

TRANSAMERICA CENTER
FOR RETIREMENT STUDIES®

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before
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Hearing on
The Challenge of Retirement Savings for Small Employers

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The Transamerica Center for Retirement Studies® (“TCRS”) 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 provided by small business. TCRS commends Committee Chairman Graves and Ranking Member Velazquez for focusing on the particular concerns of small business and their employees.

TCRS 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 toward achieving greater levels of financial security in retirement. TCRS 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.

TCRS® is a division of the Transamerica InstituteSM (The Institute), a nonprofit, private foundation. The Institute is funded by contributions from Transamerica Life Insurance Company and its affiliates and may receive funds from unaffiliated third parties. For more information about TCRS, please refer to www.transamericacenter.org.

Pertinent Facts About Small Business

Small businesses, firms with fewer than 500 employees, are the cornerstone of the United States economy. In 2010, small businesses represented more than 5.7 million employer firms, accounting for 99.7 percent of U.S. employer firms; approximately 55 million employees, representing 49 percent of private-sector employees; and 64 percent of net new private-sector jobs. From mid-2009 to 2011, small firms, led by the larger ones in the category (20 to 499 employees), accounted for 67 percent of net new jobs.¹

Role of Small Business Employers in Providing Workplace Retirement Benefits

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.

¹ U.S. Small Business Administration, Frequently Asked Questions, September 2012, http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf.

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

Historically, public policy has supported employers in providing retirement savings plans to their employees, evidenced by the tax incentives passed by Congress both for employers to sponsor retirement plans and for employees to accumulate long-term savings through those plans. Today's tax system also helps to ensure savings will be available for retirement by placing restrictions on pre-retirement distributions and imposing tax penalties for most early withdrawals.

TCRS has completed its 14th Annual Transamerica Retirement Survey ("Transamerica Survey") of 750 employers, including 450 small companies (10 and 499 employees); 3,651 full-time and part-time workers, including 1,764 from small companies; and 610 unemployed or underemployed workers, including 332 from small companies.²

The Transamerica Survey found that small companies are less likely than large companies to offer a 401(k) or similar plan (e.g., SEP, SIMPLE). Additionally, small companies that offer plans tend to have fewer plan features. In order to better understand the gaps, the survey segments small companies (10 to 499 employees) into micro companies (10 to 99 employees) and small non-micro companies (100 to 499 employees). It also offers comparisons with large companies (500 or more employees).

The survey findings underscore the importance of workplace retirement benefits in helping small business workers ("workers") prepare for retirement. The vast majority of workers (88 percent) at small companies value retirement benefits as important. Of the small-company workers surveyed, 36 percent expect 401(k), 403(b) accounts, and/or IRAs to be their primary source of income when they retire. Other workers indicated that they plan to rely on Social Security (28 percent), followed by other savings and investments (20 percent), company-funded pension plan (seven percent), inheritance (three percent), home equity (two percent), and other (five percent).

The survey also found that 76 percent of small business workers who have access to workplace retirement plans participate in their company's defined contribution retirement plan.

Small Business Retirement Plan Sponsorship Versus Coverage Rates

Policymakers, experts, and the retirement industry seek to increase plan coverage among workers, specifically those of small companies. Much of this discussion has focused on encouraging more employers to offer a plan. However, the research shows plan *sponsorship* is not synonymous with plan *coverage*.

Plan sponsorship rates have been resilient and, in some cases, flourished in an extremely difficult economy. During the challenging years between 2007 and 2010, the number of firms with fewer than 100 employees declined by 5.6 percent,³ while the number of defined contribution plans at companies of that size declined by only 1.5 percent.⁴ During that same time period, the number of SIMPLE IRA plans increased by 11.3 percent.⁵

Calculating plan sponsorship rates can be elusive. Much of the reporting is derived from the IRS Form 5500 database, a tax form that is required by employers who sponsor qualified plans (e.g., defined contribution

² Transamerica Center for Retirement Studies®, the 14th Annual Transamerica Retirement Survey. Employers, Workers, and Unemployed/Underemployed, 2013. www.transamericacenter.org.

³ U.S. Census Bureau, Statistics of U.S. Businesses, 2010. <http://www.census.gov/econ/susb/index.html>.

⁴ U.S. Department of Labor, Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables and Graphs, June 2013. <http://www.dol.gov/ebsa/pdf/historicaltables.pdf>.

⁵ Investment Company Institute. 2013. "The U.S. Retirement Market, First Quarter 2013" (June). http://www.ici.org/info/ret_13_q1_data.xls.

including 401(k), defined benefit, or other). However, many small businesses offer SEPs or SIMPLE IRAs, which are not required to file a Form 5500, and therefore, do not get counted.

The Transamerica Survey asked employers if they sponsored a 401(k) plan or a similar employee-funded plan (e.g., SEP, SIMPLE, other). Consistent with other studies, fewer small companies offer retirement benefits than large companies. However, the degree of the gap may be smaller than expected. The survey found:

- Seventy-two percent of small companies offer a plan, including:
 - Seventy-one percent of micro companies, and
 - Eighty-nine percent of small non-micro companies, compared to
- Ninety-five percent of large companies offer a plan.

Among the 28 percent of small companies that do not offer a plan, only 22 percent are likely to do so in the next two years. The most frequently cited reason for not planning to do so is cost (64 percent). In contrast, nearly one-third (32 percent) indicate they would be likely to consider joining a multiple employer plan offered by a vendor who handles many of the fiduciary and administrative duties at a reasonable cost.

A key to expanding coverage among workers of small companies is increasing plan *sponsorship* rates for micro companies. A key to expanding *coverage* among workers of all company sizes is encouraging existing plan sponsors to extend eligibility to their part-time workers.

TCRS' analysis revealed a pervasive gap in plan coverage: part-time workers. At small companies, only 36 percent of part-time workers say they are offered a 401(k) or similar plan compared to 68 percent of full-time workers. This coverage gap also persists among large companies.

As policymakers and industry seek to expand retirement plan coverage among American workers, it should be acknowledged that plan sponsorship rates are relatively high with room to grow and that part-time workers should be a special area of focus and attention.

Plan Features Less Prevalent Among Small Business Plan Sponsors

The Transamerica Survey found that plan features offered by small companies typically lag behind those offered by large companies. Increasing the availability of such features to small-company workers can help boost retirement security and their retirement outlook.

Matching Contributions

One of the most important features of a 401(k) plan is the employer's matching contribution, which incentivizes its employees to join the plan. Small companies (70 percent) lag behind large companies (86 percent) in offering matching contributions as part of their 401(k) or similar plan. In recent years, especially during the recession, there were widespread news reports of employers dropping their matching contributions. This year's survey found that while 14 percent of small companies had reduced or suspended their match, among them, six percent have subsequently reinstated it.

Automatic Enrollment

Automatic enrollment, a feature which automatically enrolls eligible employees into the plan with the ability for them to opt out, has been widely recognized as one of the most effective ways to increase plan participation rates. Small companies are far less likely than large companies to offer automatic enrollment:

- Nineteen percent of small companies have adopted automatic enrollment, including:
 - Eighteen percent of micro companies, and
 - Twenty-nine percent of non-micro companies.
- Forty-three percent of large companies offer automatic enrollment.

The median default contribution rate is three percent of annual salary among automatic enrollment plans offered by both small and large companies, which is consistent with the current safe harbor for automatic enrollment plans. It should be highlighted that three percent is low and sends a potentially misleading message to plan participants that it is adequate to meet retirement savings needs when, in most cases, it is not sufficient.

Hybrid Funds

Hybrid funds, such as target date funds, lifecycle funds, and strategic allocation funds, have become a staple in retirement plan investment options in recent years. These types of funds enable the plan participant to invest in a professionally managed fund that is essentially tailored to his/her years to retirement and risk tolerance profile. Forty-seven percent of small companies offer hybrid funds as part of their 401(k) or similar plan, including 46 percent of micro companies and 65 percent of small non-micro companies. In comparison, 79 percent of large companies offer hybrid funds.

Retirement Transition Assistance

Workers nearing retirement age face a myriad of difficult decisions regarding when and how they transition into retirement. Employers of all sizes share a tremendous opportunity to work with their retirement plan providers to offer resources and tools to these participants. While the majority of plan sponsors of all company sizes provide planning materials and information about distribution options, fewer than half offer financial counseling, pre-retirement seminars, or an annuity as a payout option as part of their plan.

Post-Recession: The Retirement Outlook of Small Business Workers

As the economy continues its recovery from the recession, savings rates among small business workers have remained steady while views and expectations about retirement have changed.

The majority of small-company workers (64 percent) said they are less confident about their ability to achieve a financially secure retirement since 2008. Many small-company workers (40 percent) now expect to work longer and retire at an older age, a slightly higher percentage than that of large-company workers (37 percent).

Fifty-five percent of small-company workers are confident that they will be able to fully retire with a comfortable lifestyle, including 11 percent who are 'very confident' and 44 percent who are 'somewhat confident.'

The majority of small-company workers (59 percent) plans to work past age 65 or does not plan to retire. Workers of micro companies (61 percent) are slightly more likely to plan to do so and those of large companies (56 percent) are slightly less likely.

The majority of small-company workers (55 percent) plans to continue working after retirement, 45 percent plan to work part-time and 10 percent full-time. Workers of large companies (52 percent) are slightly less likely.

Among the small-company workers who plan to continue working in retirement, two-thirds (66 percent) plan to do so because they want or need the income or health benefits.

Delaying retirement and/or continuing to work in retirement is an important way to continue generating income, bridge savings shortfalls, and stay active and involved. However, an alarmingly few small-company workers (20 percent) have a backup plan if retirement happens unexpectedly due to health issues, job loss, or other unforeseen circumstances. Fewer large-company workers (18 percent) have a backup plan.

Retirement Savings Habits of Small Business Workers

Among workers who are offered a 401(k) or similar plan, the participation rate of small-company workers (76 percent) is slightly less than for large-company workers (79 percent). However, there is a wide disparity between micro-company (71 percent) and small non-micro-company workers (83 percent).

This disparity in participation rates among workers of different company sizes may be explained, in part, by whether the employer utilizes automatic enrollment, a feature which drives higher participation. Larger companies are far more likely to automatically enroll employees than micro companies.

Among employees who participate, the median annual salary deferral rate is slightly higher among small-company workers (eight percent) compared to large-company workers (seven percent). This may be partly explained by the prevalence of automatic enrollment in larger companies, which in most cases, enrolls employees at a three percent salary deferral rate, thereby bringing down the median deferral rate.

Small-company workers (13 percent) are less likely than large-company workers (19 percent) to have taken a loan from a retirement plan. Of the small-company workers who did so, 41 percent cite paying off debt as the reason. Only four percent of workers of all company sizes took a hardship withdrawal in the past 12 months, with the most frequently cited reason being to prevent eviction from primary residence (31 percent). Among the unemployed and underemployed who had a 401(k) or similar plan at their most recent employer, 42 percent of small-company workers and 44 percent of large-company workers have taken withdrawals from their accounts.

Perhaps the ultimate measure of a worker's retirement outlook is his/her level of household savings in all retirement accounts. The 2013 estimated median household retirement savings among Baby Boomers, the generation closest to retirement, is lower among small-company workers (\$92,000), including \$94,000 among micro company and \$88,000 among small non-micro company workers. Baby Boomers employed by large-company workers have saved more (\$113,000). These 2013 savings levels represent a significant increase from 2007, when the estimated median household retirement savings among Baby Boomers was just \$60,000 for small-company workers and \$91,000 for large-company workers.

Inspiring Small Business Workers to Learn More About Saving and Investing

Workers reported what would motivate them to learn more about saving and investing for retirement would be simplifying the topic with a good starting point and educational materials that are 'easier to understand.' Larger tax breaks and incentives for saving in a retirement plan and a financial advisor were also frequently cited motivators among workers.

Tax incentives can be powerful motivators for people to save for retirement – but only if they know about them. Among workers of all company sizes, awareness of the Saver's Credit is low. Only 23 percent of small-company workers and 25 percent of large-company workers are aware of this important tax credit for low- to moderate- income tax filers who save in a qualified retirement plan or IRA. Awareness is lowest among micro-company workers at 20 percent.

The majority of small-company workers (56 percent) would like more information on how to reach their retirement goals, yet only 42 percent of employers believe this to be the case. There is an opportunity to close this disconnect: only 11 percent of small-company workers had spoken to their employer about retirement benefits and only 29 percent of small-company employers had surveyed their employees on the topic.

Recommendations: A Seven Step Plan to Increase Retirement Security

Small businesses they have diverse business circumstances, unique retirement plan-related needs, and differing concerns about costs. As policymakers seek to increase retirement security among workers, the most effective solutions are best accomplished by offering a variety of cost-effective solutions, within the context of the existing system and available to all plan types, to address these needs and concerns.

Seven steps toward increasing retirement security in small business include:

1. Increase plan sponsorship rates

Plan sponsorship rates are lowest among companies with fewer than 100 employees and, therefore, should be an area of focus. Solutions to increase plan sponsorship rates include:

- a. 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 for the start-up tax credit which currently allows small businesses to claim a tax credit of up to \$500 for three years for establishing a retirement plan.
- b. 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 plan (MEP). To be effective, a MEP 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 liability for the acts or failures to act of other employers participating in the plan, and (2) provide tax incentives for employers and employees to encourage participation. MEPs tend to provide standard plan terms, and therefore, employers that want plan design flexibility, such as by offering a more robust investment menu, should continue to offer their own plans.

2. Expand plan coverage among part-time workers

Many employers who sponsor a retirement plan exclude part-time employees from being eligible to join the plan. Potential reasons for employers choosing to exclude their part-time employees include cost, administrative complexity, and difficulties in passing non-discrimination testing. Solutions to create incentives and/or reduce impediments include:

- a. Additional tax incentives and safe harbors from non-discrimination testing.
- b. Lower or eliminate required top-heavy minimum contribution for part-time workers.
- c. Provide relief from being a Form 5500 “large plan filer” if the reason that the plan has more than 100 participants is covering part-time workers.

3. Increase default contribution rates in plans using automatic enrollment

The current minimum default contribution rate in the safe harbor, which range from three percent to six percent, sends a misleading message to plan participants that saving at those levels are sufficient to ensure a secure retirement. A new automatic enrollment safe harbor, under which employees are enrolled at six percent (increasing to eight percent, then 10 percent), which also provides a tax credit for adopting it, could drive up plan sponsor adoption rates and participant savings rates.

4. Promote and expand the Saver’s Credit

The Saver’s Credit is a meaningful incentive for low- to moderate-income Americans to save for retirement. However, many are unaware of it. Recommendations include: promoting the Saver’s Credit and expanding it by raising the income eligibility requirements so that more tax filers are eligible.

5. Reduce leakage from retirement accounts

Extend the 401(k) loan repayment period for terminated plan participants and eliminate the six-month suspension period following hardship withdrawals.

6. *Illustrate savings as retirement income on retirement plan account statements*

Require retirement plan statements to state participant account balances in terms of a lifetime income stream as well as a lump sum to raise awareness of savings needs. Such illustrations demonstrate that while lump sum amounts sound large, when translated into lifetime income, they are revealed to be much smaller. This can help participants realize that they need to save more. The illustrations also help educate participants about the importance of ensuring that their savings will last throughout their life.

7. *Facilitate retirement savings to last a lifetime*

Proposals that help participants both manage their investment risk and ensure their retirement savings will last their lifetime are encouraged, including facilitating the offering of in-plan annuities and annuities as a distribution option. Investments such as annuities will enable an employee to shift the investment risk and risk of outliving his or her retirement savings to the annuity provider.

Conclusion

Workplace retirement benefits play a vital role in helping workers save for retirement. The workplace retirement savings system has succeeded in serving as the preferred method of saving for retirement for millions of workers. However, more work can and should be done by policymakers, industry, and employers to improve the current system.

There are many opportunities for enhancements to retirement plans that are well within reach and not necessarily time consuming and costly to implement. The notion that there could be a single solution for retirement security seems impossible. However, many meaningful steps can be taken and improvements made that have the potential to dramatically improve Americans' retirement readiness.

T CRS commends Committee Chairman Graves and Ranking Member Velazquez on their consideration of the particular challenges and needs of small businesses in providing and maintaining retirement savings plans for their employees as the economy continues to recover.

T CRS 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.