

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: September 30, 2013
Re: Hearing: "The Challenge of Retirement Savings for Small Employers"

On Wednesday, October 2, 2013, the Committee on Small Business will meet at 1:00 p.m. in Room 2360 of the Rayburn House Office Building in Washington, DC, for the purpose of receiving testimony on the state of retirement savings for small business owners.

I. Background

A June 2013 Bankrate.com survey found that three quarters of Americans are living paycheck to paycheck, with little to no emergency savings.¹ This is true for individuals, households, and workers.²

Saving for retirement has always been a challenge for Americans. According to the Employee Benefit Research Institute, 46% of all American workers have saved less than \$10,000 for retirement.³ And more than half report that they have no workplace retirement plan.⁴

A report by a task force of actuaries and retirement professionals projects that baby boomers approaching retirement found that most have not taken the steps necessary – saving, selecting investment vehicles, managing the investments, following a budget,

¹ Angela Johnson, *Seventy Six Percent of Americans Living Paycheck to Paycheck*, CNNMONEY (June 24, 2013), available at <http://money.cnn.com/2013/06/24/pf/emergency-savings/index.html>.

² *Id.*

³ EMPLOYEE BENEFIT RESEARCH INSTITUTE, Retirement Confidence Survey 1 (2013), available at http://www.ebri.org/files/Final-FS.RCS-13.FS_4.Age.FINAL.pdf.

⁴ *Id.* at 2.

choosing retirement dates – to provide reliable income to last the rest of their lives.⁵ The task force went so far as to call the results of their findings a “retirement crisis.”⁶

The low retirement savings rate can be partly attributed to the recovering economy, which means small firms have less capital to put back into their business and take home. In addition, the cost and complexity of administering retirement plans has dissuaded many small firms from offering them.

II. Retirement Savings and Small Businesses

Few Americans are saving sufficiently for retirement, yet it has never been more important. Life expectancy is increasing, and other retirement income sources, such as Social Security, are in doubt.⁷ According to one estimate, one-third of America’s retiree’s get at least 90% of their retirement income from Social Security.⁸ Most Americans have never even calculated the amount of savings needed for retirement.

Despite the aging workforce, many small firms do not offer retirement plans. Small business owners can find saving even more difficult.⁹ A paper prepared for the Small Business Administration in 2010 found that IRA ownership among small businesses is only about 36%. Only about 18% of business owners participated in a 401(k) plan.¹⁰

In June, the Government Accountability Office reported that only 14% of small employers sponsored a retirement plan in 2012.¹¹ Those with 1 to 4 workers had the lowest plan sponsorship rate – 5%. Those with 26 to 100 workers had a sponsorship

⁵ RISKY BUSINESS: LIVING LONGER WITHOUT INCOME FOR LIFE 3, AMERICAN ACADEMY OF ACTUARIES, July 2013, available at http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf.

⁶ *Id.*

⁷ RISKY BUSINESS: LIVING LONGER WITHOUT INCOME FOR LIFE 4, AMERICAN ACADEMY OF ACTUARIES, July 2013, available at http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf. In 1935, when the Social Security Act was enacted, the life expectancy for a person who reached age 65 was 13 years for men and 15 years for women. In 2012, the life expectancy at age 65 was 18.9 years for men and 20.9 years for women. *Id.*

⁸ Steven Greenhouse, *How They Do it Elsewhere*, N.Y. TIMES, May 14, 2013, available at <http://www.nytimes.com/2013/05/15/business/retirementspecial/international-retirement-plans-offer-insight-to-aid-americas-system.html?pagewanted=all>.

⁹ JULES H. LICHTENSTEIN, UNITED STATES SMALL BUSINESS ADMINISTRATION, SAVING FOR RETIREMENT: A LOOK AT SMALL BUSINESS OWNERS 9 (Mar. 2010), available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CC4QFjAA&url=http%3A%2F%2Fwww.sba.gov%2Fadvo%2Fresearch%2Frs362tot.pdf&ei=Yc7eUYytMZGy4AOs5oCoCw&usg=AFQjCNFCM8WhrddiGuNL7zof4weArTyubA&sig2= N8XbwFScGra_h1LqA0xlQ&bvm=bv.48705608,d.dmg.

¹⁰ JULES H. LICHTENSTEIN, UNITED STATES SMALL BUSINESS ADMINISTRATION, SAVING FOR RETIREMENT: A LOOK AT SMALL BUSINESS OWNERS 9 (Mar. 2010), available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CC4QFjAA&url=http%3A%2F%2Fwww.sba.gov%2Fadvo%2Fresearch%2Frs362tot.pdf&ei=Yc7eUYytMZGy4AOs5oCoCw&usg=AFQjCNFCM8WhrddiGuNL7zof4weArTyubA&sig2= N8XbwFScGra_h1LqA0xlQ&bvm=bv.48705608,d.dmg.

¹¹ GOVERNMENT ACCOUNTABILITY OFFICE, RETIREMENT SECURITY: CHALLENGES AND PROSPECTS FOR EMPLOYEES OF SMALL BUSINESSES 8 (2013) (GAO-13-748T, available at <http://www.gao.gov/products/GAO-13-748T>).

rate of 31%.¹² GAO also found that small employers with plans frequently did not understand the fees associated with them and participants in those plans often paid higher recordkeeping and management fees than those in larger employers.¹³

Small business owners often say they don't believe they could afford a retirement plan for their employees (or themselves).¹⁴ Some don't save for retirement because they spend too much. Retirement may seem too far in the future, or saving over the long term with today's weak economy could seem too risky. The cost and complexity of retirement plans can deter small firms from offering plans.

Some small business owners do not save for retirement because they believe they will be able to sell their business and live off the proceeds.¹⁵ Financial advisors caution that a business may not always be liquid, may not be valued by experts or purchasers as highly as the owner or may not be marketable at all.¹⁶

The recession may have been a wake-up call for small firms. Today, some small firms may be better able to offer retirement plans. According to a recent Capital One survey, nearly half of all small business owners believe the economy is gaining strength, small business conditions are improving, and their business will be in a stronger financial position in the next few months.¹⁷ However, these results contradict the August 2013 NFIB Optimism Index, which found favorable employment plans but increasingly negative expectations for improved general business conditions.¹⁸

III. Retirement Savings Vehicles

Small employers who offer retirement savings plans can choose from many different options.¹⁹ Several of these savings options are described below.

¹² *Id.*

¹³ *Id.*

¹⁴ *Recessions and Bull Markets: Why Small Businesses Should Hedge Retirement Bets*, FORBES (Jun. 19, 2013), available at <http://www.forbes.com/sites/stuartrobertson/2013/06/19/recessions-and-bull-markets-why-small-businesses-should-hedge-retirement-bets/>.

¹⁵ *Sell a Business to Cover Retirement? Don't Count on It*, N.Y. TIMES, July 25, 2013, available at <http://www.nytimes.com/2013/07/25/business/smallbusiness/sell-a-business-to-cover-retirement-dont-count-on-it.html?pagewanted=all>.

¹⁶ *Id.*

¹⁷ CAPITAL ONE SPARK SMALL BUSINESS BAROMETER (Jun. 2013), available at <http://www.businesswire.com/news/home/20130617005794/en/Small-Business-Conditions-Improving-Concerns-Remain-Capital>.

¹⁸ NATIONAL FEDERATION OF INDEPENDENT BUSINESS, *NFIB Optimism Index*, September 2013, available at <http://www.nfib.com/research-foundation/surveys/small-business-economic-trends>.

¹⁹ See UNITED STATES DEPARTMENT OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, *Choosing a Retirement Solution for Your Small Business*, available at <http://www.dol.gov/ebsa/publications/choosing.html>.

A. Pensions

1. Defined Benefit Plans

According to the Department of Labor, defined benefit plans promise a specified benefit at retirement, such as \$100 per month once you retire.²⁰ The amount of the benefit is sometimes based on a set percentage of pay multiplied by the number of years of employee service. While generally small firms offer defined contribution plans, defined benefit plans may be suitable for small business owners who are over age 50 and need to accumulate a large amount of retirement savings in a short period of time.²¹ An actuarial firm typically drafts the plan document and calculates the benefit, and these plans can be more costly to administer.²²

2. Defined Contribution Plans

Defined contribution plans do not promise a specific benefit at retirement. In these plans, the employees, employer, or both, contribute to the employee's individual plan accounts, often at a set rate (such as a percentage of salary) per year.²³ An increasing number of small employers offer these plans.²⁴

B. Other Retirement Savings Vehicles

1. SIMPLE Plan

A Savings Incentive Match for Employees (SIMPLE) Plan is a savings option for employers of 100 or fewer employees involving a type of IRA. It allows employees to contribute a percentage of their annual salary each pay period and also allows their employer to contribute. Employers can either match that contribution dollar for dollar – up to 3% of the employee's wage -- or make a fixed contribution of 2% of pay for all eligible employees. Employees are 100% vested in contributions, decide how and where

²⁰ EMPLOYEE BENEFITS SECURITY ADMINISTRATION, UNITED STATES DEPARTMENT OF LABOR, FREQUENTLY ASKED QUESTIONS ABOUT PENSION PLANS AND ERISA, *available at* http://www.dol.gov/ebsa/faqs/faq_compliance_pension.html.

²¹ Gail Perry, Are Defined-Benefit Plans Better for Small Businesses? Accounting Web, *available at* <http://www.accountingweb.com/article/are-defined-benefit-retirement-plans-better-small-businesses/219557>.

²² Greg Stevens, Fox Business Small Business Center, Four Retirement Options for Small Businesses, *available at* <http://smallbusiness.foxbusiness.com/entrepreneurs/2012/11/14/4-retirement-options-for-small-business-owners/>.

²³ EMPLOYEE BENEFITS SECURITY ADMINISTRATION, UNITED STATES DEPARTMENT OF LABOR, FREQUENTLY ASKED QUESTIONS ABOUT PENSION PLANS AND ERISA, *available at* http://www.dol.gov/ebsa/faqs/faq_compliance_pension.html.

²⁴ *Id.*

the money is invested, and keep their IRA accounts even when they move to a different job. There is little administrative burden or paperwork.²⁵

2. SEPs (Simplified Employee Pensions)

With a SEP, employers establish an individual retirement account, known as a SEP-IRA, for themselves and their employees.²⁶ Employers contribute a uniform percentage of pay for each employee. Employer contributions are limited to a certain percentage of an employee's annual salary or an annual limit, indexed for inflation, whichever is lower.²⁷ SEPs have low startup and administration cost, and can be established using a short form.²⁸

3. 401(k) and Profit-Sharing Plans

401(k) plans are commonly-used savings vehicles for many small businesses and, according to the Department of Labor, are used by over 25 million workers and have assets of over \$3 trillion.²⁹ In a 401(k) plan, employees designate a percentage of their pay to be deducted and contributed to the plan on a tax-deferred basis. An employee is subject to a maximum annual limit, adjusted for inflation, but the annual percentage may be changed annually.³⁰ Employers may also make contributions to a worker's 401(k) account, usually a percentage of wages or a percentage of the employee's contribution, subject to an annual limit.

IV. Effects on Retirement Savings

A. *The Economy*

America's economy continues its recovery. Over the past few years, the financial performance of pensions and retirement savings plans has been uneven. Increasingly, large and small companies are mindful of how these plans can affect their earnings and balance sheet.

Some believe that retirement plans have over-relied on investments in the stock market. In recent years, the market's performance made individuals and business owners concerned about the viability of their retirement investments. Mark Williams, Professor of Finance at Boston University, has said that a downturn in the economy can

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

force large firms into mergers or asset sales.³¹ In such a climate, many small firms have difficulty offering or maintaining a benefit plan. There are also statutory concerns. The Pension Protection Act of 2006³² established evolving accounting standards to prevent companies from getting too far in arrears in their pension obligations to retirees. Others have urged companies and individuals to save more but to invest less.³³

Because they are based on long-term growth, many company pension funds are heavily invested in stocks. These funds were hard hit during the economic downturn. More employers could shift from defined benefit pensions to defined contribution plans, because this would reduce the employer's risk over time, but this is not easy to do. A 2008 study by the Employee Benefit Research Institute³⁴ on 401(k) account balances found that employers were reducing or even ending employer contributions, but by early 2013, the plans had shown improvement.³⁵

B. Legislative Proposals

Historically, one area where Congress has had bipartisan agreement is that of encouraging Americans to save for retirements.³⁶ During the late 1990s and early 2000s, Congress enacted some key laws affecting defined contribution plans and IRAs that are still in operation today.³⁷

Since that time, various retirement savings proposals have been introduced, such as mandatory employee payroll deductions for IRA enrollment. Most retirement plans, including the proposed automatic IRAs, are subject to the Employee Retirement Income Security Act (ERISA).³⁸ ERISA is the federal statute which establishes the minimum standards for pension plans offered by private sector employers, and provides extensive rules for the federal income tax treatment of transactions associated with employee benefit plans.

³¹ *Pension Funds Weakened by Stock Market Decline*, TIME (Oct. 31, 2008), available at <http://www.time.com/time/business/article/0,8599,1855076,00.html>.

³² Pub. L. No. 109-280, 120 Stat. 780, codified at 29 U.S.C. 1001 (2006).

³³ *The New Retirement Plan: Save More, Invest Less*, FORBES, available at <http://www.forbes.com/sites/investor/2012/10/11/the-new-retirement-plan-save-more-invest-less/>.

³⁴ Jack VanDerhei, Issue Brief, Employee Benefit Research Institute, February 2009, available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_2-2009_Crisis-Impct.pdf.

³⁵ BUSINESS ADMINISTRATION INFORMATION, EBRI REVIEW SHOWS LONG-TERM IMPROVEMENT IN 401(K) BALANCES, February 16, 2013, available at <http://www.businessadministrationinformation.com/news/ebri-review-shows-long-term-improvement-in-401k-balances>.

³⁶ *Hearing on Tax Reform and Tax-Favored Retirement Accounts Before the House Committee on Ways and Means*, 112th Cong., April 17, 2012 (statement of Randolph H. Hardock, American Benefits Council), available at http://waysandmeans.house.gov/uploadedfiles/hardock_testimony.pdf.

³⁷ One of those is the Retirement Security Act, Pub. L. No. 107-16, 115 Stat. 49 (2001).

³⁸ Pub L. No. 93-406, 98 Stat. 2705 (1984).

V. Conclusion

Individuals have traditionally had difficulty saving for retirement. Small companies, with their thin margins and low operating capital, have found it challenging to offer a full array of employee benefits, including pension or retirement savings plans. The uneven economic climate has made it more difficult for small firms to offer and maintain retirement savings plans for their employees. At the same time, the need for Americans to save is greater, as Social Security's future is uncertain. This hearing will examine the challenges small companies face in offering these plans, and suggest some options for expanding them.