Credit, a tax credit which was created by EGTRRA and made permanent by the PPA, offers a meaningful incentive for encouraging low- to middle-income Americans to save for retirement. The Center applauds the Internal Revenue Services' recent efforts to increase the visibility of the Saver's Credit and broadly promote it.

However, the Transamerica Survey found that awareness of the Saver's Credit remains low at 18% among workers reporting an annual household income of less than $50,000. The survey results continue to raise concerns that many workers, who are already saving for retirement through a company-sponsored retirement plan such as a 401(k), or through an individual retirement account, may miss out on taking the Saver's Credit simply because they are unaware of it.

While many qualifiers may be missing out on this significant tax credit, there are also likely to be non-savers who might start saving for retirement with the help of an incentive like this if they were aware of the opportunity.

To increase awareness, usage, and encourage retirement savings among low- to middle-income workers, recommended solutions include:

1. Encourage the IRS to continue promoting the Saver's Credit.

2. Add to the 1040EZ form and/or ensure that online "Free File" programs are designed to catch the Saver's Credit even if the filer is unaware of it.

3. Expand the Saver's Credit by increasing the eligible income limits and making it refundable so that those many low- to middle-income workers without federal income tax liability would receive a direct and meaningful financial incentive to save.

Conclusion

The Center commends Committee Chairwoman Velazquez and Ranking Member Graves on their consideration of the particular challenges and needs of small businesses in providing and maintaining retirement savings plans for their employees during these difficult economic times.

The Center appreciates the opportunity to present its survey findings on the challenges faced by small business and its suggestions to help alleviate some of the issues.

TESTIMONY OF EDWARD FERRIGNO

THE DROP IN RETIREMENT SAVINGS: THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

HOUSE COMMITTEE ON SMALL BUSINESS

February 25, 2009

Thank you, Chairwoman Velázquez, Ranking Member Graves, and members of the Committee for the opportunity to appear before you today to discuss the impact of the economic crisis on small business retirement plans. The Profit Sharing / 401k Council of America (PSCA) is a national non-profit association of 1,200 companies and their six million employees that advocates increased retirement security through profit sharing, 401(k), and related defined contribution programs to federal policymakers. It makes practical assistance available to its members on profit sharing and 401(k) plan design, administration, investment, compliance, and communication issues. Established in 1947, PSCA is based on the principle that defined contribution partnership in the workplace fits today's reality. PSCA's services are tailored to meet the needs of both large and small companies, with members ranging in size from Fortune 100 firms to small entrepreneurial businesses.

SMALL BUSINESS PLANS SHARE MANY ISSUES WITH LARGE PLANS. FIRST AND FOREMOST, THE MARKET CRISIS MUST BE ADDRESSED

401(k) plan participants, working in partnership with employers, can successfully manage normal market risks and cycles and accumulate ample assets for retirement. However, they cannot succeed without efficient and transparent capital markets.

The drop in 401(k) account balances in 2008 was not caused by a defect in the 401(k) system or by ignorant participants. These plans are caught in the same financial crisis that has paralyzed business and financial organizations throughout the world. 401(k) participants have suffered along with everyone else. Inadequate enforcement, misguided policy, reckless conduct, and unethical behavior in the capital markets are the problem, not 401(k) plans. We urge the Committee, and Congress, to direct their efforts

to ensuring that a similar market collapse never again occurs. 401(k) participants, as well as all other investors, will then be able to move confidently forward, knowing that saving and investing for the long term will pay off as expected.

The Department of Labor reports that in 2006, the latest year available, participants and employers contributed over $250 billion to 401(k) type plans. The plans continue to improve, benefitting from a regulatory structure that permits flexible plan design and innovation. Automatic enrollment and target date funds were rare five years ago, but they are quickly becoming dominant plan design features. PSCA urges Congress to fix the markets and continue to work together with plan sponsors and providers to continually improve the very successful 401(k) system

Contrary to several published reports, real current data indicates that 401(k) participants are remaining resolute. They are not stopping contributions or increasing their loan activity. Hardship withdrawals have increased slightly, but the percentage of participants taking a hardship distribution remains well below two percent[1].

SMALL BUSINESS PLANS ARE NOT MONOLITHIC

The Small Business Administration classifies a small business as one with 500 employees or less. For purposes of retirement plans, there is a wide variance in the characteristics and concerns within this group.

In 2008, sixty-one percent of private sector workers had access to a retirement plan at work and fifty-one percent participated. Seventy-one percent of full-time workers had access and sixty percent participated.

Seventy-nine percent of all workers in establishments employing 100 or more workers had access to a retirement plan and sixty-seven percent participated. However, only forty-five percent of workers in establishments of less than 100 workers had access to a plan and thirty-seven percent participated. For establishments with between 50 and 100 workers, fifty-eight percent had access and forty-five percent participated. In businesses with less than fifty workers, forty-one percent had access and thirty-our percent participated[2] These participation rates are at a single point in time. They are not indicative of whether or not a non-participant or their household will choose to participate in a 401(k) plan for a substantial period of a working career.

The participation rate when offered a plan is encouraging, but can be improved. There are two areas in which to concentrate our efforts - lower-paid workers and small business plan coverage. We also need to increase participation by African-Americans and some ethnic groups, as revealed by some recent studies.

These statistics mean little if a worker is not saving for retirement. *One fact is abundantly clear – whether a worker saves for retirement is overwhelmingly determined by whether or not a worker is offered a retirement plan at work.*

Small business owners need simplicity and meaningful benefits for themselves to compensate for the costs of providing a plan to their workers.

The cost –benefit analysis for micro plans changes in an economic downturn.

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[1] *Fidelity Reports on 2008 Trends in 401(k) Plans*, Fidelity Investments, January 28, 2009, and *Update on Participant Activity Amid Market Volatility*, Vanguard Center for Retirement Research, February 19, 2009.
[2] *Employee Benefits in the United States, March 2008*, Bureau of Labor Statistics, August 7, 2008.

In a very small business, the owner's personal financial situation is a major factor in deciding to offer a plan to employees. In exchange for the benefit of personally saving in a plan, the owner must be willing to absorb the expenses of offering a retirement plan to employees. The equation changes in an economic downturn. First, the personal benefit of a tax deferral for retirement contributions is reduced as the owner's tax rate is diminished by the reduced profitability of the business. On the other end, plan service providers might increase plan fees paid by the owner because plan assets are lower and participant activity resulting from market collapse is increasing. The owner may reconsider the advantages of offering a plan and merely contribute to an IRA. Another option is a low cost variable annuity, with no contribution limits, in which investment earnings are deferred the same as in a qualified plan. Variable annuities with no protection of principal are available for twenty-five basis points. If the owner has no current tax liability, this option is probably significantly more attractive than offering a plan.

SMALL BUSINESS ISSUES

The top-heavy rules should be repealed.
Many small companies have uncertain cash flows, and a required contribution to a retirement program could jeopardize a company's survival. Unfortunately, ERISA requires that most small companies do just that. An economic downturn, if accompanied by lay-offs, will exacerbate the problem.

The rules for employer-sponsored defined contribution plans may look the same for large and small companies, but, in practice, the results are very different. Large companies can exclude some employees from their plans and limit company contributions to those who make voluntary contributions or even make no company contribution at all. In contrast, small companies that are top heavy must contribute three percent of pay for every full-time employee over the age of twenty-one with one year of service.

This outcome stems from the top-heavy rules, one of the many government-imposed limitations and rules designed to ensure that company managers do not disproportionately benefit from 401(k) plan participation. Specifically, the top-heavy rules provide that if sixty percent of a plan's assets are in the accounts of highly compensated or key employee participants (HCEs), then the company must make a three percent contribution to all eligible employees. In addition, the top-heavy rules are among the most complex regulations in ERISA. For example, the top-heavy test is more complex than the 401(k) anti-discrimination test. In addition, the definition of those considered to be in the top paid group is broad and includes more employees, which makes the test more onerous.

In practice, nearly all companies with fewer than fifty employees will eventually fail the top-heavy test, even if they are not top-heavy initially. For companies with fewer than twenty-five employees, it is a virtual certainty. This is because small companies are owner-managed, so there is virtually no turnover in the company's HCEs. In contrast, turnover within the rest of a small company's workforce is usually very high – typically higher than turnover among similar employees at large companies. Large companies where the ratio of HCEs to non-highly compensated employees (NHCEs) is large are in no danger of failing the top-heavy test and can thus take advantage of all of the plan design flexibilities provided in the rules governing qualified retirement plans.

If a plan is top-heavy and does not comply with the required remedies, there are severe penalties: immediate disqualification of the plan, serious tax fines, and the possibility that the company may be liable for substantial make-up contributions and legal fees. For small businesses, the resources to cover

these fines and reparations – especially those with 50 or fewer employees – may put the entire company at risk.

Reform proposals should consider small plans
As Congress considers fee disclosure and other reforms, it is critical that a "lowest common denominator" approach be used. Small businesses do not have nearly the resources of a large business to meet their duties under ERISA. Legislators must keep this in mind when considering new provisions. For example, small businesses rely on service providers to tell them about plan fees. However, under ERISA, they have the responsibility to ensure that plan fees are reasonable, not the service provider. PSCA supports legislation that shifts the burden from plan sponsors to try to determine plan fees to service providers who will be required to furnish this information.

Many small businesses prefer reviewing costs in an aggregate or "bundled" manner. As long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis. For example, if a person buys a car, they don't need to know the price of the engine if it were sold separately. They do need to know the horsepower and warranty. Any final legislation should preserve this option.

Mandatory payroll IRAs may result in significant costs
In the 110th Congress, HR 2176 was introduced by Representative Richard Neal. The bill creates mandatory payroll IRAs in which a business of ten or more employees that does not offer a retirement plan must offer a payroll IRA to employees. Employees age eighteen or older must be automatically enrolled at three percent of compensation. A small credit is intended to offset employer costs, which are portrayed to be minimal. President Obama supported this proposal during his candidacy and it will likely be included in his budget.

Because a default investment is required, the plans are subject to ERISA under HR 2167. The default investment must be prudently selected and fees must be reasonable. This duty normally entails significant cost, time, and liability exposure to plan sponsors. HR 2167 includes a TSP-type board to manage investments, but this provision is controversial.

PSCA is concerned about any mandatory benefit program. Additionally, the potential for significant costs for small businesses, when they can least afford them, has to be carefully considered when the proposal is reintroduced in the 111th Congress.

401(k) FEES IN THE ERISA FRAMEWORK
Numerous aspects of ERISA (the Employee Retirement Income Security Act of 1974) safeguard participants' interests and 401(k) assets. Plan assets must generally be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

To comply with ERISA, plan administrators must ensure that the price of services is reasonable at the time the plan contracts for the services and over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed

costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled arrangement to make this assessment.

It is important to understand the realities of fees in 401(k) plans. There are significant recordkeeping, administrative, and compliance costs related to an employer provided plan that do not exist for individual retail investors. Nevertheless, because of economies of scale and the fiduciary's role in selecting investments and monitoring fees, the vast majority of participants in ERISA plans have access to capital markets at *lower cost* through their plans than the participants could obtain in the retail markets.

The Investment Company Institute reports that the average overall investment fee for stock mutual funds is 1.5% and that 401(k) investors pay half that amount.[3] The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars invested and/or number of participants), average participant account balances, asset mix, and the types of investments and the level of services being provided. Larger, older plans typically experience the lowest cost. Employer provided plans are often the only avenue of mutual fund investment available to lower-paid individuals who have great difficulty accumulating the minimum amounts necessary to begin investing in a mutual fund or to make subsequent investments. Finally, to the degree an employer provides a matching contribution, and most plans do, the plan participant is receiving an extraordinarily high rate of return on their investment that a retail product does not provide.

A study by CEM Benchmarking Inc. of 88 US defined contribution plans with total assets of $512 billion (ranging from $4 million to over $10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points (bps) or 0.06 to 1.54 percent of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps. In a separate analysis conducted for PSCA, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

Other surveys have found similar costs. HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2008 Ninth Edition of the book reveals that average total plan costs ranged from 161 bps for plans with 25 participants to 96 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 120 members manage $1.5 trillion in defined benefit and defined contribution plan assets on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 29 bps.

PRINCIPLES OF REFORM

PSCA supports effective and efficient disclosure efforts. The following principles should be embodied in any effort to enhance fee disclosure in employer-provided retirement plans.

- **Sponsors and Participants' Information Needs Are Markedly Different.** Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.

[3] *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, 2006, Investment Company Institute, September 2007.

- **Overloading Participants with Unduly Detailed Information Can Be Counterproductive.** Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.

- **New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified.** Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.

- **New Disclosure Requirements Should Not Require the Disclosure of Component Costs That Are Costly to Determine, Largely Arbitrary, and Unnecessary to Determine Overall Fee Reasonableness.** Bundled service providers should disclose the included services in detail. However, a requirement to "unbundle" bundled services and provide individual costs in many detailed categories would be arbitrary, is not particularly helpful, and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services if they were not offered outside a bundled contract. These costs will ultimately be passed on to plan participants through higher administrative fees. The increased burden for small businesses could inhibit new plan growth.

- **Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions.** Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.

- **Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format.** Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.

- **Participants Should Receive Information at Enrollment and Have Ongoing Access.** Participants should receive fee and other key investment option information at enrollment and be informed periodically about fees.

HR 3185

PSCA supports legislation that will effectively improve fee transparency for sponsors and participants. HR 3185, as reported by the Committee on Education and Labor on April 16, 2008, reflects many of our principles and is a significant improvement over the original legislation. In addition to numerous minor adjustments to ensure that HR 3185 reflects the complexity of the retirement plan system, PSCA recommends three key changes. First, the legislation needs to include a "matching proposal" that specifies that the fiduciary duty to determine that fees are reasonable is limited in scope to the fees required to be disclosed under the legislation. The Committee agreed to examine this issue when Representative Kline offered and withdrew an implementing amendment during the 2008 mark-up. Second, Congress should abandon the "unbundling' requirement in the bill and permit both models to compete in the marketplace. Bundled providers should provide a detailed description of the services they

offer so that plan fiduciaries can determine that the aggregate fee is reasonable. Finally, the index fund requirement in the revised bill remains problematic.

DEFINED CONTRIBUTION PLANS WORK FOR EMPLOYEES, EMPLOYERS, AND AMERICA

Employers offer either a defined benefit or defined contribution, and sometimes both types, of retirement plan to their workers, depending on their own business needs. There are questions about the ability of the defined contribution system to produce adequate savings as it becomes the dominant form of employer provided retirement plan.

While some workers have enjoyed a full working career under a defined contribution plan such a as profit sharing plan, 401(k)-type plans in which the employee decides how much to save have existed for only slightly over twenty years, and most participants have participated in them for a much shorter period of time. The typical participant in 2000 had only participated in the plan for a little over seven years.[4] Policymakers must be wary of statistics citing average 401(k) balances and balances of those approaching retirement because they have not saved over their full working career and some balances belong to brand new participants. For example, a recent Investment Company Institute report stated that at the end of 2006, the average 401(k) balance was $61,346 and the median balance was $18,986.[5] The median age of the participants in the study was 44 and the median tenure in their current 401(k) plan was eight years. But when the study looked at individuals who were active participants in a 401(k) plan from 1999 to 2006 (including one of the worst bear markets since the Depression) the average 401(k) balance at the end of 2006 was $121,202 and the median balance was $66,650. Long-tenured (30 years with the same employer) individuals in their sixties who participated in a 401(k) plan during the 1999-2006 period had an average account balance of $193,701 at the end of 2006. The study does not reflect that many individuals and households have multiple 401(k)-type accounts or assets rolled over into an IRA.

In their April 2007 paper, *The Rise of 401(k) Plans, Lifetime Earnings, and Wealth at Retirement*, James Poterba, Steven Venti, and David A. Wise reported the following:

> "*Our projections suggest that the average (over all persons) present value of real DB benefits at age 65 achieved a maximum in 2003, when this value was $72,637 (in year 2000 dollars), and then began to decline. The projections also suggest that by 2010 the average level of 401(k) assets at age 65 will exceed the average present value of DB benefits at age 65. Thereafter the value of 401(k) assets grows rapidly, attaining levels much greater than the historical maximum present value of DB benefits. If equity returns between 2006 and 2040 are comparable to those observed historically, by 2040 average projected 401(k) assets of all persons age 65 will be over six times larger than the maximum level of DB benefits for a 65 year old achieved in 2003 (in year 2000 dollars).*
>
> *Even if equity returns average 300 basis points below their historical value, we project that average 401(k) assets in 2040 would be 3.7 times as large as the value of DB benefits in 2003. These analyses consider changes in the aggregate level of pension assets. Although the projections indicate that the average level of retirement assets will grow very substantially over the next three or four decades,*

[4] *Rise of 401(k) Plans, Lifetime Earnings and Wealth at Retirement*, James Poterba, Steven F. Venti, and David A. Wise, NBER Working Paper 13091, May 2007.

[5] *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, Investment Company Institute, August 2007.

> *it is also clear that the accumulation of assets in 401(k)-like plans will vary across households. Whether a person has a 401(k) plan is strongly related to income. Low-income employees are much less likely than higher-income employees to be covered by a 401(k) or similar type of tax-deferred personal account plan."*

The Congressional Research Service estimates that a married household that contributes ten percent of earnings to a retirement plan for 30 years will be able to replace fifty-three percent of pre-retirement income. If they save for forty years, they will replace ninety-two percent of income.[6] A ten percent savings rate is realistic given average contribution rates of seven percent and average employer contributions of three percent. These estimates do not consider Social Security payments

The growth of automatic enrollment plans will substantially increase retirement plan participation by lower and middle-income workers that are most likely to be induced to save by this type of plan design. Ninety percent of workers that are automatically enrolled choose not to opt out of the plan.[7] A 2005 ICI/EBRI study projects that a lowest quartile worker reaching age 65 between 2030 and 2039 who participates in an automatic enrollment program with a 6% salary deferral (with no regard for an employer match) and investment in a life-cycle fund will have 401(k) assets adequate for 52% income replacement at retirement, not including social security that provides another 52% income replacement under today's structure.[8]

The lesson is clear – long-term participation in a 401(k) plan will result in the accumulation of assets adequate to provide a secure retirement.

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[6] *Retirement Savings: How Much Will Workers Have When They Retire?*, CRS Report For Congress, January 29, 2007.
[7] *Hewitt Study Reveals Impact of Automatic Enrollment on Employees' Retirement Savings Habits*, Hewitt Associates, October 25, 2006.
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AMERICAN BENEFITS
COUNCIL

STATEMENT FOR THE HEARING RECORD

FOR THE

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS

HEARING ON

"DROP IN RETIREMENT SAVINGS:
THE CHALLENGES SMALL BUSINESSES FACE
FUNDING AND MAINTAINING RETIREMENT PLANS
IN A STRUGGLING ECONOMY"

Wednesday, February 25, 2009

AMERICAN BENEFITS
COUNCIL

February 25, 2009

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system and successfully assist tens of millions of families in accumulating retirement savings. While individuals have understandable retirement income concerns resulting from the recent market and economic downturns – concerns fully shared by the American Benefits Council – it is critical to acknowledge the vital role defined contribution plans play in creating personal financial security.

Congress has adopted rules that facilitate employer sponsorship of these plans, encourage employee participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. As a result 401(k) plans are valued by workers who participate in them as important resources for delivering retirement benefits. Nevertheless, improvements to the system can certainly be made. Helping workers to manage market risk and to translate their defined contribution plan savings into retirement income are areas that would benefit from additional policy deliberations. An additional area in which reform would be particularly constructive is increasing the number of Americans who have access to a defined contribution or other workplace retirement plan.

The goal should be a 401(k) system that functions in a transparent manner and provides meaningful benefits at a fair price. At the same time, we all must bear in mind that unnecessary burdens and cost imposed on these plans will slow their growth and reduce participants' benefits, thus undermining the very purpose of the plans. It is important to understand the facts relating to these plans. The Council believes the following principles are critical in evaluating any reform measures in this area:

- **Defined Contribution Plans Reach Tens of Millions of Workers and Provide an Important Source of Retirement Savings.** There are now more than 630,000 private-sector defined contribution plans covering more than 75 million active and retired workers, with another 10 million employees covered by tax-exempt and governmental defined contribution plans.

- **Employers Make Significant Contributions Into Defined Contribution Plans.** Many employers make matching, non-elective, and profit-sharing contributions to complement employee deferrals and share the responsibility for financing retirement. Recent surveys of defined contribution plan sponsors found that at least 95% make some form of employer contribution.

- **Employer Sponsorship Offers Advantages to Employees.** Employer sponsors of defined contribution plans must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. Employers exercise oversight through selection of plan investment options, educational materials and workshops about saving and investing and professional investment advice.

- **Defined Contribution Plan Coverage and Participation Rates Are Increasing.** The number of employees participating in these plans grew from 11.5 million in 1975 to more than 75 million in 2005, and 65% of full-time employees in private industry had access to a defined contribution plan in 2008.

- **Defined Contribution Plan Rules Promote Benefit Fairness.** Congress has established detailed rules to ensure that benefits in defined contribution plans are delivered across all income groups. Extensive coverage, nondiscrimination and top-heavy rules promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans.

- **401(k) Plans Have Evolved in Ways That Benefit Workers.** Both Congress and private innovation have enhanced 401(k) plans, aiding their evolution from bare-bones savings plans into retirement plans. Among these enhancements have been incentives for plan creation, catch-up contributions for older workers, accelerated vesting schedules, tax credits, automatic contribution escalation, single-fund investment solutions and investment education programs.

- **Recent Enhancements to the Defined Contribution System Are Working.** The Pension Protection Act of 2006 (PPA) encourages automatic enrollment and automatic contribution escalation. PPA also provided new rights to diversify contributions made in company stock, accelerating existing trends toward greater diversification of 401(k) assets.

- **Defined Contribution Plan Savings is an Important Source of Investment Capital.** With more than $4 trillion in combined assets as of March 2008, these plans represent ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of American investment capital.

- **Defined Contribution Plans Should Not Be Judged on Short-Term Market Conditions.** Workers and retirees are naturally concerned about the impact of the recent market turmoil. It is important, however, for policymakers and participants to judge defined contribution plans based on whether they serve workers' retirement interests over the long term.

- **Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk.** The recent market downturn has spawned questions about whether defined contribution plan participants may be subject to undue investment risk. Yet it is difficult to imagine any retirement plan design that does not have some kinds of risk. Any efforts to mitigate risk should focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.

The Council has prepared the attached white paper to more fully develop these principles. We encourage a full and vigorous debate over ways to improve retirement security for American workers. At the same time, it is critical that the debate not serve to undermine retirement security by inadvertently increasing the costs to participants or discouraging plan sponsorship.

AMERICAN BENEFITS COUNCIL

February 5, 2009

DEFINED CONTRIBUTION PLANS: A SUCCESSFUL CORNERSTONE OF OUR NATION'S RETIREMENT SYSTEM

Introduction

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system, playing a critical role along with Social Security, personal savings and employer-sponsored defined benefit plans. Defined contribution plans successfully assist tens of millions of American families in accumulating retirement savings. Congress has adopted rules for defined contribution plans that:

- facilitate employer sponsorship of plans,
- encourage employee participation,
- promote prudent investing by plan participants,
- allow operation of plans at reasonable cost, and
- safeguard plan assets and participant interests through strict fiduciary obligations and intensive regulatory oversight.

While individuals have understandable retirement income concerns resulting from the recent market and economic downturns -- concerns fully shared by the American Benefits Council -- it is critical to acknowledge the vital role defined contribution plans play in building personal financial security.

Defined Contribution Plans Reach Tens of Millions of Workers and Provide an Important Source of Retirement Savings

Over the past three decades, 401(k) and other defined contribution plans have increased dramatically in number, asset value, and employee participation. As of June 30, 2008, defined contribution plans (including 401(k), 403(b) and 457 plans) held $4.3 trillion in assets, and assets in individual retirement accounts (a significant share of which is attributable to amounts rolled over from employer-sponsored retirement plans, including defined contribution plans) stood at $4.5 trillion.[1] Of course, assets have declined significantly since then due to the downturn in the financial markets. Assets in 401(k) plans are projected to have declined from $2.9 trillion on June 30, 2008 to $2.4

trillion on December 31, 2008,[2] and the average 401(k) account balance is down 27% in 2008 relative to 2007.[3] Nonetheless, 401(k) account balances are up 140% when compared to levels as of January 1, 2000.[4] Thus, even in the face of the recent downturn (which of course has also affected workers' non-retirement investments and home values), employees have seen a net increase in workplace retirement savings. This has been facilitated by our robust and expanding defined contribution plan system. As discussed more fully below, employees have also remained committed to this system despite the current market conditions, with the vast majority continuing to contribute to their plans.

In terms of the growth in plans and participating employees, the most recent statistics reveal that there are more than 630,000 defined contribution plans covering more than 75 million active and retired workers with more than 55 million current workers now participating in these plans.[5] Together with Social Security, defined contribution plan accumulations can enable retirees to replace a significant percentage of pre-retirement income (and many workers, of course, will also have income from defined benefit plans).[6]

Employers Make Significant Contributions Into Defined Contribution Plans
When discussing defined contribution plans, the focus is often solely on employee deferrals into 401(k) plans. However, contributions consist of more than employee deferrals. Employers make matching, non-elective, and profit-sharing contributions to defined contribution plans to complement employee deferrals and share with employees the responsibility for funding retirement. Indeed, a recent survey of 401(k) plan sponsors with more than 1,000 employees found that 98% make some form of employer contribution.[7] Another recent study of employers of all sizes indicated that 62% of defined contribution sponsors made matching contributions, 28% made both matching and profit-sharing contributions, and 5% made profit-sharing contributions only.[8] While certain employers have reduced or suspended matching contributions as a result of current economic conditions, the vast majority have not.[9] Those that have are often doing so as a direct result of substantially increased required contributions to their defined benefit plans or institution of a series of cost-cutting measures to preserve jobs. As intended, matching contributions play a strong role in encouraging employee participation in defined contribution plans.[10]

The Defined Contribution System is More Than 401(k) Plans
The defined contribution system also includes many individuals beyond those who participate in the 401(k) and other defined contribution plans offered by private-sector employers. More than 7 million employees of tax-exempt and educational institutions participate in 403(b) arrangements,[11] which held more than $700 billion in assets as of earlier this year.[12] Millions of employees of state and local governments participate in 457 plans, which held more than $160 billion in assets as of earlier this year.[13] Finally, 3.9 million individuals participate in the federal government's defined contribution plan (the Thrift Savings Plan), which held $226 billion in assets as of June 30, 2008.[14]

401(k) Plans Have Evolved in Ways That Benefit Workers
Even when focusing on 401(k) plans, it is important to keep in mind that these plans have evolved significantly from the bare-bones employee savings plans that came into being in the early 1980s. As discussed more fully below, employers have enhanced these arrangements in numerous ways, aiding their evolution into robust retirement plans. Congress has likewise enacted numerous enhancements to 401(k) plans, making major improvements to the 401(k) system in the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Pension Protection Act of 2006. Among the many positive results have been incentives for plan creation, promotion of automatic enrollment, catch-up contributions for workers 50 and older, safe harbor 401(k) designs, accelerated vesting schedules, greater benefit portability, tax credits for retirement savings, and enhanced rights to diversify company stock contributions.

There also has been tremendous innovation in the 401(k) marketplace, with employer plan sponsors and plan service providers independently developing and adopting many features that have assisted employees. For example, both automatic enrollment and automatic contribution escalation were first developed in the private sector. Intense competition among service providers has helped spur this innovation and has driven down costs. Among the market innovations that have greatly enhanced defined contribution plans for participants are:

- on-line and telephonic access to participant accounts and plan services,
- extensive financial planning, investment education and investment advice offerings,
- single-fund investment solutions such as retirement target date funds and risk-based lifestyle funds, and
- in-plan annuity options and guaranteed withdrawal features that allow workers to replicate attributes of defined benefit plans.

These legislative changes and market innovations have resulted in more employers wanting to sponsor 401(k) plans and have -- together with employer enhancements to plan design -- improved both employee participation rates and employee outcomes.

Long-Term Retirement Plans Should Not Be Judged on Short-Term Market Conditions
Workers and retirees are naturally concerned about the impact of the recent market turmoil. It is important, however, for policymakers and participants to evaluate defined contribution plans based on whether they serve workers' retirement interests over the long term rather than over a period of months. Defined contribution plans and the investments they offer employees are designed to weather changes in economic conditions -- even conditions as anxiety-provoking as the ones we are experiencing today. (Market declines and volatility are, of course, affecting all types of retirement plans and investment vehicles, not just defined contribution plans.) Although it is

difficult to predict short-run market returns, over the long run stock market returns are linked to the growth of the economy and this upward trend will aid 401(k) investors. Indeed, one of the benefits for employees of participating in a defined contribution plan through regular payroll deduction is that those who select equity vehicles purchase these investments at varying prices as markets rise and fall, achieving effective dollar cost averaging. If historical trends continue, defined contribution plan participants who remain in the system can expect their plan account balances to rebound and grow significantly over time.[15] That being said, the American Benefits Council favors development of policy ideas (and market innovations) to help those defined contribution plan participants nearing retirement improve their retirement security and generate adequate retirement income.

It is important to note that in the face of the current economic crisis and market decline, plan participants remain committed to retirement savings and few are reducing their contributions. Rather, the large majority of participants continue to contribute at significant rates and remain in appropriately diversified investments. One leading 401(k) provider saw only 2% of participants decrease contribution levels in October 2008 (1% actually increased contributions) despite the stock market decline and volatility experienced during that month.[16] Another leading provider found that 96% of 401(k) participants who contributed to plans in the third quarter of 2008 continued to contribute in the fourth quarter.[17] Research from the prior bear market confirms that employees tend to hold steady in the face of declining stock prices, remaining appropriately focused on their long-term retirement savings and investment goals.[18]

Demonstrating the importance of defined contribution plans to employees, a recent survey found that defined contribution plans are the second-most important benefit to employees behind health insurance.[19] The same survey found that 9% of employees viewed greater deferrals to their defined contribution plan as one of their top priorities for 2009.[20]

Defined Contribution Plan Coverage and Participation Rates Are Increasing
Participation in employer-sponsored defined contribution plans has grown from 11.5 million in 1975 to more than 75 million in 2005.[21] This substantial increase is a result of many more employers making defined contribution plans available to their workforces. Today, the vast majority of large employers offer a defined contribution plan,[22] and the number of small employers offering such plans to their employees has been increasing modestly as well.[23] In total, 65% of full-time employees in private industry had access to a defined contribution plan at work in 2008 (of which 78% participated).[24] Small businesses that do not offer a 401(k) or profit-sharing plan are increasingly offering workers a SIMPLE IRA, which provides both a saving opportunity and employer contributions.[25] Indeed, as of 2007, 2.2 million workers at eligible small businesses participated in a SIMPLE IRA.[26]

The rate of employee participation in defined contribution plans offered by employers also has increased modestly over time[27] -- with further increases anticipated as a result of automatic enrollment adoption. Moreover, participating employees are generally saving at significant levels -- levels that have risen over time.[28] Younger workers, in particular, increasingly look to defined contribution plans as a primary source of retirement income.[29]

There are understandable economic impediments that keep some small employers, particularly the smallest firms, from offering plans. The uncertainty of revenues is the leading reason given by small businesses for not offering a plan, while cost, administrative challenges, and lack of employee demand are other impediments cited by small business.[30] Indeed, research reveals that employees at small companies place less priority on retirement benefits relative to salary than their counterparts at large companies.[31] As firms expand and grow, the likelihood that they will offer a retirement plan increases.[32] Congress can and should consider additional incentives and reforms to assist small businesses in offering retirement plans, but some small firms will simply not have the economic stability to do so. Mandates on small business to offer or contribute to plans will only serve to exacerbate the economic challenges they face, reducing the odds of success for the enterprise, hampering job creation and reducing wages.

Some have understandably focused on the number of Americans who do not currently have access to an employer-sponsored defined contribution plan. Certainly expanding plan coverage to more Americans is a universally shared goal. Yet statistics about retirement plan coverage rates must be viewed in the appropriate context. Statistics about the percentage of workers with access to an employer retirement plan provide only a snapshot of coverage at any one moment in time. Given job mobility and the fact that growing employers sometimes initiate plan sponsorship during an employee's tenure, a significantly higher percentage of workers have access to a plan for a substantial portion of their careers.[33] This coverage provides individuals with the opportunity to add defined contribution plan savings to other sources of retirement income. It is likewise important to note that individuals' savings behavior tends to evolve over the course of a working life. Younger workers typically earn less and therefore save less. What younger workers do save is often directed to non-retirement goals such as their own continuing education, the education of their children or the purchase of a home.[34] As they age and earn more, employees prioritize retirement savings and are increasingly likely to work for employers offering retirement plans.[35]

Defined Contribution Plan Rules Promote Benefit Fairness

The rules that Congress has established to govern the defined contribution plan system ensure that retirement benefits in these plans are delivered across all income groups. Indeed, the Internal Revenue Code contains a variety of rules to promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans. These requirements include coverage rules to ensure

that a fair cross-section of employees (including sufficient numbers of non-highly compensated workers) are covered by the defined contribution plan and nondiscrimination rules to make certain that both voluntary employee contributions and employer contributions for non-highly compensated employees are being made at a rate that is not dissimilar to the rate for highly compensated workers.[36] There are also top-heavy rules that require minimum contributions to non-highly compensated employees' accounts when the plan delivers significant benefits to top employees.

Congress has also imposed various vesting requirements with respect to contributions made to defined contribution plans. These requirements specify the timetable by which employer contributions become the property of employees. Employees are always 100% vested in their own contributions, and employer contributions made to employee accounts must vest according to a specified schedule (either all at once after three years of service or in 20% increments between the second and sixth years of service).[37] In addition, the two 401(k) safe harbor designs that Congress has adopted -- the original safe harbor enacted in 1996 and the automatic enrollment safe harbor enacted in 2006 -- require vesting of employer contributions on an even more accelerated schedule.[38]

Employer Sponsorship of Defined Contribution Plans Offers Advantages to Employees

As plan sponsors, employers must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. ERISA imposes, among other things, duties of prudence and loyalty upon plan fiduciaries. ERISA also requires that plan fiduciaries discharge their duties "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of providing participants and beneficiaries with benefits.[39] These exceedingly demanding fiduciary obligations (which are enforced through both civil and criminal penalties) offer investor protections not typically associated with savings vehicles individuals might use outside the workplace.

One area in which employers exercise oversight is through selection and monitoring of the investment options made available in the plan. Through use of their often considerable bargaining power, employers select high-quality, reasonably-priced investment options and monitor these options on an ongoing basis to ensure they remain high-quality and reasonably-priced. Large plans also benefit from economies of scale that help to reduce costs. Illustrating the value of this employer involvement, the mutual funds that 401(k) participants invest in are, on average, of lower cost than those that retail investors use.[40] Recognizing these benefits, an increasing number of retirees are leaving their savings in defined contribution plans after retirement, managing their money using the plan's investment options and taking periodic distributions. With the investment oversight they bring to bear, employers are providing a valuable service that employees would not be able easily or inexpensively to replicate on their own outside the plan.

Employers also typically provide educational materials about retirement saving, investing and planning, and in many instances also provide access to investment advice services.[41] To supplement educational materials and on-line resources, well over half of 401(k) plan sponsors offer in-person seminars and workshops for employees to learn more about retirement investing, and more than 40% provide communications to employees that are targeted to the workers' individual situations.[42] Surveys reveal that a significant percentage of plan participants utilize employer-provided investment education and advice tools.[43] Although participants can obtain such information outside of the workplace, it can be costly or require significant effort to do so, yielding yet another advantage to participation in an employer-sponsored defined contribution plan.

Recent Enhancements to the Defined Contribution System Are Working
Recent legislative reforms are improving outcomes for defined contribution plan participants. The Pension Protection Act of 2006 ("PPA"), in particular, included several landmark changes to the defined contribution system that are already beginning to assist employees in their retirement savings efforts.

Employee participation rates are beginning to increase thanks to PPA's provisions encouraging the adoption of automatic enrollment. This plan design, under which workers must opt out of plan participation rather than opt in, has been demonstrated to increase participation rates significantly, helping to move toward the universal employee coverage typically associated with defined benefit plans.[44] And more employers are adopting this design in the wake of PPA, in numbers that are particularly notable given that the IRS's implementing regulations have not yet been finalized and the Department of Labor's regulations were not finalized until more than a year after PPA's enactment.[45] One leading defined contribution plan service provider saw a tripling in the number of its clients adopting automatic enrollment between year-end 2005 and year-end 2007,[46] and other industry surveys show a similarly rapid increase in adoption by employers.[47] Moreover, many employers that have not yet adopted automatic enrollment are seriously considering doing so.[48]

Employers are also beginning to increase the default savings rate at which workers are automatically enrolled,[49] which is important to ensuring that workers have saved enough to generate meaningful income in retirement. Studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income, younger, and minority workers because these groups are typically less likely to participate in a 401(k) plan where affirmative elections are required.[50] Thus, PPA's encouragement of auto enrollment is helping to improve retirement security for these often vulnerable groups.

PPA also encouraged the use of automatic escalation designs that automatically increase an employee's rate of savings into the plan over time, typically on a yearly basis. This approach is critical in helping workers save at levels sufficient to generate

meaningful retirement income and can be useful in ensuring that employees save at the levels required to earn the full employer matching contribution.[51] Employers are increasingly adopting automatic escalation features.[52]

In PPA, Congress also directed the Department of Labor (DOL) to develop guidance providing for qualified default investment alternatives, or QDIAs -- investments into which employers could automatically enroll workers and receive a measure of fiduciary protection. QDIAs are diversified, professionally managed investment vehicles and can be retirement target date or life-cycle funds, managed account services or funds balanced between stocks and bonds. There has been widespread adoption of QDIAs by employers and this has helped improve the diversification of employee investments in 401(k) and other defined contribution plans.[53] Congress also directed DOL in PPA to reform the fiduciary standards governing selection of annuity distribution options for defined contribution plans, and the DOL has recently issued final regulations on this topic.[54] As a result, fiduciaries now have a clearer road map for the addition of an annuity payout option to their plan, which can give participants another tool for translating their retirement savings into lifelong retirement income.

Defined Contribution Plans Provide Employees with the Tools to Make Sound Investments

As a result of legislative reform and employer practices, employees in defined contribution plans have a robust set of tools to assist them in pursuing sound, diversified investment strategies. As noted above, employers provide educational materials on key investing principles such as asset classes and asset allocation, diversification, risk tolerance and time horizons. Employers also provide the opportunity for sound investing by selecting a menu of high-quality investments from diverse asset classes that, as discussed above, often reflect lower prices relative to retail investment options.[55] Moreover, the vast majority of employers operate their defined contribution plans pursuant to ERISA section 404(c),[56] which imposes a legal obligation to offer a "broad range of investment alternatives" including at least three options, each of which is diversified and has materially different risk and return characteristics.

The development and greater use by employers of investment options that in one menu choice provide a diversified, professionally managed asset mix that grows more conservative as workers age (retirement target date funds, life-cycle funds, managed account services) has been extremely significant and has helped employees seeking to maintain age-appropriate diversified investments.[57] As mentioned above, the use of such options has accelerated pursuant to the qualified default investment alternatives guidance issued under PPA.[58] These investment options typically retain some exposure to equities for workers as they approach retirement age. Given that many such workers are likely to live decades beyond retirement and through numerous economic cycles, some continued investment in stocks is desirable for most individuals in order to protect against inflation risk.[59]

One potential challenge when considering the diversification of employee defined contribution plan savings is the role of company stock. Traditionally, company stock has been a popular investment option in a number of defined contribution plans, and employers sometimes make matching contributions in the form of company stock. Congress and employers have responded to encourage diversification of company stock contributions. PPA contained provisions requiring defined contribution plans (other than employee stock ownership plans) to permit participants to immediately diversify their own employee contributions, and for those who have completed at least three years of service, to diversify employer contributions made in the form of company stock.[60] And today, fewer employers (23%) make their matching contributions in the form of company stock, down from 45% in 2001.[61] Moreover, more employers that do so are permitting employees to diversify these matching contributions immediately (67%), up from 24% that permitted such immediate diversification in 2004.[62]

The result has been greater diversification of 401(k) assets. In 2006, a total of 11.1% of all 401(k) assets were held in company stock.[63] This is a significant reduction from 1999, when 19.1% of all 401(k) assets were held in company stock.[64]

New Proposals for Early Access Would Upset the Balance Between Liquidity and Asset Preservation

The rules of the defined contribution system strike a balance between offering limited access to retirement savings and restricting such saving for retirement purposes. Some degree of access is necessary in order to encourage participation as certain workers would not contribute to a plan if they were unable under any circumstances (e.g., health emergency, higher education needs, first-home purchase) to access their savings prior to retirement.[65] Congress has recognized this relationship between some measure of liquidity and plan participation rates and has permitted pre-retirement access to plan savings in some circumstances. For example, the law permits employers to offer workers the ability to take loans from their plan accounts and/or receive so-called hardship distributions in times of pressing financial need.[66] However, a low percentage of plan participants actually use these provisions, and loans and hardship distributions do not appear to have increased markedly as a result of the current economic situation.[67] To prevent undue access, Congress has limited the circumstances in which employees may take pre-retirement distributions and has imposed a 10% penalty tax on most such distributions.[68]

In 2001, as part of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), Congress took further steps to ease portability of defined contribution plan savings and combat leakage of retirement savings. EGTRRA required automatic rollovers into IRAs for forced distributions of balances of between $1,000 and $5,000 and allowed individuals to roll savings over between and among 401(k), 403(b), 457 and IRA arrangements at the time of job change.[69]

As a result of changes like these, leakage from the retirement system at the time of job change has been declining modestly over time -- although leakage is certainly an issue worthy of additional attention.[70] Participants, particularly those at or near retirement, are generally quite responsible in handling the distributions they take from their plans when they leave a company, with the vast majority leaving their money in the plan, taking partial withdrawals, annuitizing the balance or reinvesting their lump sum distributions.[71] In sum, policymakers should acknowledge the careful balance between liquidity and preservation of assets and should be wary of proposals that would provide additional ways to tap into retirement savings early.

Defined Contribution Plan Savings is an Important Source of Investment Capital
The amounts held in defined contribution plans have an economic impact that extends well beyond the retirement security of the individual workers who save in these plans. Retirement plans held approximately $16.9 trillion in assets as of June 30, 2008.[72] As noted earlier, amounts in defined contribution plans accounted for approximately $4.3 trillion of this amount, and amounts in IRAs represented approximately $4.5 trillion (much of which is attributable to rollovers from employer-sponsored plans, including defined contribution plans).[73] Indeed, defined contribution plans and IRAs hold nearly 20% of corporate equities.[74] These trillions of dollars in assets, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American businesses. This capital permits greater production of goods and services and makes possible additional productivity-enhancing investments. These investments thereby help companies grow, add jobs to their payrolls and raise employee wages.

Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk
The recent market downturn has generated reasonable inquiries about whether participants in defined contribution plans may be subject to undue investment risk. As noted above, the American Benefits Council favors development of policy proposals and market innovations that seek to address these concerns. Yet it is difficult to imagine any retirement plan design that does not have some kind or degree of risk. Defined benefit pensions, for example, are extremely valuable retirement plans that serve millions of Americans. However, employees may not stay with a firm long enough to accrue a meaningful benefit, benefits are often not portable, required contributions can impose financial burdens on employers that can constrain pay levels or job growth, and companies on occasion enter bankruptcy (in which case not all benefits may be guaranteed).

Some have suggested that a new federal governmental retirement system would be the best way to protect workers against risk. Certain of these proposals would promise governmentally guaranteed investment returns, which would entail a massive expansion of government and taxpayer liabilities at a time of already unprecedented federal budget deficits. Other proposals would establish governmental clearinghouses

or agencies to oversee retirement plan investments and administration. Such approaches would likewise have significant costs to taxpayers and would unnecessarily and unwisely displace the activities of the private sector. Under these approaches, the federal government also would typically regulate the investment style and fee levels of retirement plan investments. These invasive proposals would constrain the investment choices and flexibility that defined contribution plan participants enjoy today and would establish the federal government as an unprecedented rate-setter for many retirement investments.

Rather than focusing on new governmental guarantees or systems, any efforts to mitigate risk should instead focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.

The Strong Defined Contribution System Can Still Be Improved
While today's defined contribution plan system is proving remarkably successful at assisting workers in achieving retirement security, refinements and improvements to the system can certainly be made. Helping workers to manage market risk and to translate their defined contribution plan savings into retirement income are areas that would benefit from additional policy deliberations. An additional area in which reform would be particularly constructive is increasing the number of Americans who have access to a defined contribution or other workplace retirement plan. The American Benefits Council will soon issue a set of policy recommendations as to how this goal of expanded coverage can be achieved. We believe coverage can best be expanded through adoption of a multi-faceted set of reforms that will build on the successful employer-sponsored retirement system and encourage more employers to facilitate workplace savings by their employees. This multi-faceted agenda will include improvements to the current rules governing defined contribution and defined benefit plans, expansion of default systems such as automatic enrollment and automatic escalation, new simplified retirement plan designs, expanded retirement tax incentives for individuals and employers, greater use of workplace IRA arrangements (such as SIMPLE IRAs and discretionary payroll deduction IRAs), more effective promotion of existing retirement plan options, and efforts to enhance Americans' financial literacy.

ENDNOTES

[1] Peter Brady & Sarah Holden, *The U.S. Retirement Market, Second Quarter 2008*, INVESTMENT COMPANY INST. FUNDAMENTALS 17, no. 3-Q2, Dec. 2008. This paper reveals that, as of June 30, 2008, total U.S. retirement accumulations were $16.9 trillion, a 13.4% increase over 2005 and a 59.4% increase over 2002. As noted above, these asset figures have decreased in light of recent market declines although assets held in defined contribution plans and individual retirement accounts still make up more than half of total U.S. retirement assets. *See* Brian Reid & Sarah Holden, *Retirement Saving in Wake of Financial Market Volatility*, INVESTMENT COMPANY INST., Dec. 2008.

[2] 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 Account Balances: Estimates from Jack VanDerhei, EBRI.

[3] Press Release, Fidelity Investments, Fidelity Reports on 2008 Trends in 401(k) Plans (Jan. 28, 2009).

[4] 1999 and 2006 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2007 and 2008 Account Balances: Estimates from Jack VanDerhei, EBRI. The analysis is based on a consistent sample of 2.2 million participants with account balances at the end of each year from 1999 through 2006 and compares account balances on January 1, 2000 and November 26, 2008. *See also* Jack VanDerhei, Research Director, Employee Benefit Research Institute, What Is Left of Our Retirement Assets?, PowerPoint Presentation at Urban Institute (Feb. 3, 2009).

[5] According to the Department of Labor, there were 103,346 defined benefit plans and 207,748 defined contribution plans in 1975. In 2005, there were 47,614 defined benefit plans and 631,481 defined contribution plans. U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (Feb. 2008). *See also* Sarah Holden, Peter Brady, & Michael Hadley, *401(k) Plans: A 25-Year Retrospective*, INVESTMENT COMPANY INST. PERSPECTIVE 12, no. 2, Nov. 2006.

[6] A joint ICI and EBRI study projected that 401(k) participants in their late 20s in 2000 who are continuously employed, continuously covered by a 401(k) plan, and earned historical financial market returns could replace significant amounts of their pre-retirement income (103% for the top income quartile; 85% for the lowest income quartile) with their 401(k) accumulations at retirement. Sarah Holden & Jack VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?*, INVESTMENT COMPANY INST. PERSPECTIVE 8, no. 3, Nov. 2002.

[7] *Report on Retirement Plans – 2007*, Diversified Investment Advisors (Nov. 2007).

[8] *401(k) Benchmarking Survey – 2008 Edition*, Deloitte Consulting LLP (2008).

[9] In an October 2008 survey, only 2% of employers reported having reduced their 401(k)/403(b) matching contribution and only 4% said they planned to do so in the upcoming 12 months. WATSON WYATT WORLDWIDE, EFFECT OF THE ECONOMIC CRISIS ON HR PROGRAMS 4 (2008).

[10] According to one study, defined contribution plans with matching contributions have a participation rate of 73% compared with 44% for plans that do not offer matching contributions. *Retirement Plan Trends in Today's Healthcare Market – 2008*, American Hospital Association & Diversified Investment Advisors (2008). Some have wondered whether employers would reduce matching contributions as they adopt automatic enrollment since automatic enrollment is proving successful in raising participation rates. Current data suggest this is not occurring. For example, from 2005 to 2007 the number of Vanguard plans offering automatic enrollment tripled. During the same period, the percentage of Vanguard plans offering employer matching contributions increased by 4%. *How America Saves 2008: A Report on Vanguard 2007 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2008); *How America Saves 2006: A Report on Vanguard 2005 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2006).

[11] W. Scott Simon, *Fiduciary Focus*, Morningstar Advisor, Apr. 5, 2007.

[12] Brady & Holden (Dec. 2008), *supra* note 1.

[13] Brady & Holden (Dec. 2008), *supra* note 1.

[14] Gregory T. Long, Executive Dir., Fed. Ret. Thrift Inv. Fund, Statement Before the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia (July 10, 2008).

[15] The average 401(k) account balance increased at an annual rate of 8.7% from 1999 to 2006, despite the fact that this period included one of the worst bear markets since the Great Depression. Sarah Holden, Jack VanDerhei, Luis Alonso, & Craig Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, INVESTMENT COMPANY INST. PERSPECTIVE 13, no. 1/EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 308, Aug. 2007.

[16] Jilian Mincer, *401(k) Plans Face Disparity Issue*, WALL ST. J., Nov. 6, 2008, at D9.

[17] Fidelity Investments (Jan. 28, 2009), *supra* note 3. *See also* Reid & Holden (Dec. 2008), *supra* note 1 (noting that only 3% of defined contribution plan participants ceased contributions in 2008); *The Principal Financial Well-Being Index Summary – Fourth Quarter 2008*, Principal Financial Group (2008) (finding that, in the six months leading up to its October 2008 survey, 11% of employees increased 401(k) contributions, while only 4% decreased contributions and only 1% ceased contributions entirely); *Retirement Outlook and Policy Priorities*, Transamerica Center for Retirement Studies (Oct. 2008) (finding that participation rates are holding steady among full-time workers who have access to a 401(k) or similar employer-sponsored plan, with 77% currently participating; 31% of participants have increased their contribution rates into their retirement plans in the last twelve months; only 11% have decreased their contribution rates or stopped contributing); Press Release, Hewitt Associates, Hewitt Data Shows Americans Continue to Save in 401(k) Plans Despite Economic Woes (Nov. 24, 2008) (finding, in a November analysis, that average savings rates in 401(k) plans have only dipped by 0.2%, from 8.0% in 2007 to 7.8% in 2008).

[18] *See* Sarah Holden & Jack VanDerhei, *Contribution Behavior of 401(k) Plan Participants During Bull and Bear Markets*, NAT'L TAX ASS'N 44 (2004) (citing a number of studies which indicate little variation in before-tax contributions and a slight decrease in employer contributions as a percentage of participant pay during the 1999-2002 bear market).

[19] Principal Financial Group (2008), *supra* note 17.

[20] *Id.*

[21] *Private Pension Plan Bulletin Historical Tables* (Feb. 2008), *supra* note 5.

[22] In 2007, 82% of employers with 500 or more employees offered 401(k) plans to their employees, and 19% of these employers offered a defined contribution plan other than a 401(k) plan to their employees. *9th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2008).

[23] 59% of employers with between 10 and 499 employees offered their employees 401(k) plans in 2007, as compared with 56% in 2006. Transamerica Center for Retirement Studies (2008), *supra* note 22; *8th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2007).

[24] U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2715, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN THE UNITED STATES, MARCH 2008, tbl. 2 (Sept. 2008).

[25] As of December 2007, there were more than 500,000 SIMPLE IRAs. At the end of 2007, $61 billion was held in SIMPLE IRAs. *See* Brady & Holden (Dec. 2008), *supra* note 1; Peter Brady & Stephen Sigrist, *Who Gets Retirement Plans and Why*, INVESTMENT COMPANY INST. PERSPECTIVE 14, no. 2, Sept. 2008.

[26] Brady & Sigrist (Sept. 2008), *supra* note 25. *See also* U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2589, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN PRIVATE INDUSTRY IN THE UNITED STATES, 2005 (May 2007) (indicating 8% of private-sector workers at eligible small businesses participated in a SIMPLE IRA).

[27] Among all full-time, full-year wage and salary workers ages 21 to 64, 55.3% participated in a retirement plan in 2007. This is up from approximately 53% in 2006. Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 322, Oct. 2008 (examining the U.S. Census Bureau's March 2008 Current Population Survey). *See also* The Vanguard Group, Inc. (2008), *supra* note 10 (noting that, out of all employees in Vanguard-administered plans, 66% of eligible employees participated in their employer's defined contribution plan); *51st Annual Survey of Profit Sharing and 401(k) Plans*, Profit Sharing/401(k) Council of America (Sept. 2008) (noting that 81.9% of eligible employees currently have a balance in their 401(k) plans).

[28] Participants in plans administered by Vanguard saved 7.3% of income in their employer's defined contribution plan in 2007. The Vanguard Group, Inc. (2008), *supra* note 10. Among non-highly compensated employees, the level of pre-tax deferrals into 401(k) plans has risen from 4.2% of salary in 1991 to 5.6% in 2007. Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[29] *See* Transamerica Center for Retirement Studies (Oct. 2008), *supra* note 17 (finding that 35% of Echo Boomers, 34% of Generation X, 28% of Baby Boomers, and 7% of Matures consider employer-sponsored defined contribution plans as their primary source of retirement income).

[30] Jack VanDerhei, *Findings from the 2003 Small Employer Retirement Survey*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE NOTES 24, no. 9, Sept. 2003.

[31] Both small employers and workers in small businesses consider salary to be a greater priority than retirement benefits, but the inverse is true for the majority of larger employers and workers in larger businesses. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that 56% of employees in larger businesses consider retirement benefits to be a greater priority, where 54% of employees in smaller companies rank salary as a priority over retirement benefits). *See also* Brady & Sigrist (Sept. 2008), *supra* note 25.

[32] For example, one survey found that more than half of small business respondents would be "much more likely" to consider offering a retirement plan if company profits increased. VanDerhei (Sept. 2003), *supra* note 30. *See also* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that large companies are more likely than smaller companies to offer 401(k) plans (82% large, 59% small)).

[33] It should also be remembered that those without employer plan coverage may be building retirement savings through non-workplace tax-preferred vehicles such as individual retirement accounts or deferred annuities.

[34] *See* Brady & Sigrist (Sept. 2008), *supra* note 25.

[35] Based on an analysis of the Bureau of Labor Statistics' Current Population Survey, March Supplement (2007), of those most likely to want to save for retirement in a given year, almost 75% had access to a retirement plan through their employer or their spouse's employer, and 92% of those with access participated. Brady & Sigrist (Sept. 2008), *supra* note 25.

[36] Voluntary pre-tax and Roth after-tax contributions must satisfy the Actual Deferral Percentage test ("ADP test"). The ADP test compares the elective contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective contributions are expressed as a percentage of his or her compensation. The numbers are then averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ADP"). The ADP test is satisfied if (i) the average ADP for the eligible highly compensated employees for a plan year is no greater than 125% of the average ADP for all other eligible employees in the preceding plan year, or (ii) the average ADP for the eligible highly compensated employees for a plan year does not exceed the average ADP for the other eligible employees in the preceding plan year by more than 2% <u>and</u> the average ADP for the eligible highly compensated employees for a plan year is not more than twice the average ADP for all other eligible employees in the preceding plan year. Treas. Reg. § 1.401(k)-2.

Employer matching contributions and employee after-tax contributions (other than Roth contributions) must satisfy the Actual Contribution Percentage test ("ACP test"). The ACP test compares the employee and matching contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective and matching contributions are expressed as a percentage of his or her compensation, and the resulting numbers are averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ACP"). The ACP test utilizes the same percentage testing criteria as the ADP test. Treas. Reg. § 1.401(m)-2.

[37] A trust shall not constitute a qualified trust under 401(a) unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards). *See* I.R.C. § 401(a)(7).

[38] *See* I.R.C. §§ 401(k)(12) and (13).

[39] ERISA § 404. I.R.C. § 401(a) also requires that a qualified trust be organized for the exclusive benefit of employees and their beneficiaries.

[40] Sarah Holden & Michael Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2007*, INVESTMENT COMPANY INST. PERSPECTIVE 17, no. 5, Dec. 2008.

[41] *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that, regardless of company size, almost two-thirds of employers offer investment guidance or advice as part of their retirement plan; of those who do not currently offer guidance or advice, 18% of large employers and 7% of small employers plan to offer advice in the future); Deloitte Consulting LLP (2008), *supra* note 8 (51% of 401(k) sponsors surveyed offer employees access to individualized financial counseling or investment advice services (whether paid for by employees or by the employer)); *Trends and Experience in 401(k) Plans 2007 – Survey Highlights*, Hewitt Associates LLC (June 2008) (40% of employers offer outside investment advisory services to employees).

[42] Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[43] 46% of plan participants consulted materials, tools, or services provided by their employers. John Sabelhaus, Michael Bogdan, & Sarah Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007*, INVESTMENT COMPANY INST. RESEARCH SERIES, Fall 2008.

[44] *See, e.g., Measuring the Effectiveness of Automatic Enrollment*, Vanguard Center for Retirement Research (Dec. 2007) (stating that "[a]n analysis of about 50 plans adopting automatic enrollment confirms that the feature does improve participation rates, particularly among low-income and younger employees"); Deloitte Consulting LLP (2008), *supra* note 8 (stating that "[a] full 82% of survey respondents reported that auto-enrollment had increased participation rates"); *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans*, Fidelity Investments (2007) (stating that in 2006 overall participation rates were 28% higher for automatic enrollment-eligible employees than for eligible employees in plans that did not offer automatic enrollment; overall, automatic enrollment eligible employees had an average participation rate of 81%).

[45] A recently-surveyed panel of experts expects automatic enrollment to be offered in 73% of defined contribution plans by 2013. *Prescience 2013: Expert Opinions on the Future of Retirement Plans*, Diversified Investment Advisors (Nov. 2008).

[46] *See* The Vanguard Group, Inc. (2008), *supra* note 10.

[47] *See* Deloitte Consulting LLP (2008), *supra* note 8 (42% of surveyed employers have an automatic enrollment feature compared with 23% in last survey); Hewitt Associates LLC (June 2008), *supra* note 41 (34% of surveyed employers have an automatic enrollment feature compared with 19% in 2005); Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27 (more than half of large plans use automatic enrollment and usage by small plans has doubled).

[48] *See* Deloitte Consulting LLP (2008), *supra* note 8 (stating that 26% of respondents reported they are considering adding an auto-enrollment feature).

[49] One leading provider has noted an upward shift since 2005 in the percentage of sponsors that use a default deferral rate of 3% or higher, and a corresponding decrease in the percentage of sponsors that use a default deferral rate of 1% or 2%. The Vanguard Group, Inc. (2008), *supra* note 10.

[50] *See, e.g.*, Copeland (Oct. 2008), *supra* note 27 (noting that Hispanic workers were significantly less likely than both black and white workers to participate in a retirement plan); Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 318 (June 2008) (noting that industry studies have shown relatively low participation rates among young and low-income workers); Fidelity Investments (2007), *supra* note 44 (stating that, in 2006, among employees earning less than $20,000, the participation boost from automatic enrollment was approximately 50%); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-8, PRIVATE PENSIONS: LOW DEFINED CONTRIBUTION PLAN SAVINGS MAY POSE CHALLENGES TO RETIREMENT SECURITY, ESPECIALLY FOR MANY

LOW-INCOME WORKERS (Nov. 2007); Daniel Sorid, *Employers Discover a Troubling Racial Split in 401(k) Plans*, WASH. POST, Oct. 14, 2007, at F6.

[51] *See* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, the average deferral rate for participants in automatic escalation programs was 8.3%, as compared to 7.1% in 2005).

[52] *See* The Vanguard Group, Inc. (2008), *supra* note 10 (post-PPA, two-thirds of Vanguard's automatic enrollment plans implemented automatic annual savings increases, compared with one-third of its plans in 2005); Hewitt Associates LLC (June 2008), *supra* note 41 (35% of employers offer automatic contribution escalation, compared with 9% of employers in 2005); Transamerica Center for Retirement Studies (2008), *supra* note 22 (26% of employers with automatic enrollment automatically increase the contribution rate based on their employees' anniversary date of hire).

[53] A leading provider states that "QDIA investments are often more broadly diversified than portfolios constructed by participants. Increased reliance on QDIA investments should enhance portfolio diversification." The Vanguard Group, Inc. (2008), *supra* note 10. *See also* Fidelity Investments (2007), *supra* note 44 (where a lifecycle fund was the plan default option, overall participant asset allocation to that option was 19.4% in 2006; where the lifecycle fund was offered but not as the default option, overall participant asset allocation to that option was only 9.8%).

[54] Selection of Annuity Providers: Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447 (Oct. 7, 2008) (to be codified at 29 C.F.R. pt. 2550).

[55] *See* Holden & Hadley (Dec. 2008), *supra* note 40.

[56] One survey found that 92% of companies surveyed stated that their plan is intended to comply with ERISA section 404(c). Deloitte Consulting LLP (2008), *supra* note 8.

[57] In 2006, the percentage of single investment option holders who invested in lifecycle funds – "blended" investment options – was 24%. 42% of plan participants invested some portion of their assets in lifecycle funds. The average number of investment options held by participants was 3.8 options in 2006. Fidelity Investments (2007), *supra* note 44.

[58] In 2007, 77% of employers offered lifecycle funds as an investment option, compared with 63% in 2005. Hewitt Associates LLC (June 2008), *supra* note 41. *See also* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, 19% of participant assets were invested in a lifecycle fund in plans that offered the lifecycle fund as the default investment option, compared with 10% of participant assets in plans that did not offer the lifecycle fund as the default investment option).

[59] *See Target-Date Funds: Still the Right Rationale for Investors*, The Vanguard Group, Inc. (Nov. 28, 2008) (noting that "even investors entering and in retirement need a significant equity allocation" and citing the 17- to 20-year life expectancy for retirees who are age 65). *See also* Fidelity Investments (2007), *supra* note 44 ("In general . . . the average percentage of assets invested in equities decreased appropriately with age . . . to a low of 45% for those in their 70s.").

[60] I.R.C. § 401(a)(35); ERISA § 204(j).

[61] Hewitt Associates LLC (June 2008), *supra* note 41.

[62] Hewitt Associates LLC (June 2008), *supra* note 41.

[63] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that, at year-end 2008, company stock made up approximately 10% of Fidelity's overall assets in workplace savings accounts, compared with 20% in early 2000).

[64] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* William J. Wiatrowski, *401(k) Plans Move Away from Employer Stock as an Investment Vehicle*, MONTHLY LAB. REV., Nov. 2008, at 3, 6 (stating that (i) in 2005, 23% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for their employee contributions, compared to 63% in 1985, and (ii) in 2005, 14% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for employer matching contributions, compared to 29% in 1985).

[65] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/HEHS-98-2, 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME (Oct. 1997) (noting that plans that allow borrowing tend to have a somewhat higher proportion of employees participating than other plans).

[66] *See* I.R.C. §§ 72(p) and 401(k)(2)(B).

[67] *See, e.g.*, Reid & Holden (Dec. 2008), *supra* note 1 (stating that, in 2008, 1.2% of defined contribution plan participants took a hardship withdrawal and 15% had a loan outstanding); Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that only 2.2% of its participant base initiated a loan during the fourth quarter of 2008, compared with 2.8% during the fourth quarter of 2007, and 0.7% of its participant base took a hardship distribution during the fourth quarter of 2008, compared with 0.6% during the fourth quarter of 2007); Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15 (noting that most eligible participants do not take loans); Fidelity Investments (2007), *supra* note 44 (noting that only 20% of active participants had one or more loans outstanding at the end of 2006). Most participants who take loans repay them. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (only 18% of participants have loans outstanding, and almost all participants repay their loans).

[68] I.R.C. § 72(t).

[69] *See* I.R.C. § 402(c)(4).

[70] In 2007, among participants eligible for a distribution due to a separation of service, 70% chose to preserve their retirement savings by rolling assets to an IRA or by remaining in their former employer's plan, compared with only 60% in 2001. The Vanguard Group, Inc. (2008), *supra* note 10; *How America Saves 2002: A Report on Vanguard Defined Contribution Plans*, The Vanguard Group, Inc. (2002).

[71] *See* Sabelhaus, Bogdan, & Holden (Fall 2008), *supra* note 43 (stating that retirees make prudent choices at retirement regarding their defined contribution plan balances: 18% annuitized their entire balance, 6% elected to receive installment payments, 16% deferred distribution of their entire balance, 34% took a lump sum and reinvested the entire amount, 11% took a lump sum and reinvested part of the amount, 7% took a lump sum and spent all of the amount, and 9% elected multiple dispositions; additionally, only about 3% of accumulated defined contribution account assets were spent immediately at retirement).

[72] Brady & Holden (Dec. 2008), *supra* note 1.

[73] *Id.* It is highly doubtful that Americans would have saved at these levels in the absence of defined contribution plans given the powerful combination of pre-tax treatment, payroll deduction, automatic enrollment and matching contributions.

[74] *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL RESERVE STATISTICAL RELEASE Z.1, FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES (December 11, 2008); Brady & Holden (Dec. 2008), *supra* note 1.

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