Testimony of Catherine Collinson
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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

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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.