



# AMERICAN BENEFITS COUNCIL

September 16, 2014

## STATEMENT TO THE U.S. SENATE FINANCE COMMITTEE ON THE HEARING: "RETIREMENT SAVINGS 2.0: UPDATING SAVINGS POLICY FOR THE MODERN ECONOMY"

### SUMMARY

Employer-sponsored defined contribution and defined benefit retirement plans are an indispensable building block of our nation's retirement system. Retirement plans, like those sponsored and administered by American Benefits Council members, successfully assist tens of millions of families in accumulating retirement savings, allowing for a more financially secure retirement and providing trillions of dollars in retirement income.

The American Benefits Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly, or provide services to, retirement and health plans that cover more than 100 million Americans.

With more than 100 million active and retired workers (and their spouses) accumulating retirement savings under employment-based retirement plans and Individual Retirement Accounts (IRAs), today's retirement system is working well and has been embraced by the American people. Employer-sponsored plans enable American workers to accumulate meaningful savings for retirement, thereby providing sustainable health and financial well-being.

It is important to remember that the employer-sponsored retirement system is premised on its voluntary nature – employers are encouraged through tax incentives to provide retirement plans to their workers, but they are not required to do so. That voluntary system is built to supplement the benefits provided by Social Security.<sup>1</sup>

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<sup>1</sup> Ensuring a robust Social Security program through entitlement reform is critical for providing retirement security for individuals of all incomes, especially low-income workers.

Changes in the retirement plan tax incentives, even seemingly small ones, can have significant inadvertent consequences, which generate enormous costs without making the retirement system stronger for most Americans.

As Congress considers retirement issues (in a tax reform context or otherwise), it will be critical to pursue policies that will help individuals and employers generate retirement income sufficient for employees to maintain their standard of living. Too often, retirement policy is driven by extraneous considerations, such as the need to generate revenue for the federal government. When these revenue considerations are at the forefront, the result has almost always been unnecessary complexity and cost – and worse yet, direct harm to Americans’ financial well-being and retirement prospects.

Proposals that purport to increase short-term federal tax receipts by redirecting, eliminating, or eroding the existing retirement savings incentives achieve those additional taxes *largely because individuals save less for retirement*. Making matters worse, any short-term revenue gain that might be derived from changes in the retirement savings incentives is largely illusory because when a worker saves less money today, it will mean smaller distributions (and less tax revenue) when the individual retires. That is a lose-lose situation for the retiree and the government.

Still, the retirement system can and should be improved, both with respect to defined contribution and defined benefit plans. Even at current savings levels, too many Americans are at risk of a financially insecure retirement. More must be done to increase retirement security (and overall financial security) for all American families, especially those with lower incomes who find it the most difficult to save. With or without tax reform, we have the opportunity to do just that with relatively modest targeted changes that build upon the successful defined contribution plan structure to generate greater retirement savings.

## **EMPLOYERS PLAY A CRITICAL ROLE IN ENSURING WORKERS’ RETIREMENT SECURITY**

The role of employers in ensuring workers’ retirement security must not be underestimated. Employer-sponsored retirement plans provide savings opportunities for more than 90 million Americans<sup>2</sup> by reducing burdens and costs on individuals and public programs.

Among all private industry full-time workforces, 74 percent of employees have access to an employer-sponsored retirement plan and 79 percent of those individuals participate in the plan. For companies with 500 or more employees, 89 percent of

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<sup>2</sup> U.S. Department of Labor, Employee Benefits Security Administration, [Private Pension Plan Bulletin: Abstract of 2011 Form 5500 Annual Reports](#), June 2013.

employees have access, and 86 percent of those individuals participate.<sup>3</sup> The high coverage and participation rates illustrate the value employees place in employer-sponsored retirement plans when it comes to retirement savings and income. These plans would likely not be available to millions of working Americans if it were not for the existing tax incentives that motivate employee saving and that encourage employers to maintain and contribute to retirement plans.

Employers have a unique understanding of the retirement needs of their employee populations and can tailor retirement programs to these needs. Employers are continually innovating to improve participation rates and outcomes.

Bipartisan legislation has brought many of these innovations into the mainstream. For example, the Pension Protection Act of 2006 (PPA) included several landmark clarifications to the defined contribution plan rules, encouraging voluntary automatic enrollment and automatic contribution escalation. According to a report by Vanguard, more than 60 percent of new plan entrants in 2013 were enrolled via automatic enrollment, and more than half of all contributing participants in 2013 were in plans with automatic enrollment.<sup>4</sup>

Companies are also increasingly providing access to broader financial education to help address financial stresses that block retirement savings and threaten overall financial well-being.

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

It is clear that the defined contribution system works and the incremental changes adopted in recent years have made them even more effective. There are still gaps; more can and should be done to expand coverage and to increase contributions. But one of the most important advantages of the current retirement savings tax incentive structure is that it efficiently produces retirement benefits for millions of American families. In a recent study, 86 percent of households opposed the government taking away the tax advantages of defined contribution accounts, and 83 percent opposed reducing the amount that individuals can contribute to defined contribution accounts. Fully 92 percent of households expressing an opinion had favorable impressions of 401(k) plans. About nine out of 10 households agreed that these plans helped them think about the

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<sup>3</sup> U.S. Department of Labor, U.S. Bureau of Labor Statistics, [National Compensation Survey: Employee Benefits in Private Industry in the United States](#), March 2014.

<sup>4</sup> Vanguard, [How America Saves 2014](#), June 13, 2014.

long term and made it easier for them to save. Nearly half of defined contribution plan-owning households state that they probably would not be saving for retirement at all if it were not for their employer-sponsored plans.<sup>5</sup> Clearly, Americans value these employer-sponsored retirement plans that allow participants to consistently save for retirement in a vehicle that offers long-term growth while preserving those savings until they are needed in retirement.

## CURRENT TAX INCENTIVES ARE THE FOUNDATION OF OUR SUCCESSFUL RETIREMENT SAVINGS SYSTEM

The U.S. retirement savings system successfully encourages individuals to save for retirement by providing tax incentives – including income tax exclusions or deductions – for contributions to employer-sponsored retirement plans and IRAs, up to statutory limits. This tax structure provides a strong and effective incentive for individuals at all income levels to save for retirement and encourages employers to sponsor plans that deliver meaningful benefits to Americans up and down the income scale. Inherent in the existing tax structure are limits on higher income earners participating in a plan. The benefits available to highly compensated participants on a tax-deferred basis are tied to the benefits being accumulated for non-highly paid individuals.

The fundamental principles of the current retirement tax incentives are:

- **Contributions are excludable or deductible from income – until withdrawn.**
- **Employer contributions are exempt from payroll tax.** Because employer contributions to plans are not regarded as wages, neither employees nor employers owe payroll taxes on these amounts.
- **Taxes on investment gains are deferred while funds remain *inside* the retirement plan.** This deferral is critical for incenting savings as workers know they will not have to divert income year-by-year to pay tax on their retirement savings.
- **The Saver’s Credit supplements exclusion/deduction.** The Saver’s Credit, which provides a credit to low- and middle-income individuals who contribute to defined contribution plans and IRAs, provides a more robust savings tax incentive for eligible individuals than would be provided by the exclusion or deduction alone.
- **Contributions are limited and rules promote fairness.** Individual contributions to defined contribution plans and IRAs are subject to maximum

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<sup>5</sup> Investment Company Institute, [Americans’ Views on Defined Contribution Plan Saving](#), January 2014.

dollar limits. These limits act to constrain the tax-preferred savings of upper-income savers while allowing robust tax-preferred savings by low- and middle-income households and are designed to ensure that individuals at all income levels receive fair benefits.

More than 80 percent of defined contribution-owning households view the immediate tax savings from their retirement plans as a big incentive to contribute.<sup>6</sup> More simply, tax incentives lower the cost of savings for individuals. The tax incentives for retirement are important factors in companies' decisions to establish and keep 401(k) and similar plans.<sup>7</sup>

Analyses have shown that the tax expenditure produces very substantial tax revenue in the future. According to an analysis by Principal Financial Group, over the course of a 40-year career for a typical middle-income worker, for every \$1 of taxes deferred, the federal government collects at least \$4 in tax revenue when the contributions and earnings are withdrawn.<sup>8</sup> This multiplier effect produces a remarkable amount of benefits for retirees; in 2013, the Department of Commerce reported employer-sponsored retirement plans paid out more than \$960 billion in benefits,<sup>9</sup> substantially more than the \$812 billion in retirement benefits paid by Social Security in the same year.<sup>10</sup>

## RETIREMENT TAX INCENTIVES LEAD TO LONG-TERM REVENUE GAINS

The retirement savings tax incentives should not be reduced or altered to pay for other initiatives. The bulk of the existing "tax expenditure" for retirement plans is attributable to the deferral of tax provided to already-saved retirement assets, not to future annual permitted contributions. True, there are trillions of dollars in tax-deferred retirement savings plans. The Federal Reserve recently reported that the total financial assets held in defined benefit and defined contribution plans and IRAs is nearly \$15 trillion, with \$3 trillion in defined benefit pension plans, \$5.3 trillion in defined contribution plans and \$6.6 trillion in IRAs.<sup>11</sup> However, these trillions of dollars in assets, which represent ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American

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<sup>6</sup> Investment Company Institute, [America's Commitment to Retirement Security: Investor Attitudes and Actions](#), February 2013.

<sup>7</sup> American Benefits Institute, Mathew Greenwald & Associates Inc., [Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals](#), 2012.

<sup>8</sup> Larry Zimpleman, [Letter to the Editor of Politico](#), December 20, 2012, and updated as part of Principal Financial Group's submission to the Senate Finance Committee, September 2014.

<sup>9</sup> Bureau of Economic Analysis, U.S. Department of Commerce, [Survey of Current Business, National Income and Product Accounts Table 6.11D](#), 2014.

<sup>10</sup> Social Security Administration, [Trustees Report](#), 2014.

<sup>11</sup> Board of Governors of the Federal Reserve System, [Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States](#), September 2014.

businesses.<sup>12</sup> As of the first quarter of 2014, the financial assets in defined contribution plans and IRA assets alone were collectively larger than the GDP of China. This capital permits greater production of goods and services and makes possible additional investments that help companies grow, add jobs to their payrolls and raise employee wages.

Reducing the current tax incentives on retirement plans would result in American workers saving less for retirement when we need to encourage them to save more to ensure they have the financial security to retire. In addition, it is critical to understand that any short-term revenue gain that might be derived from changes in the retirement tax incentives is largely illusory and cannot responsibly be used to offset costs of reducing tax rates or other government initiatives.

The revenue scoring that is performed by the Treasury Department and the Joint Committee on Taxation generally produces estimates in five- and ten-year budget windows, using a cash-flow analysis. Under that methodology, the taxes an employee will pay when he or she retires and starts taking taxable plan distributions generally occur *outside* the budget window. Proposals that reduce retirement savings today will mean the government actually collects *less* revenue in years outside the budget window because retirees will have less taxable retirement income. As a result, total long-term budgetary savings that might result from scaling back the existing retirement savings tax incentives would be considerably smaller than the short-term revenue estimates might suggest. In fact, a study completed by former staff of the Joint Committee on Taxation finds that the present value of tax benefits attributable to current-year retirement savings contributions is as much as *77 percent less* than estimates of revenue loss under Treasury's methodology.<sup>13</sup> In effect, proposals that reduce retirement savings would actually increase the burden on future generations. That type of shortsighted thinking will not help the nation address its structural budget deficits, nor would it offset the long-range costs of other changes in the tax law. In that regard, it is important to bear in mind that the assets saved in the employment-based retirement system supplement and help reduce pressure on other government programs, like Social Security and Medicare.

It is critical to remember that pre-tax contributions made to defined contribution plans and IRAs – and the earnings on these contributions – do not escape taxation but rather are taxed when withdrawn and when an individual takes a distribution from a retirement plan, the U.S. Treasury will be paid at ordinary income tax rates, not capital gains rates. Thus, the federal tax incentives devoted to spur savings are not lost but are reclaimed as additional tax revenue when individuals make withdrawals. In one example, for a worker in a 25 percent tax bracket, a \$1,000 contribution to a 401(k) plan

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<sup>12</sup> At year-end 2011, 49 percent of mutual funds' assets were held in a tax-deferred household account. See Investment Company Institute, [2012 Investment Company Fact Book](#), Figure A.3.

<sup>13</sup> American Society of Pension Professionals & Actuaries, [Retirement Savings and Tax Expenditure Estimates](#), May 2011.

over 20 years will generate \$2,405 in distributions and \$802 in federal taxes. The same \$1,000 contribution to a taxable account over 20 years will generate \$1,809 in distributions and \$603 in federal taxes. Even if a cap on deferrals were enacted on higher income tax brackets, the federal government would still sacrifice revenue over the long term.<sup>14</sup>

## **THE CURRENT TAX INCENTIVES ENCOURAGE DECISION-MAKERS TO SPONSOR AND ENHANCE PLANS**

Employers must consider a great number of factors when designing compensation and benefit programs for their employees. Not only are these programs shaped by a company's core business goals and competitiveness in an increasingly global marketplace, they are also central to human capital recruitment and retention strategy.

The decision to sponsor a retirement plan for one's employees, for small- and mid-sized business owners, requires a substantial commitment of administrative effort and financial resources. Since coverage and take-up rates among employees at large companies are relatively high, the promise of gains in retirement plan coverage will need to come from smaller plans. In this regard, coverage gains among smaller employers not only are critical from a social policy perspective, but also serve everyone's interest, because without broad enough coverage, concerns regarding the tax incentives and the private retirement system will increase.

For many decision-makers at small companies, tax advantages represent an important incentive to establish and maintain a retirement plan. The existing nondiscrimination rules then compel these plans to ensure that moderate-wage workers benefit as well, using tools such as matches and automatic features. Harnessing behavioral economics, through features like automatic enrollment and escalation, has proven to be an effective approach for improving outcomes for many employee populations. But none of this matters if the decision is not made to adopt a plan or to continue to place a high importance on the plan. In this way, the existing tax incentives are an essential element of the employer-sponsored system, since they are a critical catalyst for plan adoption and maintenance among smaller employers.

And the direct effect on larger companies of tax incentive reductions should not be overlooked. Thirty years ago, we all assumed that defined benefit pension plans were a permanent part of the retirement landscape for large employers. We have learned that that is not the case, and we need to heed that lesson as we work on defined contribution plan issues. While the very top executives may have alternative methods to save, the operation of nondiscrimination rules and dollar limits on deferrals tend to curtail the savings opportunities for employees at the lower end of the highly compensated

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<sup>14</sup> Investment Company Institute, [The Tax Benefits and Revenue Costs of Tax Deferral](#), 2012.

employee group. If the tax incentives for this broad group of employees at larger companies are reduced, large companies will naturally turn to other means of compensating them as a means to attract and retain key managers. In turn, the decision-makers will focus less on exploring enhancements and improvements to the company's defined contribution plan. If this decrease in interest is combined with the growing increase in regulatory burdens, plan-related litigation and potential liabilities, we could easily see defined contribution plans being slowly de-emphasized at large companies over a number of years, which will not serve anyone's interest.

## **CHANGES IN RETIREMENT POLICY SHOULD BUILD ON THE EXISTING SYSTEM, NOT DESTABILIZE IT**

Promoting retirement savings must remain one of our nation's top policy priorities. Any changes made should build upon our existing and successful tax incentive structure so it works even more effectively to facilitate retirement plan coverage and savings for American families.

The Council recently issued a long-term public policy strategic plan, [\*A 2020 Vision: Flexibility and the Future of Employee Benefits\*](#), in which we project that the employee benefits environment five years from now will be characterized by:

- Integration of personal health and financial well-being, rather than health and retirement benefits existing in separate silos
- Global competitiveness driving benefit plan design
- Emphasis on simplicity and predictability in benefit plan administration
- Maximum flexibility for employers and employees

The Council has developed five goals that will allow employer sponsored plans to thrive in this environment, focusing on sustainability, empowerment, value, innovation and technology. Connected to these goals are 46 specific policy recommendations, many of which would empower individuals to save for a secure financial future in retirement. The recommendations include the following:

***Increase the compensation and contribution thresholds for retirement plans and index the limits to ensure they keep pace with inflation.***

Increased limits and more appropriate indexing will allow individuals to save more effectively. While some may advocate reducing the tax incentives on retirement plans in a misguided attempt to increase revenue, doing so would cause Americans to save less when they need to be encouraged to save more. Increased retirement savings will help Americans meet their long-term financial needs and rather than signaling that less savings is enough, tax policy should encourage more.

***Establish an alternative automatic escalation safe harbor for retirement plans.***



As introduced in the [Retirement Plan Simplification and Enhancement Act \(H.R. 2117\)](#), sponsored by Representative Richard Neal (D-MA), and the [Secure Annuities for Employee \(SAFE\) Retirement Act \(S. 1270\)](#), sponsored by Senate Finance Committee Ranking Member Orrin Hatch (R-UT), an alternative automatic escalation safe harbor should be established with higher default rates and allow employers to escalate employee contributions beyond the current 10 percent cap. Default mechanisms such as automatic enrollment and escalation, lifestyle funds and retirement target date funds may help individuals who decline to enroll in a retirement plan to become savers and invest assets appropriately for their age and risk level. The 10 percent cap on default contributions under the current safe harbor should be eliminated. Also, a new safe harbor should be adopted with higher minimum default contribution rates that start at 6 percent.

***Increase catch-up contribution limits and lower eligibility to age 45.***

Considering greater longevity and the need to start saving for retirement as early as possible and to as great an extent as possible, the establishment of higher limits and a younger start date for “catch-up” contributions will help individuals achieve personal financial security. Congress must act to help Americans realize the importance of savings. Allowing employees, who begin saving later in their career, to start “catch-up” contributions earlier will help empower more Americans to prepare for a financially secure retirement.

***Increase public awareness of the financial risks associated with increased longevity.***

The average time spent in retirement has lengthened from 9.6 years in 1970 to 17.6 years today for men and from 14 years to 20.6 years for women over that same period.<sup>15</sup> This reality underscores the imperative for policies that meet the retirement income needs brought about by longer life expectancies. The federal government should undertake efforts to increase employees’ understanding of the value of delaying Social Security benefits and the importance of planning for longer life expectancies.

***Improve opportunities for small business to maintain retirement plans.***

It is also important to acknowledge that employee access to employer-sponsored retirement plans remains a challenge in some areas, especially with small businesses. We strongly support proposals such as helping small businesses join multiple employer plans and other initiatives that would help expand employer-sponsored retirement coverage.

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<sup>15</sup> U.S. Centers for Disease Control, [Health: United States, 2013](#), 2013; the Organisation for Economic Cooperation and Development, [Statistics on average effective age and official age of retirement in OECD countries](#), 2012.

These recommendations and others incorporated in *A 2020 Vision* work to empower individuals to save for a secure retirement. Our member companies sponsor retirement plans with strong participation levels and we want to ensure that American workers tap into the full value of their retirement plans. We stand ready to assist the government to ensure support for Americans as they undertake the substantial challenge of increasing retirement preparedness.

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