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ROUNDTABLE DISCUSSION: PENSION MODERNIZATION FOR A 21ST CENTURY WORKFORCE

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

EXAMINING PENSION MODERNIZATION FOR A 21ST CENTURY WORKFORCE

SEPTEMBER 20, 2012

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C O N T E N T S

STATEMENTS

THURSDAY, SEPTEMBER 20, 2012

ROUNDTABLE DISCUSSION: PENSION MODERNIZATION FOR A 21ST CENTURY WORKFORCE

THURSDAY, SEPTEMBER 20, 2012

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room SD–430, Dirksen Senate Office Building, Hon. Tom Harkin, chairman of the committee, presiding.

Present: Senators Harkin, Enzi, Franken, and Blumenthal.

OPENING STATEMENT OF SENATOR HARKIN

The CHAIRMAN. The Senate Committee on Health, Education, Labor, and Pensions will come to order. I want to welcome everyone to this extraordinary roundtable we're holding today. We've brought together a number of very experienced and thoughtful participants to talk about an issue that is critically important for America, and that's rebuilding the pension system.

I've said often in the past I think it's one of the most underreported crises facing us as a Nation. But it is a crisis confronting us, and I think we in the Congress are going to have to address it very shortly. Defined benefit pension plans are one of the simplest, most cost-effective ways for middle-class Americans to earn a dependable source of retirement income. They're very effective at keeping older Americans out of poverty.

Pensions boost savings rates and reinvest in the economy. I want to just add about reinvesting in the economy that when we start looking at this, we find that pension plans play a very important role in two areas of our economy. One is in terms of small startup companies that are seeking to expand. If you look at the companies like Apple or Google or any of those companies that have expanded and are employing thousands of Americans, a lot of their early investments came from pension funds.

The second part is infrastructure. Pension funds buy a lot of municipal bonds, and those are used for sewer and water systems, streets, bridges, roads, and buildings. Pension funds invest in buildings, office buildings, things like that that are long-term infrastructure items in our country. So pension funds do play an instrumental role in those two areas and in creating jobs.

The problem is that defined benefit pensions are disappearing. Only about one in five today have a pension. Thirty years ago, that was one out of every two. This has had a profoundly negative impact on retirement security. Again, it's made worse by the fact that the middle class is being squeezed between stagnant wages and rising costs. It's getting tougher and tougher for people to prepare for retirement, and that is the crisis.

I'm told that the retirement income deficit, the difference between what people need for retirement in the future and what we actually have, is about $6.6 trillion. Half of Americans have less than $10,000 in savings. So on that supposedly three-legged stool of retirement—social security, pensions, savings—about all some people have left is social security, and that's just not enough.

I was in Iowa recently and met a woman by the name of Linda. I won't give her last name. She was a home healthcare worker. She has worked hard all her life and played by the rules. She got sick. That wiped out whatever little savings she had. Now, she's in retirement, and she's struggling to make ends meet. All she has is social security. She never had an opportunity to earn a pension. And that's just simply not enough for her.

I've met a lot of people like this in hearings across my State that I've had on this retirement system. We've had 2 years of hearings and discussions and investigations by this committee into this. I recently released a report called "The Retirement Crisis and a Plan to Solve It." The basic idea is to provide universal access to a new type of privately run pensions. I'm calling it the Universal Secure and Adaptable Retirement Funds, USA Retirement Funds for short.

As I have proffered it, it is sort of like a hybrid between defined benefits and 401(k)s. People would make contributions, but their money would be professionally managed by fiduciaries. Then when they retire, they get an annuity check every month as long as they live. It would also be portable. There would be no responsibility by employers to prefund anything. All they would have to do is just cut a check like they do for withholding right now for social security. So employers would have no fiduciary responsibility whatsoever.

The idea, again, is to get a discussion going as to how we can build a system. Defined benefits have gone down for a lot of reasons. So what can we fill in there? What can we do to get people to begin to do more to put money away for retirement?

That's why we have this roundtable here today. We have a lot of experts, people in the field that know what they're doing. How should we be looking at this? Any thoughts and suggestions that you have for how we proceed on this? That's what we're here for.

With that, I'll turn to Senator Enzi for an opening statement.

OPENING STATEMENT OF SENATOR ENZI

Senator ENZI. Thank you, Mr. Chairman. I appreciate you holding this roundtable discussion today. I like that format. When it comes to retirement, I always warn people that looking at the statistics that come through our committee, most of the people who die are retired.

The CHAIRMAN. Wait a minute. Let me think about that.

Senator ENZI. Now, that's the usual——

The CHAIRMAN. I can't get my head around that.

[Laughter.]

Senator ENZI. That's the usual reaction that I get to that. But I've watched people as they have wiped out dreams and wound up with nothing to do, and then they die. So what we want is for them to have a retirement so that they can keep doing things, the things that they put off doing, the things they want to do, the dreams they've had, the different things they want to do. We need to stimulate them to do that as well.

Over the last couple of years, we've held several retirement hearings looking at all aspects of the retirement system, from the auto enrollment features contained in the Pension Protection Act of 2006 to why the traditional defined benefit system has been in a state of decline. Recently, you released a white paper looking at ways to bring back the traditional pension for workers and their families. The white paper should make for a good topic of conversation, and I look forward to hearing our roundtable participants discuss the paper. I appreciate the testimony that's been submitted already, with a lot of good ideas in there, and we'll try to make use of those, too, as we look for other ways to help and improve retirement savings in our country.

Through the years, I've been a supporter of the traditional defined benefit plan system, as it forms one of the key legs of our three-legged stool that the chairman mentioned—the social security, the defined benefit, and then other savings, particularly 401(k)'s and IRAs. I also recognize that some people do not save enough through their 401(k)'s and IRAs for retirement, and these people will place a greater strain on very shaky Federal entitlement programs.

As a former small business owner, I appreciate the carrot rather than the stick approach for getting small business owners to participate. Mandatory participation in a contribution on behalf of employees by small business owners is troublesome, especially for those businesses that have low-profit margins and are already overburdened by the day-to-day obligations of running a business. If you ask a small business owner about making required contributions to a retirement plan, every small business owner will tell you they already make mandatory retirement contributions on behalf of their employees to the social security system.

There is little doubt about the power of retirement dollars in our economy. Recently reported statistics show that there are more than $18 trillion of U.S. retirement assets invested in our economy. Currently, the greatest share of that comes from 401(k) and individual retirement accounts. The share from the traditional payment system is growing smaller each year. However, we still have room for improvement, and we will have to cover the problem of people moving from job to job and being able to move their retirement as well and be sure there aren't complications in that.

Mr. Chairman, I thank you for holding this hearing. I'm looking forward to hearing from our witnesses today on what can or should be done to help encourage greater participation by the private sector in our retirement system and whether alternatives for the traditional defined benefit system can be found.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Enzi.

As I mentioned, this roundtable is going to be a little bit different from the typical Senate hearing. We're reviving a format that Senator Enzi pioneered during the time that he was chair of this committee. Usually, we have a big square table and we sit around it. But we couldn't get a bigger room today. And because I knew we'd have a lot of people here who would be interested in this issue, if we put that out there, we wouldn't have room for people to come in and listen. So we had to do it in this way.

But the format will be the same. Basically, we're just going to ask a question, and then we're going to start getting involved in a dialog, rather than questions and answers, that kind of thing. I request that responses be a couple of minutes or less and no long speeches. We just gave our long speeches.

But I'll just briefly introduce everyone who is here. First, we have Jim Davis, who is owner of Iowa Title in Charles City, IA. Mr. Davis appeared at one of the hearings I had in Iowa on this issue and was very eloquent in talking about the problems that a small main street business person has in terms of having pensions.

Next we have Aliya Wong from the Chamber of Commerce, the Executive Director of Retirement Policy, involved in pension policy for years. She led the Chamber's legislative efforts during the pension reform in 2006.

Susan Breen-Held is a consulting actuary at Principal Financial in Des Moines. She has helped small and medium-sized employers establish and maintain pensions for a long time.

Richard Hudson is a consulting actuary at Cheiron. He has worked to develop some incredibly innovative plan designs that make it easier for employers to offer pensions. I'm told that he has even helped some employers start new pensions recently. Well, that would be interesting to know.

Karen Friedman, executive vice president at the Pension Rights Center, heads up the Retirement USA Coalition. We have worked together on issues in the past on retirement. It's good to have you here.

John Adler is the Retirement Security Campaign director at SEIU. He works with the Service Employees International Union locals and State councils to address threats to the retirement security of its members and advocate for solutions to the retirement security crisis.

Andrew Biggs is the resident scholar at the American Enterprise Institute, where he works on issues related to retirement security. Prior to joining AEI, he was the principal deputy commissioner of the Social Security Administration.

Finally, we have David Madland, director of the American Worker Project at the Center for American Progress, who has written extensively about retirement policy and I'm told did his dissertation on pension issues.

I thank you all for being here today. What I would like to do is to propose a first question and then start to get into it. Then maybe Senator Enzi would have the second question that we might propose, if that's the way we'll go on it. And then we'll just sort of see how this flows. Like I say, there's not a strict format on this.

Senator ENZI. We might mention that while we have all of the jurisdiction on private pension funds, the Finance Committee has jurisdiction on social security. So we won't be debating that. We're trying to find out what to do in the private sector.

The CHAIRMAN. Good point. We don't have jurisdiction. You're right. That's a good point. So we want to talk about private pensions rather than social security.

I'll start off by saying this. Defined benefit pension plans have provided a secure retirement for millions. But it is clear that the traditional pension system is in decline, that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. So, a broad question, what should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

I'll start here with Mr. Madland. And then what I'd like to do is if you'd like to respond and get involved in that, take that name tag of yours and just hold it up or just turn it on end. Just put it on end, and that way—well, I guess everybody, then. OK.

[Laughter.]

Let's just do this. We'll just go down the line. What should a pension system look like to meet these challenges, the global challenges we have and the changing workforce structure here in America? I think we all agree we need something. What is it?

STATEMENT OF DAVID MADLAND, DIRECTOR OF THE AMERICAN WORKER PROJECT, CENTER FOR AMERICAN PROGRESS, WASHINGTON, DC

Mr. MADLAND. Thank you very much for having me, Senators. I think the pension system of the future should ensure that all workers have a cost-effective and secure way to save for retirement so that they can retire with dignity. But in designing the private side plan to facilitate this, I think there's a couple of big things to keep in mind.

The idea is that all retirement plans involve tradeoffs between cost, risk, and adequacy, and choices about who bears those costs and risks, employer, employee, or taxpayers. There's just no getting around these basic facts that retirement planning is about these kinds of tradeoffs.

What is also really important to understand is that there are better ways of managing these tradeoffs, especially than the current 401(k) system. Andrew Biggs and I were talking about it a little bit before. It's bad right now, but it's a good situation to be in, because there are ways to improve people's outcomes without making other people worse off.

First, just to briefly explain what I mean by the 401(k) system not being good at managing these tradeoffs, for employers, it's pretty good at managing costs and risks. It's contained. But for the employee, there are lots of costs and risks involved—that the performance of their investments won't do well, that they're trying to retire at a time when the stock market tanks, or so on, or high fees, ET cetera. So, we know all the facts.

But the typical near retiree who has a 401(k) has a balance that would give them an annuity of about $575 a month, not that much, not sufficient to maintain their standard of living. We also know that about half don't even have a plan at work. So I think the future plan needs to be much better than the 401(k) at managing these tradeoffs.

The CHAIRMAN. Excuse me. I want to get that clear. The average 401(k) at retirement right now is providing $575 a month.

Mr. MADLAND. That includes their IRA assets as well, because those are probably accumulated in the 401(k). But, yes, a near retiree, if you add all their private retirement assets together, that would purchase an annuity of about $575. So these tradeoffs that I was talking about can be managed a lot better. I think, Senator Harkin, your plan does a very good job of managing these tradeoffs.

For employers, it's a defined contribution plan. But for employees, it looks more like a defined benefit plan, and that's, in fact, very similar to a plan the Center for American Progress is releasing today called The Collective Defined Contribution Plan. The key thing I want to emphasize—and I'll be happy to talk more about this in future answers—is that these plans significantly reduce risk for workers and significantly reduce the cost of saving for retirement. They are so much more efficient and so much less risky for workers, while maintaining the same sort of structure as a 401(k) for employers, that I think there are tremendous advantages to be had in moving

The CHAIRMAN. Very good.

Mr. Biggs.

STATEMENT OF ANDREW G. BIGGS, Ph.D., RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC

Mr. BIGGS. Thank you very much for the opportunity to speak this morning. I think I'll make five quick points, which certainly aren't exhaustive in terms of what we'd like a pension system to look like, but I'll hit on points that I think are important.

The first one is simplicity, both on the employer's side and the employee's side. When a pension is excessively complex, that reduces participation by the employees. It makes it more difficult for them to plan ahead and decide how much they need to save, when they're going to retire, and so on. It also makes it more difficult for businesses, in particular, small businesses, to take on the fixed cost of offering a pension. So I think plan design simplicity really does make sense.

The point is broad participation. The big difference people focus on between a defined benefit and defined contribution pension is who bears the risk. Under a DB plan, it's the employer or the plan sponsor. Under a DC plan, it's the employee.

An even bigger or more important distinction is that under DB pensions, generally, participation is universal. Under defined contribution plans, participation is voluntary. So you get a lot of people who simply don't sign up, and that's a real problem in terms of pension accumulation. The Pension Protection Act has worked toward automatic enrollment, and I think that's a really welcome addition. But getting broad participation really makes sense.

A third point is adequate contribution rates. Many people will sign up for a defined contribution plan, but then contribute only at a low rate. There are plans such as the Save More Tomorrow plan which ramp up people's contribution rates over time. It's very difficult for people to know how much they need to save for retirement, because it's a very, very complex calculation. But I think if we can get more people saving more, that gives them a little bit more of a buffer, a margin of error, in terms of retirement income security.

Fourth, is it's important to focus on life-long income. Defined benefit pensions have an advantage in that they pay benefits as an annuity, meaning it lasts as long as you live. It is very difficult for individuals to take a lump sum today and manage that lump sum over the course of an uncertain retirement. There are clearly efficiencies to be had, large efficiencies to be had, in annuitization where that mortality risk is pooled. So encouraging annuitization, I think, really makes sense.

The final point I make is financial transparency. One of the main objections or problems I have with defined benefit pensions, both at the private sector level and at the State and local level where I do quite a bit of work, is a lack of financial transparency. There are a million different variables that can be used to alter the cost, the perceived cost, to the employer. Thinking about discount rates, thinking about mortality assumptions, thinking about wage growth assumptions—all of these things are difficult to get on top of and are incentives for plan sponsors to use those assumptions to lower cost to themselves.

You just have the key problem that people want to promise a benefit, but they don't always want to pay for it. Using financially transparent measures, meaning measures that are comparable with what markets would say, I think is a key issue. It's the degree you diverge from the way markets would judge the value of things, the cost of risk, and I think there's potential danger there.

The CHAIRMAN. Thank you very much. That's very succinct. Thank you for those points, Mr. Biggs.

Now we'll go on down the line.

Mr. Adler.

STATEMENT OF JOHN ADLER, RETIREMENT SECURITY CAMPAIGN DIRECTOR, SEIU, NEW YORK, NY

Mr. ADLER. Thank you both for inviting me. It's an honor to be here. I'd like to point out the extent to which the three-legged stool has ceased to exist for most Americans. There's a chart, which, hopefully, you have in front of you, that shows sources of retiree income by income quartile. You'll see that at the top of the chart is the bottom 25 percent, the bottom quartile, and 87 percent of their income comes from social security. So there's no three-legged stool here.

What might be more surprising is if you look at the middle 50 percent income group, 74 percent of their income also comes from social security. So you really don't have a three-legged stool there, either. It is only for the top 25 percent, the bottom pie in the chart, where you see there is a legitimate three-legged stool for retirement income for Americans. That is what's most disturbing and what we really need to address through the proposals we're discussing today.

The CHAIRMAN. Can I ask you a question, Mr. Adler?

Mr. ADLER. Yes.

The CHAIRMAN. I was struck by the "other"—5, 9, and 21 percent. What's the other? I understand dividends, rentals, things like that. What's the other?

Mr. ADLER. Honestly, I think it may be people——

The CHAIRMAN. People working, maybe?

Mr. ADLER. People working. I actually don't know. The source is the U.S. Bureau of Labor Statistics, their current population survey. This was 2010 for the period 2007 to 2009. If you want, Senator Harkin, I can try to go back and research that and see what it is that consists of the other.

The CHAIRMAN. If that's work and other things, then I'm a little confused about why the top quartile would have such a big other compared to the bottom, because the bottom quartile seems to be people who really do have to work when they're in retirement. I would think it would be more of a factor there. But, anyway, let me know.

Mr. ADLER. Sure. We'll get back to you on that.

In terms of where we go in the future, what we do to try to address the problem of the erosion of the three-legged stool for the majority of Americans, we clearly—I mean, I honestly agree with most of the points that Andrew Biggs just made. We're a sponsor of Retirement USA that Karen Friedman is here representing today, so I'm going to let her go into greater detail. I just want to make a couple of points before I pass it along.

Clearly, the goal here should be that workers, after a lifetime of work, can maintain their standard of living throughout retirement through social security combined with a life-long annuity stream. That's really what we don't have anymore. Because of the shift to 401(k)'s and other forms of defined contribution, they just don't provide enough retirement income. So we need to figure out how to replace that life-long stream of income to supplement social security.

We believe that it should be the shared responsibility of employees, employers, and the government, with each making contributions. Obviously, the government already does in the form of tax deductions. One of the things that we would like to see is that the government take a stronger role in funding retirement for lower income workers. Because of the nature of the tax code, lower income workers get proportionately very little of the tax benefit from retirement accounts that upper income workers do. So I think we ought to look at using credits to balance that out more.

The only other point that I want to make before I pass it along is that we ought to set minimum standards, we believe, that over a lifetime of work will enable workers to have an adequate stream of income to maintain their standard of living. But we also ought to enable increased contributions up to prescribed limits so that either through collective bargaining or just in non-union situations, companies and employees can contribute more if they want to.

But we need to make sure that it's not just universal access, but there's actual adequacy, which I think is actually one of the points that Mr. Biggs made, that the contribution rates have to be adequate to fund sufficient lifetime income. And I will leave it there.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Adler.

Ms. Friedman. What's our pension system going to have to look like?

STATEMENT OF KAREN FRIEDMAN, RETIREMENT USA, WASHINGTON, DC

Ms. FRIEDMAN. Thanks, Senator Harkin and Senator Enzi. Thank you so much for inviting me here to this roundtable. Maybe we should call this a very long table discussion. I also want to just say that on behalf of both the Pension Rights Center and Retirement USA, we thank both of you for your strong leadership on retirement issues. You guys have both been terrific on this.

I've also had the pleasure of working with just about everybody at this table in some shape or form, if not the people themselves, their organizations. I think that while everybody here may not agree on everything, I think we're all here because we're committed to the importance of retirement security. I really, again, want to thank you for having this discussion today, because I think that by listening to each other and looking for common ground rather than places that we disagree, we can shape measures that really ensure that hardworking Americans can retire with dignity and are able to make it, so that they don't die—wither away, as Senator Enzi said.

Before I start to address the big issue of what our pension system should look like for the 21st century, I want to make a few quick comments on defined benefit plans and kind of reemphasize what you said, Senator Harkin. We all believe that defined benefit plans are the most efficient means for providing retirees with guaranteed income for retirement. And as you also pointed out, they're critical to the economy. For these reasons, we believe we should do everything possible to preserve and encourage defined benefit plans.

However, recognizing the realities and the fact that defined benefit plans are on the decline in the private sector, we also have been very involved in trying to develop new and creative solutions for the 21st century. That's why the Pension Rights Center launched Retirement USA with 27 organizations, including the SEIU and the AFL–CIO and others, to advocate for a new pension system that in conjunction with social security is universal, secure, and adequate.

What I'm going to share with you today—and John alluded to—is that Retirement USA developed 12 principles for a new private retirement system. Actually, many of those principles are reflected in your report, Senator Harkin. These principles combine the best parts of defined benefit plans and 401(k) savings plans and other features. So I'm going to quickly go through them and summarize what's in my written questions.

We have three overarching principles that we think should underlie the design of a new system. These are universal coverage, and that means a new retirement system that supplements social security, should include all workers unless they're in plans that provide equally secure and adequate benefits; security, meaning that workers should be able to count on a steady lifetime stream of retirement income to supplement social security; and adequacy, that the average worker should have sufficient income together with social security to maintain a reasonable standard of living in retirement.

Additional principles include shared responsibility, which John talked about, and that's contributions by employees and employers. We also feel that the government should subsidize the contributions of lower income workers. We also think that contributions to the system should be pooled and professionally managed. There should be pay outs only at retirement and lifetime payments. There should be portability and effective administration and oversight.

I also want to say before I move on, Senator Harkin, that your USA Retirement Funds proposal meets, I would say, almost all of our principles and takes an innovative and realistic approach to risk sharing. Your proposal for a new system of privately run pension plans with employer contributions relieves employers of administrative and fiduciary burdens while also providing retirees with a lifetime benefit while also—and this is a very unique feature that we think is great—you share risks among the participants.

I think it's also important to point out—and I can talk more about this later—that the Pension Rights Center recently held a conference called Reimagining Pensions with representatives of the business community. We looked at eight proposals, and many of them are risk-sharing—other types of risk-sharing approaches, including the Cheiron proposal. The Pension Rights Center also has our own proposal called Retirement Security Funds that we also unveiled at that conference. It has a lot of the same common elements of your proposal.

I'm going to end here for now. But, again, I want to thank you for holding this discussion today.

The CHAIRMAN. You said there were eight proposals?

Ms. FRIEDMAN. Yes, there were eight proposals, and many of them—and there's even more. I mean, there were sort of 25 proposals that meet all of our principles. But for the Reimagining Pensions conference, we had eight different proposals, some from business representatives, some from labor unions. As I said, Rich did his proposal at the conference. A lot of those proposals have the same elements that are in your proposal, Senator. So we'd be happy to share that with you.

The CHAIRMAN. Well, I think what we ought to do—I just told my staff and I stated to Senator Enzi that we ought to take a look at those and put a matrix up and see what's identical in all those things and see what the areas of agreement are that people are really looking at. I think we ought to do that.

Mr. Hudson.

STATEMENT OF RICHARD HUDSON, CONSULTING ACTUARY, CHEIRON, WASHINGTON, DC

Mr. HUDSON. Thank you for inviting us to come down. We do appreciate your time and efforts on this important issue. I think, as you've already heard and will continue to hear, there are several aspects of what we've been doing, what your proposal is, and what other people are considering about risk mitigation, risk sharing, and how better to look at the retirement plans as a whole.

One of the things we feel is, a lot of companies took a lot of risk in their pension plans to create benefits that were, in essence, free.

In doing that, they never really realized what they were getting themselves into until the market downturned and they had to post their liabilities, and it just got out of control.

As you've heard and, I think, will continue to hear throughout the day, defined benefits plans are the best way to provide retirement income for participants. They provide a secure retirement income. You know what you're going to get every single month until you die. The plans don't pay out too much and they don't pay out too little. If you die, the checks stop. You don't have to worry about am I going to run out of money before I die. So they are the best avenue for providing the income to retired participants.

Insurance companies have been producing annuities for many, many years, and they're not running into trouble. The biggest difference there is they understand how to manage the risk. What we're looking at is trying to figure out how to do the same thing in a corporate or multi-employer plan or even a public sector plan. The plan designs that we've been looking at are hitting very strong chords with all three of those aspects.

Defined contribution plans that are being favored by today's employers are shifting all of the risk onto the participants. The biggest issue that we see is that people don't understand fully that when they make that risk transfer to the participants, not only are they transferring all of the financial risk, but they're introducing new forms of risk and then passing that on to the participants. And that form of risk is longevity or mortality risk.

In a defined benefit plan, it's pooled amongst thousands of people. In a defined contribution plan, you have your own pool of assets and you have your own longevity risk. That cannot be managed on an individual-by-individual basis. So we're looking at ways of assisting people in understanding that and how we can manage the financial risk in a defined benefit world but still be able to pool the longevity risk in a larger plan.

Did you have a question?

Senator ENZI. Yes. You're suggesting that if people die early and they've been contributing to this plan, they don't get anything out of it?

Mr. HUDSON. What we're looking at is a true traditional defined benefit plan. The employer is making contributions to the plan on behalf of the participants. Now, if they're married, they're guaranteed a joint survivor plan. It's a risk-protected plan. But you're pooling that mortality risk across the entire group. So it's not an employee contribution.

What we would say is the employee contributions would go into a savings plan, and they can take as much or as little financial risk as they want in their 401(k) plan or their IRAs or what-have-you. But in the defined benefit world, the risk should be mitigated, managed, and appropriately dealt with. It's a more conservative-based plan. We allow for a variability in the benefit. So the benefit can go up or down with investment returns, but never below a floor benefit. That's one concept.

Another concept is future benefit accruals would be altered to adjust for financial downturns. But in a properly managed portfolio with a lot less risk, the portfolios that we've been testing out have proven that they can earn 6.25 percent to almost 7 percent with very low risk.

STATEMENT OF SENATOR FRANKEN

Senator FRANKEN. May I just ask a question? I'm not sure if Senator Enzi's question was totally answered by that answer. I have a pension from being in the Writer's Guild. In my plan, if I die early, my wife can benefit from my pension, and that seems to be a very common way of addressing that. She doesn't get the full benefit. There are different ways to do that, and you can choose different ways to do that. You can choose to get less money per month but protect your spouse for a longer time, ET cetera, ET cetera.

So is that in the design that you're talking about, or is that a potential design of what you're talking about?

The CHAIRMAN. You're talking about some kind of a built-in survivor's benefit.

Senator FRANKEN. Yes.

Mr. HUDSON. That's an ERISA requirement. So, yes, it's in the plan. You'd never be allowed to design a traditional defined benefit plan without that protection in there.

Senator FRANKEN. OK.

Senator ENZI. That's a little closer to what I was talking about.

Senator FRANKEN. OK. Thank you.

Senator ENZI. I'm still interested in getting really young people involved in thinking about their retirement. Of course, none of them think they're going to die, anyway. But if they don't see some way that the money that they put in comes back to their survivors or something—not necessarily a wife, because a lot of them wouldn't be married yet at that age. How do they make sure that they get some benefit out of all the money they put in or that's put in on their behalf?

Senator FRANKEN. I think if you have no survivors, there isn't really much benefit you can get after you're dead.

[Laughter.]

We're now talking a lot of philosophy, I think.

[Laughter.]

STATEMENT OF SENATOR BLUMENTHAL

Senator BLUMENTHAL. Mr. Chairman, I'm not sure I can say I'm following up on that line of questioning. Is it fairly uniform that some form of survivor's benefit is contained in these plans and policies? Is that now pretty much the standard operating procedure?

Mr. HUDSON. Yes. ERISA requires that if you have a traditional defined benefit plan, and it's operating under ERISA production, you get your IRS determination letter, it's a tax-qualified plan, there must be a joint survivor benefit for spousal coverage. So if you're married and you die, your spouse has to get some benefits from those years of work. So that's a requirement. It's not so much of the plan design as much as part of law right now.

Senator BLUMENTHAL. Does that hold true for offspring?

Mr. HUDSON. No.

Senator BLUMENTHAL. If there is no surviving spouse?

The CHAIRMAN. No.

Senator BLUMENTHAL. Would that apply also to same-sex couple marriages in States like Connecticut?

Mr. HUDSON. A lot of that would depend on how the plan document is governed. There are significant issues now with differences between Federal law and State law with marital status, because if you're married to a same-sex spouse under State law, it's the Federal law in ERISA that provides the spouse the right to select benefits and the right for protection. Federal law does not recognize a same-sex spouse.

So if the plan document allows for the same-sex spouse, you're going to lose an argument somewhere, because either you're giving a right to somebody who doesn't get it under Federal law—it's kind of circular, and you run into a lot of problems. It would be much better if all the State laws matched up with Federal law. But the plan document can be drafted the way the plan sponsor intends.

Senator BLUMENTHAL. So if I can sort of distill your answer into one sentence, the answer to the question depends on the plan document currently.

Mr. HUDSON. Yes.

Senator BLUMENTHAL. Whereas for heterosexual couples, ERISA would apply.

Mr. HUDSON. Yes.

Senator BLUMENTHAL. Thank you.

The CHAIRMAN. Thank you very much, Mr. Hudson.

We'll move on to Ms. Breen-Held.

STATEMENT OF SUSAN L. BREEN-HELD, CONSULTING ACTUARY, PRINCIPAL FINANCIAL, DES MOINES, IA

Ms. BREEN-HELD. Thank you. Thank you for having us to talk about this important topic. You asked: What would the pension system look like to provide retirement security? While this panel has focused primarily on defined benefit, we feel strongly that defined benefit and defined contribution are both important sources, and that the soundest way to provide good retirement benefits, adequate retirement benefits, is not through a single plan type but looking at the entire system as a whole and strengthening each part of the system.

Having said that, I do want to say I'm not sure that we believe that the system is broken today. I don't think it is. I think what you have is a very firm foundation with the laws as they're set up now. Is it perfect? No. But I do believe that it provides a starting place so that we can look at what's working, what's not working, and learn lessons and build on those lessons for both the government from the legal side and from the plan sponsor's side.

What are the lessons that we've learned? First, I think, as several of the speakers have said, a voluntary employer-sponsored system, and DB, in particular, is the most efficient and the most effective way to deliver retirement benefits. And when I say most efficient, what I'm talking about is the most retirement benefits out for the contributions put in. It also provides that guaranteed monthly income to participants that is so critical to them that is inherent in the defined benefit system.

The second lesson: We need to make the system simpler to operate. We need to simplify or reduce testing, some of the funding rules, some of the other regulations, especially for smaller employers, because, frankly, complexity drives the costs up. Small businesses need to have an affordable system. I'm not talking about cost of benefits. I'm talking about cost of administration. Without that, it drives up those costs, but without really improving funding or security of benefits for the smaller employers.

The third lesson that we've seen is we need to give employers more reason to voluntarily offer that plan. That may mean covering more of their incomes within the qualified plan. It certainly means continuing the tax incentives for defined benefit and defined contribution plans. We've heard very clearly that that's a very important component for them.

And, finally, I think we need to assure that the employees understand and value the defined benefit plan and the value of having an annuity benefit. I know that the policymakers are aware of that. But employees are not always, and so we need to make sure that there is an effort made so that participants, workers, understand, because appreciation will drive value, and that brings something to the business owner as well, when their employees appreciate the plan that they provide.

Senator ENZI. What kind of reasons would you put forth for them to voluntarily offer?

Ms. BREEN-HELD. Well, more on that in my later comments. But I think reasons to put forth—right now, frankly, with many sponsors that I work with, the key decisionmakers have very little skin in the game. The compensation limits over the years have been reduced. When I'm talking about a compensation limit, I'm talking about the amount of income that they can recognize to base their benefit on.

If everybody gets 20 percent of their pay, well, the people that are making the decisions about the plans only get 20 percent of a very small portion of their pay covered, not all of it. So they don't have as much stake in the plan. Those reductions have come over the years, and they've been revenue driven. I understand that. But each time that those have been dropped, we saw participation in the system drop.

Senator ENZI. Thank you.

The CHAIRMAN. Thank you, Ms. Breen-Held.

Ms. Wong.

STATEMENT OF ALIYA WONG, EXECUTIVE DIRECTOR OF RETIREMENT POLICY, U.S. CHAMBER OF COMMERCE, WASHINGTON, DC

Ms. WONG. Thank you. And thank you for inviting me to participate in this roundtable today. When people think of the Chamber, they often think of the big companies and large companies. But our membership is made up of over 96 percent of small businesses with fewer than 100 employees, and 70 percent of those have fewer than 10 employees.

The CHAIRMAN. We're going to hear from that next from Mr. Davis.

Ms. WONG. Our concerns about retirement security obviously covers a wide array of employers and their employees. When I think of the retirement system of the future of the Chamber, there are three words that come to mind: voluntary, flexible, and innovative. Obviously, I'm going to followup on the comments of Ms. Breen-Held. These may sound familiar, because we do consider the current system to be successful, and we consider it something that we should build upon and improve.

While there is widespread agreement that retirement savings and programs are important, not every employer is able to offer a retirement plan, as Senator Enzi mentioned in his opening statement. There are employers that have small profit margins, and if you mandate a benefit or increase their administrative costs associated with plans, then it makes difficult decisions for them in terms of their business, in terms of employment decisions, investment decisions, and otherwise expanding their businesses.

We believe flexibility is important. This was shown in 2008 in the financial crisis. Unfortunately, due to that crisis, a lot of companies had to suspend their matching contributions. And as we all did—individuals, government, and all—we had to tighten our belts. However, the fortunate part of that situation is that as the financial situation improved, most of those companies did reinstate that match.

We saw a situation where companies, because of the flexibility of the system, were able to take time out when their businesses couldn't afford it, but they didn't have to terminate the plan. The plan was still in place. Very quickly, when the economy started to return, they were able to reinstate that match and continue with the program.

Finally, innovation, as my other colleagues have mentioned, has been critical in the system. There has been a number of plan designs that have been sparked over the last several years. It has been important for employers to make sure that they are using plan designs that meet the needs of their workforce. Often, employers will have more than one plan design to meet those different needs. So we think it's important that the policy decisions that we make, or that Congress makes, continue to offer that flexibility and innovation so that employers are able to continue to implement plans that are important to their workforce.

I will summarize, and, obviously, there will be more detail later. But, again, just voluntary, flexible, and innovative.

Thank you.

The CHAIRMAN. Thank you very much, Ms. Wong.

And now small businesses, small main street businesses that employ few people that really don't have the wherewithal to set up DB plans—let's face it. That's the bulk of what we're looking at around America.

Mr. Davis.

STATEMENT OF JIM DAVIS, OWNER, IOWA TITLE AND REALTY, CHARLES CITY, IA

Mr. DAVIS. Thank you, Senator. I've been in business on main street in small town Iowa since 1977. It's what we call where the rubber meets the road. The goal of any pension system should be to provide for a safe and secure retirement. A pension system should be mandatory. If voluntary worked, we would not find ourselves in this dire situation.

It should be professionally managed. Investing for retirement requires a very consistent, disciplined effort that's applied without emotion. Funds should be allocated over a wide variety of investments in order to minimize risk. A modern pension system should be predicated on the reality that we now live in a global financial system. An employee should have 1 year of service at their employment location in order to be eligible for a pension. The pension plan should be subject to a 5-year vesting schedule.

Thank you.

The CHAIRMAN. OK. Back up a second, Mr. Davis. Just a second here. What did you say on the first year? What was that? What did you say about the first year?

Mr. DAVIS. Employees should have 1 year of service at their present location in order to be eligible to receive a pension.

Senator FRANKEN. I'm sorry, Mr. Chairman. May I just ask a followup to that?

One year of service to qualify for a pension, but a 5-year vesting schedule. Can you clarify that distinction a little bit?

Mr. DAVIS. Yes. I mean, you wouldn't want somebody who, if they came there on day one and then left after 6 months, to be eligible for the pension.

Senator FRANKEN. I understand the 1 year of service. But it has a 5-year vesting schedule. In my experience, to be vested, that means, you don't qualify for getting your pension until you're vested.

I'm trying to get the distinction between 1 year and 5 years here. What happens if you work there 2 years?

Mr. DAVIS. You would begin to qualify after 1 year, and then start to receive the pension. I think part of what I'm referring to is the portability and taking it with you. It's vested just like any other thing after a 5-year period.

Senator ENZI. They increase it 20 percent per year of the amount that's been contributed on their behalf, as far as being able to take it with them if they leave? When you say 5-year vesting, is that 20 percent per year of increase?

Mr. DAVIS. I guess they'd be able to take the entire amount with them that they've earned is, I guess, my thought.

The CHAIRMAN. I'll have to think about that. Let me ask this provocative question. If someone comes to work for you, and they only stay for 6 months, and then they move on to some other employment, why shouldn't they be able to have some contribution to a pension plan, no matter where they work, no matter how long they work someplace? Why shouldn't they be able to contribute?

Mr. DAVIS. I guess one of my key goals is to keep long-term employees. In order to just avoid turnover, part of my thought is if people are just qualifying so easily, that's not a good thing for me as a business person.

The CHAIRMAN. Oh, I see. You see this as an employment issue and keeping good employees. Oh, well, I never thought about that.

Senator FRANKEN. It provides an incentive to stay there, and that's what the vesting usually does, too. I don't mean to belabor this, but I still don't understand that if you're there for a year and then you're qualified for the pension, but it takes you 5 years to be vested, that means you have ownership of your own pension. Right?

Mr. DAVIS. Guaranteed, I guess, is the word that I associate with it, too.

Senator FRANKEN. OK. So after a year, you start to get payments in. But if you don't work there for 5 years, it's not guaranteed that you'll get any of the benefits from the pension. Is that correct?

Mr. DAVIS. Yes.

Senator FRANKEN. OK. Good.

The CHAIRMAN. Mr. Hudson, did you have a comment on this aspect?

Mr. HUDSON. Yes. The 1-year issue—what a lot of employers find is there's a lot of financial implications with making somebody immediately participate in a plan. If it's a DB plan, you have to pay PBGC premiums on all participants. So if the employee becomes a participant in the plan on day one, you have to start paying PBGC premiums. If you have a 1-year wait, then you save a lot of administrative costs, because if the guy is going to come in and leave— after 6 months, they leave. So a lot of plans do have a 1-year wait clause already embedded in them.

Then they have a 5-year vesting rule, so you don't actually have the right to receive any benefit from the plan until after 5 years. But the company or some individual is making contributions on behalf of that plan and accruing benefits, but you may not become vested until a 5-year period exists. In the idea of a 401(k) plan or the hybrid cash balance plans, that 5-year vesting is now down to 3 years.

The CHAIRMAN. Yes. I'm sorry.

Ms. FRIEDMAN. I was just going to say pretty much the same thing. I mean, I think that under current law—just to give you a quick history on this, before ERISA, you could work your entire life and never vest. You could work until 65, and then if you didn't make it to your retirement age, bye-bye. Then ERISA changed it to 10. Congress changed it to 5. And as Rich said, right now, under defined benefit plans, it's 5 years. Under our principles, the Retirement USA principles, there would be immediate vesting as soon as you're in there. And the Pension Rights Center has always been trying to lower the vesting standards for the very reasons that you're talking about.

The CHAIRMAN. Jim, let me ask this. In the retirement proposal that I put forward, anyway, we took all the administrative burden off of employers. You have no administration burden. All you have to do is just cut a check, just like you do withholding right now, for your employees. Wouldn't that make it easier for you to offer a benefit? I mean, you'd have no administrative burden whatsoever.

Mr. DAVIS. Absolutely. That comes up in question No. 2, and I'll just jump to that and say employers want a system that makes it easy to participate in without additional burdensome and time-consuming paperwork.

The CHAIRMAN. Mr. Adler.

Mr. ADLER. I was just going to say that I think one of the issues that we're sort of exploring here is the tension between an employer-based system and a universal system that's portable. So with an employer-based system, it makes total sense to have a wait and a vesting period to do exactly what Mr. Davis was talking about and what Senator Franken mentioned, which is incentivizing employees to stay long enough to collect the benefit.

With a universal portable system, the employer is just the conduit for money going into this system, along the lines that you propose, Senator Harkin. Then the issue of incentives to stay with a single employer if all employers are in this system, or the rationale for vesting, really evaporates. So I just think that's a tension in the plan design as we talk about a 21st century pension that we ought to acknowledge.

The CHAIRMAN. Mr. Madland.

Mr. MADLAND. Very quickly on that, I think John Adler hit that right on the head and that universality becomes increasingly important for the future. We just think of job tenure decreasing, and the kinds of jobs we are likely to have in the future, where it's less likely—yes, some people stay with the company for a long time, but it's less likely. Figuring out how to have greater universality, I think, is key in the future.

The CHAIRMAN. Well, you mentioned the second question I wanted to bring up, and that is: What would make it easier and attractive for businesses? I'm going to focus especially on small businesses. A lot of times, when you think of DB plans, yes, they're efficient. I get all that. But for a small business like Mr. Davis' and so many all across America, they can't do that. They don't have the administrative wherewithal to have a defined benefit plan.

So what would make it easier and attractive for small businesses to provide their employees with some kind of a traditional pension benefit and would reduce employers' risk and plan complexity? Almost all of you have talked about reducing complexity and making it simpler. So what would make it easier?

OK. Jump right at it.

Mr. DAVIS. Can I start out by issuing a disclaimer?

The CHAIRMAN. Sure.

Mr. DAVIS. Unlike these other folks up here on this panel, I'm not a particular expert on this topic. But, anyway, I'll repeat my first answer here. Employers want a system that makes it easy to participate in without additional burdensome and time-consuming paperwork. Employers do not want a system that is so costly that it makes their business uncompetitive.

Employers want competent fiduciaries to manage the fund so that they are not forced to spend time managing a plan. Employers do not want to make allocation decisions for which they're not capable. Employers don't want to own any pension plan. My view is that employers should expect to provide 3 percent to 5 percent of an employee's annual salary for a pension program. Finally, employers should be able to provide additional retirement benefits without costly testing or rules.

The CHAIRMAN. Say that last one again. I was making a note here.

Mr. DAVIS. Employers should be able to provide additional retirement benefits without costly testing or rules.

The CHAIRMAN. In other words, they could voluntarily contribute more.

Mr. DAVIS. Correct.

The CHAIRMAN. I see. I was trying to write all those down. Could you make sure you give those to my staff?

Mr. DAVIS. Actually, I submitted those earlier this week to Michael.

The CHAIRMAN. OK. Very good. Thank you very, very much. I appreciate it.

Mr. DAVIS. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Davis.

Senator ENZI. On the testing, what you're talking about are like the top-heavy tests?

Mr. DAVIS. I guess more what I was referring to was possibly medical tests or something for qualification. Sometimes we have to get—like with life insurance policies or something like that.

The CHAIRMAN. Well, again, throwing it open, what's going to make it easier for businesses? We have to have them to buy into this or nothing will work.

Ms. Wong, we'll just go down the line.

Ms. WONG. I will echo Mr. Davis' comments. Obviously, decreasing complexity is a huge issue that we hear about. Our small business members often tell me that I cannot overstate the need for simplification and a reduction in regulatory burdens that they see as unnecessary.

Even as a retirement expert, I often hear from businesses about very highly technical issues that I have a hard time understanding. So I can only imagine for a small business owner who is trying to follow this as well, who is not an expert and who is trying to run a business, this is something that becomes very daunting, and it's very easy at that point to say that they just don't even want to be involved.

I have some specific comments that I did submit in written testimony. But I do want to respond to two things that were said. No. 1, is about the need for a universal system. We do have a universal system. It's social security. That is immediately vested and portable. I don't think there is a tension between a universal system and the private system. Actually, from our perspective, they're a complement to each other. So a lot of employers that do have the private system often take into account the social security benefits and how that's going to work for their employees when they retire.

And, No. 2, we appreciate the desire to remove risk from employers in terms of managing pension plans. But there is a significant number of employers that do want to maintain retirement plans, and they do it for workforce reasons. They want to remain competitive. They do it to have their employees stay with them.

I go back to this point that there's not one design that's going to work for every employer. There are different needs, different reasons, and different issues that employers are trying to address. We just think it's incredibly important that there be different options and flexibility within that.

There is one or maybe two things I want to mention, specifically, when you talk about simplification—streamlining notices and disclosures. I've talked with Michael and Craig Dean about this many, many times. There are an incredible amount of notice and disclosure requirements that plan sponsors are required to comply with.

In addition to being able to streamline and consolidate those—we're not even talking about elimination, but there's just so much repetitiveness, but there is a way to streamline those issues.

In addition, if we could find a way to really encourage employers to use electronic delivery, we think that would be extremely helpful, not just in terms of eliminating administrative burdens, but also in terms of getting participants' information that they find useful and necessary at the time that they need it.

The other issue I would raise is the Financial Accounting Standards Board, FASB. Both Senators have done tremendous jobs in the Pension Protection Act and in pension reform since then. However, a lot of the work that Congress does is undone by the FASB rules. So I would just urge Congress to take a look at that and really consider that as we move forward.

Thank you.

The CHAIRMAN. Ms. Breen-Held.

Ms. BREEN-HELD. Thank you. I do want to kind of maybe set the groundwork here. Principal is a global company and a very large company. Our practice is with small- and medium-size employers. So that's the world that I'm going to be talking about here.

The No. 1 thing that we hear from employers right now that's a problem for them—that if we could fit it, it would make it more attractive—is the volatility of defined benefit plans. That happens because when market interest rates change, it can cause unexpected changes in the plan's funded status under the current rules. Now, as a business owner, that can make budgeting difficult or impossible to do. We are dealing with that in some ways now through investment strategies, but it's early get-going for that.

Structural forces, also because of the way the funding rules work, mean that in bad times, bad economic times, you're forcing businesses to put more money in than you make them put in in good times. Those rules work with the business cycle. When things are bad, the funded status looks bad, and the contributions rise. Is that volatility?

Now, I know that this committee helped quite a bit with the transportation bill, which eventually became what we affectionately call MAP–21, Moving Ahead for Progress in the 21st Century. We appreciate that support, but it really didn't go far enough. We would urge the committee to consider restoring the 10 percent corridor—and I know I'm kind of getting into the weeds. But there was a 10 percent corridor around the interest rate that you could use that phases out over time. I understand that that phase-out removes stabilization, removes that protection for businesses, and it was taken out for financial reasons.

But if we had it back, it improves the ability to budget. It is a countercyclical measure. In other words, it would reduce contributions during bad times and increase required contributions that businesses have to make in their good times. And, not incidentally, it would also raise tax revenue in the short run.

The second issue, and back to the point I mentioned earlier, is we need to give business owners a reason to offer, because, frankly, in a voluntary system, it's a business decision to offer a plan. For a small business to invest their scarce resources—and I'm not talking just money. I'm talking time—there has to be a benefit to the business. I think that's one of the things that Mr. Davis was talking about.

Compensation limits allow plans to provide benefits as just a minimal part of the total pay of the people who are sitting around the table making the decisions about the plan. They have very little incentive to maintain that plan and the risk that it represents. I see a couple of things that might incent owners, operators, to keep these plans or even possibly to create them.

The first one is, as I said, increased compensation limits. The second possibility would be either to reduce—or to raise or to remove the compensation limits for 5 years when a plan is first established, providing that owner an incentive to put the plan out there. They could balance that so that the rank-and-file also receives benefits by either requiring minimum benefits of a certain level during that period of time, or, back to Senator Franken's question, to provide immediate vesting, so that it's a win-win. At the end of the day, we want participants to have benefits and that lifetime income. We want it to come through this voluntary system.

The third idea that I want to put forth is, again, echoing Mr. Davis and several of our speakers, reducing the administrative costs for small businesses. Reducing some testing that's done right now from annually to every 3 years, similar to what's done in some rules, or for very small plans, exempting them completely, could reduce the costs without significantly risking benefits or a significant risk to the Pension Benefit Guarantee Corporation.

The CHAIRMAN. In a system that I had put out there for discussion—and others have talked about similar aspects of this—where it's voluntary and there is no administrative burden on these small businesses—there's just none.

Ms. BREEN-HELD. We have studied your proposal, and I will admit there are questions, as we've discussed with your office, because it still—concepts are not—the devil is always in the details.

The CHAIRMAN. That's why we're having these discussions. We're trying to figure that all out.

[Laughter.]

Ms. BREEN-HELD. Are we the devils? No, no, no. I think what we're doing—one of the concerns that I see is that it's replacing a system that operates within an HR department with building another completely new structure.

The CHAIRMAN. But, again, I would proffer that there's no structure within the employer. That's what makes it easier on small businesses. And as long as they don't have to set up an HR department and they don't have to do anything like that, then there's no burden on that business.

Well, anyway, I'll leave it there, and we'll talk about it, I guess. I don't know.

Mr. Hudson.

Mr. HUDSON. I hit the button first this time. I may be slow, but I get there eventually.

A couple of the issues that we're running into in real-life situations where we're working with plan sponsors is we're taking a lot of the issues that were just presented by my compatriot here about what types of risk are in the pension plan, how much volatility is there, and how to properly manage it. Some of it comes to employers investing 70 percent of the plan assets in equities when 70 percent of the participants are retired. It doesn't make sense to have that type of a mix.

So we've come up with some interesting plan design alternatives that are premised on risk mitigation and risk sharing. But they are very different than what is out there in the market today. When we present this to an employer, they say, "Well, how many other employers are doing this?" we say, "Well, you're going to be the lucky No. 1." They get scared off of it, because they're not sure if they'll get a qualification letter from the IRS, and that's huge.

We've got one plan where we submitted a determination letter. It goes through the IRS. Now it's behind in the queue with everyone else. If you're setting up a brand new pension plan, there should be a way to get some sort of priority in taking a look at that plan and making sure that it's going to be qualified by the government. That would be a great benefit for a lot of the groups that we're talking to.

The second issue that we run into is you set up a defined benefit plan, and you have to pay PBGC premiums. The PBGC premiums are escalating at extremely rapid rates, especially the flat dollar premium amount. If you set up a pension plan, and you've properly addressed the majority of the risks in the plan, you're mitigating it, and you're properly managing it, there is a very low likelihood that you'll ever go to the PBGC and ask for anything, because the plans that we're designing are designed to be fully funded at all points in time. Every precaution is taken to keep these plans fully funded, so there should never be a need to go to the PBGC and get insurance.

But what actually happens is you freeze an existing plan and you startup a new plan, and you are now paying twice the PBGC premiums. So you're doing a better job mitigating the risks, doing the right thing, and getting penalized for it by double paying the PBGC premiums, because you've got a frozen benefit in one plan and a new plan benefit accruing in the second ongoing plan.

That is extremely detrimental, and a lot of employers look at that and they say, "Well, this is just crazy. Why would we ever want to do this? We'll just go to a DC plan and we don't have the PBGC premiums." Well, you go to the DC plan and you don't have a guaranteed benefit. So it's kind of a big difference. And when you get into a DC plan, if you're working with a group of participants that are either in a labor-intensive job or a job where they just can't get to age 65 retirement, if you have to retire and go out early for a disability or just not being capable of working, you're going to get almost no annuity benefit out of that DC plan.

The third item that's hurting a lot of plans right now, which I'm sure you may hear from some of the other colleagues here, is that multi-employer plans are suffering under tremendous orphan liabilities. These are liabilities attributable to companies that have gone bankrupt, withdrawn from multi-employer plans, but those participants are still covered by the plan. The employers that were contributing on behalf of those individuals that employ them are now gone in some fashion, either bankrupt or just withdrawn from the plan.

Then there's this issue of taking on too much risk in the plan portfolio to take care of those liabilities. The market crash has decimated these plans, and now you have a liability for what we call an orphaned individual with no employer who's ever employed that person, but those existing employers have to make up that liability. That's another big avenue of stress on a lot of these plans.

And just as a side note, I'm going to go back to my first answer to answer a question that Senator Enzi posed. What would drive an employer to want one of these plans if there's a chance where they're not going to get any money back out of the plan at the end of their career? We talked about what happens if you're married and you've got a joint and survivor benefit, and those are guaranteed by ERISA. You could set up a 5-year or 10-year certain in life benefit, where if you die and you're not married, your estate would get 5 or 10 years worth of payments.

That could be designed into the plan. And if it's something that's really wanted by everybody, it could be mandated by ERISA in some fashion. It's certainly something that could be taken care of in today's plan designs.

Senator ENZI. I'd say that I really appreciate your concern over the PBGC premiums and what that does on medium and smaller companies, because the new higher fees that companies have to pay actually cost more than the actuarial statement that those people would have to do. So they're actually paying in more than what it would take to guarantee the benefit that they're offering.

Most people don't realize that that's really not going into the PBGC trust fund. That's actually going to the highway trust fund now to build the next 2 years worth of highways over the next 10 years worth of PBGC funds, and we all ought to be pretty concerned about that.

Ms. FRIEDMAN. Well, I guess I'm next, and I'll talk about the small business stuff. Before I get there, I just want to respond to one point that Aliya made. And, yes, we have a universal social security system, and the Pension Rights Center and Retirement USA believe that we have to both preserve and strengthen social security. But we have to keep in mind that social security right now is only averaging about $14,000 for the typical retiree. So we would say that everyone does need a pension. That's what this long table roundtable is about today.

Getting to why would small businesses like Jim—what could inspire them to set up plans, and how do we make it easier for small businesses? For 7 years, from 2001 to 2007, I coordinated something called the Conversation on Coverage, which was a common ground dialog, which brought together experts from business, unions, retiree groups, and others to discuss ways of increasing pensions for low-wage workers. And, particularly, we focused on those low-wage workers in small businesses.

I want to share with you today—and some of the folks here actually were part of that common ground dialog. I want to share what we learned. Jim said a lot of this, but we heard that small businesses would be much more likely to start a plan if administrative costs were eliminated or reduced and complexities and fiduciary responsibilities were reduced.

Jim, I want to say that you say, “Well, I’m not an expert.” You’re not supposed to be an expert. Even for those of us who do pension stuff every day, it’s enough to make everybody’s head explode. So small businesses should not have to be doing that.

The Conversation on Coverage developed two plans with small businesses in mind that I want to bring to your attention today. One is called the Model T plan, and it’s a simplified multiple employer plan with automatic enrollment.

Senator Enzi, I know that you have a very strong interest in new multiple employer arrangements. So I’d be happy to talk to you and your staff more about the findings of that particular multiple employer plan.

We also learned that there may be ways of structuring defined benefit plans to make them easier to be adopted by small businesses. The Conversation on Coverage developed something called the Plain Old Pension Plan, or POPP, which provides a straightforward career average defined benefit. The one part of it that really appeals to employers is that it would have predictable employer funding. As Rich pointed out, that’s one of the biggest concerns employers have in adopting defined benefit plans.

Also, Senator Harkin, the structure you developed for the USA Retirement Funds is consistent with addressing many of the concerns of small businesses, because your retirement fund proposal would be run by financial institutions. It would take the burden off of small businesses, and all businesses would have to do under your proposal would basically be to provide a modest contribution. Then they’re free, and then employees would be automatically enrolled unless they opt out. So it would seem that your type of plan, your proposal, would be highly appealing to both small businesses and their employees.

Now, I wanted to raise one concern as we’re talking about small businesses and, particularly, new forms of multiple employer plans and others, which I learned from both the Conversation on Coverage and R–USA. That is that under current law, the fiduciary issue is something that we hear over and over again from the small business community, that it’s a real burden. What that means is that employers have the fiduciary responsibility of choosing a plan provider and also monitoring the investments, which is a lot, like Jim was saying, for a small business to do.

But we just have to keep in mind that relieving employers of those responsibilities raises a lot of complex issues and also possible conflicts of interest. So the Pension Rights Center feels that it’s very important if new arrangements transfer fiduciary duties on to third parties, there has to be effective government regulation, because without really strong regulation oversight, there’s room for enormous amounts of self-dealing and other conflicts of interest. We saw that recently with Matthew Hutcheson, who many of you may remember as the fiduciary that used to come and testify a lot before Congress about 401(k) fees. And it turns out that he was indicted as an independent fiduciary for embezzling.

But I want to end by saying that since small businesses represent the fastest growing employment sector in the economy, finding creative ways to encourage employers to provide secure benefits is of paramount importance. So, again, I encourage the discussions that we're having today and applaud you for your proposal and applaud you, Senator Enzi, for looking at these new multiple employer arrangements.

The CHAIRMAN. Mr. Adler.

Mr. ADLER. Thank you, Senator Harkin.

The CHAIRMAN. Again, to refresh, what we're talking about is how to make it easier for employers, especially small employers, to have pension systems.

Mr. ADLER. Right. I think one of the keys—and this is part of your proposal—is that we're not looking here to replace the current system, because the current system does work for the one in five that have a defined benefit plan by and large. What we want to do is supplement it for those who do not have access to an adequate and secure lifetime stream of income. So we want to allow for the continuation of the voluntary system, but we want to supplement it with a system that then includes everybody who is not covered by the current system. Almost half of American workers are not covered by an employer-sponsored retirement plan today. I believe the current number is approximately 46 percent.

The CHAIRMAN. Are covered by a——

Mr. ADLER. Are not covered.

The CHAIRMAN. Not covered.

Mr. ADLER. Do not have access to an employer-sponsored retirement plan. That's an awful lot of the American workforce that are not covered. That's who we need to address.

The CHAIRMAN. Do they have access to a 401(k)?

Mr. ADLER. No, they do not have access to a 401(k). What they could do is create their own IRA, because anybody can do that. But they don't have access to a plan at work whereby they can put pretax contributions, whether or not matched by their employer, into a retirement savings plan—46 percent. Again, as you pointed out, of the, let's say—I think the 46 percent is the right number. Does that sound about right? It's higher? What is the right number, David?

Mr. MADLAND. I'd have to look at my notes. But it's more than half who do not have any sort of retirement plan at work—more than half.

Mr. ADLER. I understated the problem. It's clearly a significant problem. I think the reason we're here today is because there is a crisis, and the current system is not adequate. And, yes, we do have social security, but, as Karen pointed out, the average social security benefit is not enough to allow workers to maintain their standard of living and do what Senator Enzi talked about, allowing workers to do all the things they didn't have time to do during their work lives when they retire and live out their retirement.

I think one of the things that we need to do to enable employers and to encourage employers to participate is create safe harbors for them. In some ways, I think that's what Karen was talking about—a safe harbor whereby if they choose a third-party provider who meets government established criteria, then they have taken care of their fiduciary responsibility, instead of having to do this ongoing monitoring and so on, because I think that's a huge burden for small businesses.

If the Department of Labor could say, "OK. If you meet this checklist of criteria, then you are an acceptable provider under ERISA of a retirement plan," then the small business is off the hook, as long as you pick one of those providers. I think under your USA Retirement Funds plan, what would happen is that those financial institutions that offer these funds would have to meet the criteria that are established by the law and implemented, I assume, by the Department of Labor under ERISA in order to offer those funds, and then the employer is off the hook, just writes the check, and you're set. I think that's the kind of thing that small businesses are looking for, that safe harbor, so they don't have this ongoing fiduciary burden and regulatory burden in order to provide their employees with a retirement plan.

Let me just make a couple of other comments. I agree with those who have said that the contributions need to be predictable and stable. We've had a terrible time, really since the financial crisis in 2008, in convincing new employers to participate in the Taft-Hartley multi-employer plans that our union sponsors. The reason is that, first of all, contribution rates have skyrocketed because of the decline in both interest rates and the investment values of the funds. As a result of PPA, these plans, most of which had to go into the red zone, had to do these rehabilitation plans, and they're just extremely costly. So new employers want nothing to do with that.

Then we have the problem with withdrawal liability, which is the problem that Mr. Hudson referred to, where you have these orphaned employees from employers that have withdrawn from the fund, generally, because they went out of business, which makes it extremely difficult for new employers. Historically, we have been able to get new employers into our funds on a regular basis. Since 2008, it's impossible. So for the last 4 years, virtually no new employers are coming into any of these multi-employer funds.

The last point I wanted to make is I do have a concern about Ms. Breen-Held's proposal that I think she's stated twice now about increasing compensation limits. My concern would be that if you're talking about increasing contribution limits and the amount of tax deductible contributions that you could put into a tax-favored retirement savings plan in order to entice the executives, which is essentially what you're talking about, to create or participate in these plans so they can put more of their money in, what you're really talking about is increasing the tax subsidy for those wealthier income earners to participate in the system.

The truth is they do not need more tax subsidy, and I don't believe that we can afford a greater tax subsidy for upper income earners to save for retirement. They're going to save for retirement anyway. It's the middle and lower income workers who need help saving for retirement, not the upper income earners. I would really caution against any system that would increase the tax subsidy for those upper income earners.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Adler.

Mr. Biggs.

Mr. BIGGS. Thanks. I just have a series of short comments on what's come before, which I think hit on some points that I personally find interesting or important. First, on pension coverage, I don't want to sound Pollyannaish, as if everything is OK. But I think the figures that Mr. Adler and Mr. Madland used in terms of the percentage of people who are offered employer-sponsored pensions—I think those come from the current population survey and they're self-reported. Often, people are not very good at describing what they're offered at work.

There is research that came out a year or two ago from the Social Security Administration where they matched individuals' tax records to see if there was in fact, from the tax record, an employer-sponsored pension. I think the coverage rates were about 10 percentage points higher than that.

And, second, there's other research that came out from the Investment Company Institute, again, several years ago, that looked at the people who are not covered by pensions. And by and large, these were the people you would expect not to be covered. They are people who are either young, and those are folks who, in general—economic theory tells you they should not be focusing on retirement savings at that point. They should be focusing on paying off students loans and things like that. But it's also low-income people who can predominately expect to get retirement income from social security.

I'm not saying there aren't issues. But at the same time, if we think there's a crisis, often, it spurs action that we may later regret.

Second, Ms. Breen-Held had some comments on the volatility or the countercyclical nature of pension funding. I agree with her that you don't want a situation where you're forcing employers to pay more into pensions when times are bad and less when times are good. Ideally, you want to flip it around, and when times are flush, then they pay more in.

At the same time, though, I think—she had some other comments in terms of interest rate volatility, thinking about how we've dealt with the pension discount rate in the highway bill. The key point I want to make here is if you want to fund a guaranteed benefit for somebody in the future, it is, in fact, more expensive to do it in a low-interest rate environment. If I'm promising you a guaranteed benefit 30 years from now, the best estimate of the cost of that would be the yield on 30-year treasuries.

Looking back 25 years, in order, in my mind, to artificially generate a higher discount rate—in my initial statements, I talked about financial transparency using market-based measures. Going back to the past to dig up interest rates when the market gives you a perfectly good discount rate today is something I find a little troubling.

Finally—and this goes back to Senator Enzi's initial discussions about how payouts may be handled from defined benefit pensions. A point that I made and others made is there's enormous efficiencies from annuitization, because they offer you a guaranteed benefit that lasts as long as you live. That's really helpful in terms of retirement planning. But the way that efficiency comes is it offers you a guaranteed benefit as long as you live, not beyond where you live.

Yes, you can offer what's called a period-certain annuity, which may offer 10 years of guaranteed payments, and then sort of a life annuity thereafter. But in doing that, you're unwinding the annuity. You're raising the cost of providing a benefit. You're taking away from the efficiencies that the annuity provides.

The ideal way to think about this is if you're concerned about leaving money for your heirs, you have essentially two pools of money. You have your retirement savings, which are fully annuitized, and by fully annuitizing it, you are providing a guaranteed income in the cheapest possible way. Then you have money you set aside in a separate pool that you want to leave for your kids. When we try to combine these things, I think it's not necessarily the most efficient way to do either of those things.

So people want to have all of this. But the efficiency of the annuity is that once you die, the benefit stops. So by using that savings, they can help the people who might live to 95 or 100 and help keep them out of poverty in older age.

The CHAIRMAN. You know, the more I've gotten into this over the last couple of years in looking at this, I really agree with what you just said, Mr. Biggs, that we're trying to combine two different things here. And to a certain extent, the way I see it, when you provide for this kind of an annuity through contributions early on, it's almost like an insurance plan.

Mr. BIGGS. An annuity is an insurance product. It's not an investment product.

The CHAIRMAN. It is an insurance product. I've always said it's like when I buy car insurance. I've been buying car insurance for most of my life, obviously, and I've never had a wreck. Why shouldn't I get my money back? Well, because that's the nature of insurance. So I think we have to start thinking about it in that context of being an insurance policy rather than some kind of a savings account where you put away and then you can leave it to whoever you want. It's insuring that no matter how long you live, you're going to get some monthly stipend—simple.

Mr. BIGGS. If I could make one final point on annuities, almost all of us have made some statement of the benefits of a life-long income and the efficiencies that come from annuities. Economists love annuities. Everybody but economists hates annuities. I mean, honestly, people given the chance to annuitize won't do it. People in defined benefit plans, if you offer them a lump sum payment, they'll take it.

The CHAIRMAN. Of course.

Mr. BIGGS. In the policy arena and the practicality of doing things, that's a legitimate problem or a threshold you have to meet of how you convince people to accept something, which we have very good reason to believe is very good for them, but which, for whatever reason, they don't like. I mean, the joke about annuities is it takes a person who is a millionaire and turns them into somebody with a $50,000 a year income. That's sort of the—if you have a large premium, and you get a smaller monthly or annual payment, people can't do the math. They don't like this stuff.

That's the thing that I think is from your perspective of how you talk to people and convince them in the matter. So that's one of the ways that some of the research finds, that instead of focusing on "Well, what if I die young, and I may lose out?", think of it in terms of insurance and saying, "Well, when I'm 65, things may look good.

When I'm 75 or 85 or 95, I want to make sure I have that money there." So framing the question in that sense of protecting you and giving you money at the times when you need the money the most may be the way of getting around those hurdles.

Senator FRANKEN. Mr. Chairman.

The CHAIRMAN. Yes.

Senator FRANKEN. I, unfortunately, have to go. But I was on the Special Committee on Aging, and we had a hearing on annuities. The thing I was really surprised to hear was that most Americans underestimate how long they will live. I always felt that people—maybe that's because I've been young most of my life until recently.

[Laughter.]

But I always thought that most Americans would overestimate how long they would live. That's not the case. Most Americans underestimate how long they'll live. That speaks, again, to the problem of getting people to want to do annuities.

Mr. BIGGS. If you have a married couple—if I were not recovering from a cold, I could pull these statistics out of my head. But if you've got a married couple, you have a very good chance that at least one member of the couple is going to survive to age 85—not 85, but 95. People think about their life expectancy by the average. But there's going to be people who die before the average and people who die well beyond the average. There's a lot of people who survive to 90, 95, and 100. Those are the folks who really have worries, because at that age, you can't go back into the workforce again.

The CHAIRMAN. Mr. Madland, unless you had something, Ms. Breen-Held wanted to interject something here. Go ahead.

Ms. BREEN-HELD. I just wanted to reply while the remarks were still fresh to Mr. Adler's comment that we don't want to increase the tax subsidy for the highly paid because they'll get paid somehow. They'll take care of their retirement. I don't disagree with that at all. What my proposal was is to use the carrot so that they get paid inside of a qualified plan, because the rules are structured right now so that benefits that they get have to be balanced by benefits for the rank-and-file, so that it's actually a protection for those people.

In terms of what I've observed, when you have a CFO sitting there who has a very small stake or no stake at all in a defined benefit plan, those are the people who are looking for reasons to get rid of it. If that same person has a respectable benefit within that qualified plan, they're looking for reasons to keep it. And as your question was: How do I make plans more attractive to employers?, it seemed to answer the question.

The CHAIRMAN. Thank you very much.

Mr. Madland.

Mr. MADLAND. Thank you. The question, I think, posed is sort of: Would reducing risk and complexity encourage more employers to provide a pension-like benefit? I think there's no doubt that that's true. Employers have been shifting away from defined benefit plans for many reasons, including complexity. As was previously said, I think the central issue is the volatility. The unpredictable nature of payments and the risk that employers bear has meant that their company's profitability can be determined more by the pension rather than by the business. That's not a situation that many employers have wanted to be in.

So shifting away from that risk and complexity has been something employers have wanted to do. The central issue, though, is they've shifted that risk and complexity onto workers and added new risk and complexity onto workers. The kinds of proposals that, Senator Harkin, you have proposed and the Center for American Progress is proposing are to try to minimize the risk and complexity for employers so that they have strong incentive and ability to offer plans, while also minimizing the risk and complexity for workers.

Hybrid models can do that very well. I think that also will be especially attractive to employers, because what they will have is then a similar risk and complexity profile to a 401(k), but they will be providing a much better retirement plan to their workers. That's attractive, so that they know their workers have a good chance of retirement.

The CHAIRMAN. So we've covered the first question, which was sort of the broad view of what the plans in the future should look like. I asked you what businesses need. I thought we had a very good discussion on what businesses need.

What do workers need? What is it that workers need to—like you said, maybe they have to realize that they're actually going to die someday. I don't know. What do you do to entice workers?

I'll start with you, Mr. Davis.

Mr. DAVIS. Employees want a pension system that provides a supplement to their monthly income. Employees want peace of mind that comes from knowing that assets are safe and secure. Employees need reassurance that measures have been taken to prevent the reoccurrence of the financial meltdown of 2008.

Individuals should not be left to fend for themselves. No matter how capable that individual may be in their particular occupation, they don't have the ability to make these complex financial decisions. Employees should match the percentage contributed by their employer. And, finally, studies show that the happiest people are those that have good pensions.

The CHAIRMAN. That's really a study that was done? I can see the peace of mind, yes. Again, that's a good list to start from. Thank you.

Ms. Friedman—well, we'll just go down the line.

Ms. Wong, go ahead.

Ms. WONG. Thank you. If you'll bear with me a minute, I just want to make one point, that an employer's fiscal resources are like a pie, and each slice goes to different pieces—salaries, business investment, cost of administrative requirements. Then if anything is left over, there's benefits that it goes into. So as we're looking at mandating benefits, that pie doesn't grow. The slices just change. So we do run the risk that, if that slice for benefits increases, then it necessarily eats into things like salaries and business investment.

I bring this up, because if we talk about what employees need for a secure retirement, I would absolutely say that an employer-provided pension plan contributes to that. What a participant needs to have an employer-provided pension plan is an employer.

The real tension is making sure that we don't, in the pursuit of trying to find options that are perfect and have all the bells and whistles, drive people out of the workforce.

Having said that, for those that do have an employer-provided plan, I think what they need, again, is flexibility and innovation, at the risk of sounding like a broken record. People are living longer, and the concept of retirement is changing, and I think the retirement plans have to keep up with that. I have a number of different ideas that the Chamber has proposed, starting with phased retirement, looking at employees that don't necessarily want to leave the workforce and employers who don't want those employees to leave the workforce, and having flexibility in those programs to allow them to stay in the workforce as long as possible and maybe at the same time still collecting a pension so they can supplement their salary at the same time.

Encouraging additional distribution options—as Mr. Hudson talked about, the financial companies, insurance companies, are coming out with great products that can really be used to vary the way that people can get their retirement assets and use them long-term.

The CHAIRMAN. But that gets so complex, though. You get into all these different things. I was just looking at mine, and I don't get it. I mean, look at all the different plans. You can invest in high risk, medium risk, low risk, this, that, this, that. I don't even feel qualified to make those decisions. How does any worker out there know how to do that? I just think, when you get all these different things, it just becomes so complex.

Mr. Davis.

Mr. DAVIS. That's because somebody can sit down and measure your risk tolerance. They can ask a series of questions and put you on a scale from one to five that will show what risk tolerance you'd like to have.

Ms. WONG. I do think the financial companies have done a good job of trying to simplify these products in terms of explaining them. There's still more work to be done. Again, we can go further along that way. But I don't think we want to discourage them from coming out with these products that do respond to the different needs of the workforce and participants.

And, finally, I think allowing employers to offer different products either through retirement plans or using retirement savings, for example, retiree healthcare, long-term care insurance, longevity insurance—these are things that 401(k) assets can be used to either purchase, so they're done on a pre-tax basis, or done through cafeteria plans.

The CHAIRMAN. Thank you very much.

Ms. Breen-Held, what do workers need?

Ms. BREEN-HELD. Workers need the plan to be there.

The CHAIRMAN. I'm sorry?

Ms. BREEN-HELD. They need the defined benefit plan to be there. It's a simple answer. Not frozen, not terminated—they need the plan to be there. It's the fundamental way to provide that foundation benefit that's part of this three-legged stool that we talk about. How you do that comes back to recognizing this combination of employer and employee issues.

As well as the things I've already said, I would agree with Mr. Hudson. We need to assure that government agencies provide clear and timely guidance, and that's not just on letters for individual plans, but also as Congress passes new laws, so it can allow the sponsors to move forward with confidence to design and operate their plans. And I'll note that the committee has provided influence that's been invaluable in the past, and we very much appreciate that. But that is an area that continues to need attention.

Second, I would agree with Mr. Biggs that employees need to understand and value that lifetime annuity concept that comes out of these plans. If they understand the plans, they appreciate the plans. You can ask any 50-year-old with a pension plan if they like it or not, and they will know what you're talking about, and they will know what they're going to get out of it. It's not the same answer when you're 25 or 30, although there are signs that that's changing.

If they appreciate it, that provides that retention for the business owner. That gives them that business reason to sponsor the plan, because at the root of this, they're in business to run their business. They're not in business to provide the pension plan. That's an extra that they voluntarily provide. They need to have a reason to justify maintaining it for their employees, and that may be retention, that may be hiring.

There are signs—I saw a headline that I was excited about not too long ago that younger workers are starting to base job decisions on availability of defined benefit plans. I think that's—honest to goodness. I saw it in the press. It must be true.

[Laughter.]

I have a daughter who just entered the workforce and said to me, "Mom, they've got a retirement program." She was so excited, and I was so proud. Anyway, that's an aside. But we're starting to see that resurge a little bit. They're starting to see the value of that guaranteed benefit, as opposed to something where they're taking the risk on their own.

And, third, I would echo Ms. Wong's comments—employee flexibility on when and how to begin their defined benefit pension benefit. I'm not talking about leakage of money in advance of retirement age. I'm talking about people who, as they are approaching the end of their career, want to begin to phase down their hours but financially can't do it. So allowing them—giving them rules that will enable them to draw a portion as they phase into retirement in a defined benefit plan.

I think those three things will allow us to provide employees benefits from a defined benefit plan into the future.

The CHAIRMAN. Good. Thank you.

Mr. Hudson.

Mr. HUDSON. Thank you. I think she's been reading some of my notes here.

[Laughter.]

The CHAIRMAN. Just a second.

Senator Enzi.

Senator ENZI. Can I interrupt here for a minute, because I'm going to have to go give a speech to a bunch of small business men in just a few minutes. I'll incorporate some of the ideas that you've passed out here.

One of the things we're lacking in this country is financial literacy. This is one way of providing some of it. But there's too much of a feeling, as Ms. Breen-Held mentioned, that people aren't really in business to provide benefits. They provide benefits so they can have workers. But we're going to have to do some more on financial literacy.

I appreciate the comments on testing. I'm an accountant. I used to do testing for companies, where I looked at their different plans. I was fascinated to find out that the same form had to be filled out for health insurance provided to employees as was done for pension benefits to employees. And I've got to tell you, the questions are the same for both, but the answers are totally different.

They provide you—well, no, you buy a manual—it's about that thick—to explain how to answer the questions which are really not the right questions for what you're answering. As long as that's one of the things out there for small businesses, they're not going to do plans. So your idea of getting the administration handled somewhere else is an excellent idea, and I think there's a lot of room to work on it.

I appreciate all the ideas that have been given to us today. I just regret that I can't stay to hear some more of them. But we'll submit some questions in writing, too, that I hope you'll answer based on what we've learned here already.

Thank you.

The CHAIRMAN. Thank you, Senator Enzi. This will be the final question anyway, because we all have to leave. But thank you very much, Senator Enzi.

Mr. Hudson.

Mr. HUDSON. The primary thing that participants need is a secure income, to know what they're going to get every month, a defined benefit annuity. In a defined contribution plan, participants don't know what they're finally going to get at retirement until they retire. They don't understand the annuity value of it.

The plan that we had redesigned for a group up in Boston—the issue they faced was they had a defined contribution plan, and they had an 80 percent opt out rate. So 80 percent of the people decided that they couldn't contribute to the defined contribution plan, so they didn't get any type of benefit from the plan. So we've replaced the DC plan with a defined benefit plan.

That's counterintuitive against the rest of the world, I know, but now they get 100 percent coverage and an affordable, reasonable benefit that will be there for the participants. So, first and foremost, they need to have at least some clue as to what they're looking for at retirement.

The CHAIRMAN. Repeat that again. You had a defined contribution plan, and you said—but was it automatic enrollment?

Mr. HUDSON. No.

The CHAIRMAN. No. They had to opt in.

Mr. HUDSON. Right.

The CHAIRMAN. You said 80 percent did not opt in.

Mr. HUDSON. Right.

The CHAIRMAN. But you changed to a defined benefit, and you had more of an opt-in.

Mr. HUDSON. Well, there's no opt-in. A defined benefit just automatically covers everybody.

The CHAIRMAN. Automatically covers.

Mr. HUDSON. So that auto election—there's no more election. It's just auto coverage.

The CHAIRMAN. One of the things I've proffered in the plan that I've proposed was an automatic enrollment, but with an opt-out, because we have some data to show that automatic enrollment is basically supported by people, and if you have that—I don't know—the figure was very low, but how many actually opt out later. But if you have just the reverse of opting in, then people don't do that. That's why I had suggested we have an automatic enrollment, but with an opt-out, which continues that one aspect of a 401(k) voluntary type of situation.

Mr. HUDSON. Right. Another issue that was just stated is participants do need the plan to be there when they retire. I'll state it again. If the plan's cost is extremely volatile from year to year, there's a much more likelihood that the plan sponsor will shut the plan down, freeze it, and switch to a defined contribution plan. If they do that in the middle of a person's working career, that person worked for maybe 20 years from hire until now, getting the low-defined benefit plan accruals in the hope to get that promise of higher accruals later in their career.

If they shut the plan down and move to a defined contribution plan, they've now worked a career in a plan where they got the low DB accruals and they got the low DC accruals. They're not going to be able to retire.

Your statement earlier about, all this is about insurance—that's a true statement. The largest corporations in America who have pension plans that have been around for 30, 50, 100 years—those are some of the largest insurance companies in America. They just don't know it.

What we're showing them is in the plan design phase, we show them what that insurance or maturity risk is at the tail end of a person's working career. We make sure it's accounted for up front in the plan design and that the plan benefits factor all of that into consideration. So that's how we can stabilize the ongoing cost of the defined benefit plan.

Then the idea of, you pay your car insurance for many, many years. Why don't you get your premiums back if you don't have an accident? That goes back to my statement about the PBGC. If we design a plan where we'll never have to go to the PBGC, or very likely won't have to go there, then why do we pay double PBGC premiums?

The CHAIRMAN. Very true.

Ms. Friedman.

Ms. FRIEDMAN. Well, we're talking about what employees need from a pension. Let me start by saying that public opinion polls are reflecting that a majority of Americans have mounting anxiety about retirement. In fact, in a recent Gallup poll, the top financial concern for most Americans was not having enough money for retirement, which surpassed concerns about paying for healthcare and paying the mortgage.

So, Susan, your daughter's concerns are real and reflected in public opinion polls.

Senator Harkin, you started your statement today by talking about a home healthcare worker making a small hourly wage. We hear from those people all the time. These are people who either don't have enough in their retirement plans, if they have one, but, as John and David said, about half of Americans don't have any retirement savings plan at all. What employees want is income that is sufficient to supplement social security and that will enable them to live with dignity and lead productive lives.

So I'll go back to what I said earlier. What they need is a vehicle where both employers and employees contribute. If they're lower income, contributions are subsidized by the government. The money should be pooled and professionally managed to minimize costs and financial risks. Of course, everybody is in favor of financial education, but if the money is pooled and professionally invested, then the kinds of issues you were pointing out aren't really necessary, because individuals typically don't have either the education, experience, or even the desire to be managing their own portfolio.

The savings in a retirement plan should be locked in until retirement or for disability and should be paid over the lifetime of an employee and their spouse or life partner, which goes back to the concerns that were raised earlier. It would be desirable to have a modest guaranteed base benefit. From our perspective, having a retirement plan is part of the American dream. What employees want is to be able to continue to know that they can take care of themselves and take care of their families and also contribute to society. So that, I think, sums it up.

The CHAIRMAN. Thank you. One of the things, also, that I'm thinking about is if you have a plan similar to what a lot of you are talking about and we've talked about, then it would seem to me that at any point along that line, you would know, as a worker, if you never contributed another cent, here's what your annuity is going to be. So every year that you work, or every 5 years, you would see how much your annuity would be growing. Compound interest is a wonderful thing, right, over a long period of time, maybe not if you get out early.

Is that also a benefit to a worker?

Ms. FRIEDMAN. Oh, absolutely, I mean, just so that they know. We're long-time advocates of people being able to see what their lump sum buys as an annuity. We've supported the legislation for that, and we would encourage Congress to push that forward. I think people need to know how much money—when they have money in their account now, what it's going to buy them.

The CHAIRMAN. Mr. Hudson.

Mr. HUDSON. I just want to make one comment about that. If you look at your statement today, and you take your 401(k) plan balance or a savings account, and you price it out, and you determine what that annuity will buy today—if you do that a year later, even if you've earned 10 percent on your money, it might buy a less annuity, because the underlying interest rates have changed. So it goes up and down, and you're never really quite sure what it's going to be. I just wanted to make sure that was clear.

Ms. FRIEDMAN. Just another thing, and I'll pass it over to John. But just another thing with annuities—right now, if you're buying an annuity on an open market and it's not in a plan, women have to pay more, because, in general, they live longer and so they're charged against that. It's very difficult for people to know how much that annuity is going to be. So we're big advocates for transparency in that and making sure that there's low-cost and transparent annuities. We'd be happy to work with Principal on that.

The CHAIRMAN. Mr. Adler.

Mr. ADLER. What I think we need to focus on—there's been a lot of discussion here about what we need to do to make sure workers maintain their defined benefit plan and so on. I do think we need to focus on this very, very large group—and we can have academic debates about what the statistics actually are—but the large group of workers who have no pension other than social security.

SEIU has 2.1 million members, and 35 percent of them, over 700,000, have no retirement plan at work. These are low wage——

The CHAIRMAN. These are like the home healthcare workers and people like that.

Mr. ADLER. Home healthcare workers, janitors, childcare workers, security officers, this type of worker. They're low-wage workers. They're living paycheck to paycheck. Their employer does not offer a retirement plan. And, truthfully, even some who are with an employer where there's a defined contribution plan feel like they can't afford to put money into it. It's like your 80 percent opt-out rate.

For example, for many of our members who work in nursing homes, nursing home chains often offer a 401(k) plan. But if you're a nursing attendant and you're earning $11 or $12 an hour, you feel like you don't—and most of them don't—have the ability to take a portion of that and put it into a 401(k). What we need is a plan that works for those workers.

I believe another critical element here—and we talked earlier about younger workers and their lack of interest and younger workers needing to pay off their student loans and so on. First of all, a lot of our members don't have student loans because they didn't go to college. But the truth is the dollar you put into a retirement account when you're 22 years old will go a long way toward funding your retirement when you're in your 60's, much further, obviously, than the dollar you put in when you're 50 years old.

If we can create a system that enables employees and their employers to contribute on their behalf in their 20s throughout their working life, we're going to have a much better funded system. That's why I appreciate the universality of the USA Retirement Fund proposal in conjunction with the existing private voluntary system, not to replace it, but to supplement it for those who don't have access to a retirement plan at work.

I think we need that if we're going to address the problem of employees who have no access to a retirement plan at work for either all or part of their working lives. And, obviously, in the 21st century, where people do change jobs frequently, sometimes you have a plan and sometimes you don't. For those workers, it's not all or nothing, generally, and so you want to be able to have access to this plan so that contributions are being made consistently throughout your working life so that when you retire, there will be enough money there to generate the kind of annuity that will enable you to maintain your standard living.

The CHAIRMAN. One of the things that we touched on very briefly in the plan that we've proposed—but we haven't really flushed it all out—is this very aspect of low-income workers. There's a government program now where the government matches a dollar for a dollar type thing.

Mr. ADLER. The saver's credit.

The CHAIRMAN. The saver's credit, something like that, for low income, where if you put in something, then your employer puts in something, and then the government comes in and puts in something, sort of like the saver's credit. The only way you'll get that back is through some type of an annuity later on. You won't be able to take it out or something early on. Does that make sense?

Mr. ADLER. I think that's a terrific concept that needs to be expanded, because the truth is, it's quite low right now, and it phases out at a very, very low-income level. So even somebody who earns $28,000 a year earns too much to qualify for the saver's credit.

The CHAIRMAN. It's about 150 percent of poverty or something like that, which is very low.

Mr. ADLER. Yes, which is about $24,000.

The CHAIRMAN. Something like that.

Mr. ADLER. Yes.

The CHAIRMAN. But I hope that as we move ahead, I hope you'll help think about this idea of a matching part for the government to put in for low-income workers for annuities.

Mr. ADLER. Absolutely. It's extremely important, I think, and in the form of a tax credit, refundable tax credit.

The CHAIRMAN. Refundable or something, yes. And they don't pay taxes, so how do you get a tax——

Mr. ADLER. Exactly, refundable tax credit.

The CHAIRMAN. Mr. Biggs.

Mr. BIGGS. Rather than go through a list, which I had much of before, maybe I'll focus on this last point that you and Mr. Adler were discussing, because I think it's very important, particularly, when you're thinking about low-wage, low-income workers. One of the points Ms. Wong made earlier is the compensation paid to employees is essentially a fixed amount. Labor economics says that amount is based on what we call the marginal product of the worker, essentially the productivity of the worker.

You can shift income or you can shift the forms of compensation. You can say, "Well, you're going to get more pensions, but that might mean you're going to get less in healthcare, less in wages." It's like the toothpaste tube effect there. If you're concerned about folks who are really living paycheck to paycheck, it might be good for them to have a pension. But the problem is that's going to squeeze them on their actual paychecks. That's going to make it tougher, because we can't simply create money out of nowhere.

Two policy points come from that. First is you want to focus on making pensions low-cost, focus on making them efficient, because the costs that you think are being borne by the employer are actually going to be borne by the employee in some way, shape, or form. They're going to be shifted back to the employee, because that's just how the labor market works.

The second point—and I think this is a point that you both hit on—is that if you want to supplement low-income workers—and that may be where things like the saver's credit come in, where you say, "Look, their total compensation is a function of their productivity. We think as a social goal, they should get more money that they can put away for retirement," then that's something like the saver's credit or some other governmental policy can do. You're not going to squeeze too much more out of the employer on that end.

So I think there are two main focuses. Keep costs low and think about the government's role in terms of supplementing low earners, because that's just going to be tough to get out of the employers.

The CHAIRMAN. Mr. Madland.

Mr. MADLAND. Thank you. To follow on to Andrew's point about low cost—and I want to highlight that I might think about it in a slightly different way, although I think there's a decent amount of agreement about how we would think about low cost. I'll get to that point in a second. But I started off the testimony saying that all retirement plans involve a tradeoff between cost and risk and adequacy. What workers need is a plan that is good at managing those tradeoffs, that reduces cost, reduces risk, so that they're likely to have a secure retirement.

The collective defined contribution plan that CAP has proposed and your proposal, I think, are very good at managing cost and risk. I want to highlight the features in them that are so good and sort of what they do and why they work—professional money management, long-time horizons, and the ability to spread risk across multiple generations. These features should be a central part of the retirement plan of the future, because they are much more cost-effective and much less risky for an individual than a 401(k) kind of plan.

The thing about professional money management—that significantly reduces cost because you get much better returns. Professional money managers might not beat the market, but they're going to be diversified, stay in the market at the right time. They aren't going to make all the behavioral mistakes that individuals tend to make. Being able to invest over a long timeframe means you're going to have a balanced portfolio as a person ages, rather than get more conservative as you get closer to retirement, and that boosts your returns.

You also have low longevity risk from spreading risk across multiple generations and pooling this, so you can plan for the average life expectancy instead of a maximum life expectancy. All of those cost efficiencies are huge. The National Institute for Retirement Security estimates that those features reduce the cost of saving for adequate retirement by 46 percent, compared to a 401(k).

To put that in perspective, a person earning $50,000 the year before their retirement, age 65, that would reduce the cost that they would be contributing or their employer would be contributing by over $5,000 in the year before retirement and thousands more every year before. This is big money that's on the table from a more efficient plan design. That plan design also is much less risky for workers than the current 401(k) model.

The long timeframe—being able to invest over a much longer timeframe is much less risky. The worst performance over a 30-year period—you think that's a fairly long time period, but it's still an individual worker's kind of investment horizon. The worst performance for the Dow was basically no return over 30 years. But if you expand it to a 75-year period, you always get a good return. So this long-time horizon is big. It reduces the risk.

It also reduces the timing risk. If you're retiring—if you think about people who were trying to retire right around the Great Recession, they got hit with a huge, huge stock market risk. The estimates are that the near retiree with a 401(k) in the Great Recession lost 17 percent of their balance. Instead, this kind of pooling and long-time horizon significantly reduces those risks.

In the Netherlands, they have similar kinds of plans to what your proposal is or our proposal. The estimates are that they are around a 3 percent or 4 percent reduction in assets for people who are going to retire. So this hybrid kind of model can really ensure all workers have a cost-effective and secure plan. I think it needs to be a fundamental part of the retirement plan of the future.

The CHAIRMAN. Well, thank you very much. Our time has expired. I found this very enlightening, a very great discussion, with a lot of common threads, some differences.

I want to also say that all of your statements that you submitted will be made a part of the record in their entirety. I forgot to say that in the beginning.

The one last thing that came to my mind when Mr. Madland was talking about long-term horizons and balanced portfolios, is that this comes up a lot when we talk about taking money out of someone's paycheck to go to retirement. They say, "Well, I can barely get by right now and you're going to take some more money out."

But you have to look at it from another standpoint. I kind of mentioned this earlier. And that is that pension funds do create jobs. They do invest in new businesses. They're able, because of long-term horizons—if they invest money in a startup entrepreneurship, a business, and that business goes under, well, they lose. But they've got such a big pool. They can afford to do that.

They also do some of the best investments in long-term infrastructure projects. So this is jobs. I always call it win-win-win. You provide a savings stream for an annuity, or like a savings stream for a worker, so there's some savings. Second, you get money invested in growth industries and business in this country. And, third, you have some retirement security.

It seems to me it's kind of a win-win-win. I just keep wanting to point that out, that unlike social security, which, by law, can only invest in government securities—and there's a reason for that—this would be privately held. We're talking about private investments through professional managers that have these long horizons. It seems to me that really does invest in future growth of businesses and entrepreneurs in this country.

I think that's a benefit. A lot of times, we only look at the benefit of what about retirement? Well, how about the benefit to our economy overall from something like a mandatory plan—or not mandatory, but at least something which is automatic and we say you can opt out. But we know from data that most people, if they're automatically enrolled, tend to stay with it. If you start them young, very young, and they begin to see what that little bit is going to amount to when they're 65, well, that's pretty enticing.

I just wanted to point that out. But I think it has a present day economic benefit to our country, from how I see this, aside from a long-term benefit of secure retirements.

With that, I'll leave the record open for 10 days for any submittal of any other statements or questions.

I thank you all very much for your expertise, for being here today. I hope that I can count on all of you to continue to interact with our staff on both sides as we move ahead. As I've said before, obviously, we're not going to do anything this year. We're done here in a day or so. We'll come back for probably a lame duck session.

I really believe this committee is going to really push ahead on this next year and, I mean, very aggressively to come up with a pension system that will move us ahead in terms of some kind of a better retirement system. I don't have all the answers. But, as I said, I detected in everything I heard today these certain common threads coming through all this.

I said to Mike earlier, "We ought to get all this and put it on a matrix." Let's see where all the interconnectors are and where the outliers are and see how we kind of blend those to come up with something.

I thank you all again very much, and we'll look forward to working with you as we move ahead on this very, very critical issue, I think, for all Americans.

The committee will stand adjourned.

[Additional material follows.]

ADDITIONAL MATERIAL

RESPONSE BY DAVID MADLAND TO QUESTIONS OF THE HELP COMMITTEE

Thank you for inviting me here today to discuss pension modernization for the 21st century.

My name is David Madland and I'm the director of the American Worker Project at the Center for American Progress Action Fund.

I appreciate the opportunity to present my views on this important topic, a topic which I have been researching for some time. I wrote my dissertation about the decline of the private-sector defined-benefit pension system and have written extensively in academic and popular publications about retirement policy.

In my testimony I will address the three questions posed by this committee, which are focused on how to best improve the private retirement system, and leave discussion about Social Security for another time.

Social Security provides an essential baseline of income for retirees and must be strengthened to ensure that it continues to do so for generations to come, as the Center for American Progress has proposed.[1] But Social Security was never intended to be people's only source of income in retirement.

To maintain their standard of living in retirement, Americans depend upon accumulations in employer-sponsored retirement accounts—such as 401(k)'s and pensions—and, to a smaller degree, private savings.

Unfortunately, the private retirement system is failing too many Americans, something that is becoming abundantly clear as the first generation of workers to depend primarily on 401(k) plans—rather than the increasingly rare defined benefit pension—starts to retire.

The failures of the private retirement system could have troubling consequences. If we continue down the current path, many retirees will outlive their retirement savings, potentially saddling their children and the country with a burden that weighs down the economy and causes significant human suffering.

Question 1. Defined-benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined-benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. The pension system of the future should ensure all workers have a cost-effective and secure way to save so that Americans can maintain their standard of living in retirement and retire with dignity.

In designing a plan to meet these goals, I think it is essential to understand that all retirement plans involve tradeoffs between costs, risk, and retirement adequacy, and involve different choices about who bears these costs and risks—employers, employees, or taxpayers.

There is no getting around these tradeoffs—but there are better and worse ways to manage these tradeoffs.

Some retirement plans are simply better at managing these tradeoffs because of the way they are designed.

While 401(k)'s, the dominant defined-contribution retirement plan in the current system, have worked well for some workers, in general they do not do a particularly good job at managing these tradeoffs. 401(k)'s have relatively low risks and costs for employers, but for workers the costs and risks are quite high, such as excessive fees, the potential for significant loss of assets due to drops in the stock market, and the likelihood of outliving assets.[2]

As a result, 401(k)'s have proven unable to provide adequate retirement security for most workers. Indeed, the typical near-retirement age worker with a 401(k) has only accumulated enough money to provide a monthly payment of about $575 in retirement.[3] To make matters worse, less than half of all workers even have a retirement plan at work, and that figure has been declining over the past few decades as 401(k)'s have supplanted define benefit pensions.[4]

To create the retirement system of the future, we should learn from these challenges. All workers should have access to a high-quality retirement plan that will help create a secure retirement.

The USA Retirement Funds plan that Senator Tom Harkin (D–IA) proposed in his July report entitled "The Retirement Crisis and a Plan to Solve It" builds upon the lessons we have learned from the weaknesses of the current retirement system and is a good place to start building a modern retirement system because it manages the cost, risk, and adequacy tradeoffs quite well.[5]

Indeed USA Retirement Funds share much in common with the new retirement plan proposal from the Center for American Progress, called collective defined contribution plans—details of which are being released today in a new issue brief.[6]

Both the USA Retirement Funds and collective defined contribution plans are hybrid-type plans that combine elements of a traditional pension—such as regular payments in retirement, professional management, pooled investing, and risk sharing across generations—with elements of a 401(k)—such as predictable costs for employers and portability for workers.

This hybrid approach should be a core part of our future pension system because its features are less costly and less risky than a 401(k). Indeed, retirement plans that have the core features of these hybrid models—professional money management, long investment time horizons, and the ability to spread risks across multiple generations—are estimated to cost about half as much to provide an adequate retirement benefit, while exposing participants to much lower levels of risk than a 401(k).[7]

In subsequent answers I will elaborate more on the advantages of these features and explain why they should be part of the retirement system of the future.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. Reducing employers' risk and plan complexity would make it easier and more attractive for businesses to provide their employees with a pension benefit.

Employers have been shifting away from traditional defined-benefit pension plans for a number of reasons, including plan complexity, regulatory changes, and reduced inflation, but a central factor in the shift has been the volatility of pension funding.[8] Some employers have been willing to bear this volatility, but for most employers the risk that additional contributions may be required—especially during tough economic times when money is tight—has been a significant disincentive for employers to offer defined benefit pensions. The unpredictable nature of pension contributions can cause problems for a company's balance sheet.

Hybrid models, such as CAP's collective defined contribution plan and Senator Harkin's USA Retirement Funds can reduce this volatility for employers. That is because to employers, these kinds of hybrid plans are defined contribution plans, like a 401(k).

In these hybrid models the employer is not responsible for guaranteeing benefits, but rather is only responsible for making contributions—just like in a 401(k). Thus the employer would enjoy predictable contribution levels and minimal risk.

I think these hybrid models would be very attractive to employers. Employers would be able to provide a retirement plan that is more likely to lead to a secure retirement for their employees than a 401(k) without taking on the cost, risk, and complexity of a defined-benefit pension plan. In short, these kinds of hybrid plans allow employers to provide a good retirement plan to their workers without bearing the responsibilities of a defined pension plan.

Question 3. What do employees need from a pension plan to ensure they will have a secure retirement?

Answer 3. As I mentioned before, retirement planning is a tradeoff between cost, risk, and adequacy. Workers need a retirement plan that does a good job managing these tradeoffs, meaning the plan is cost-effective, minimizes risks, and has a very high likelihood of providing an adequate retirement benefit.

There are three core elements in retirement plan design that are particularly important in effectively managing the costs and risks of retirement: professional money management, long investment time horizons, and the ability to spread risks across multiple generations. Both Senator Harkin's USA Retirement Funds and CAP's collective defined contribution plans include these features.

Let's start with how these features reduce the cost of saving for retirement.

Professional money management of a pension fund leads to higher investment returns than most 401(k) participants achieve.[9] Though fund managers have a hard time beating market averages,[10] they typically do much better than individual investors—in large part by avoiding common investing pitfalls such as failing to diversify assets and pulling money out of stocks at the bottom of the market and thus missing the rally.[11] Professional money managers would ensure retirement portfolios are properly diversified and invested for the long haul to achieve better returns than most individual investors are likely to achieve.

Similarly, pooling investment risks over a longer time period also boosts investment returns: Individuals in a 401(k) have to become more conservative with their investments as they age because they have less time to recover any possible losses, resulting in lower returns. But when accounts of both older and younger workers are pooled together, the fund manager can maintain a balanced portfolio that achieves higher returns. This effect, called intergenerational risk sharing, can substantially raise pension returns.[12]

Finally, pooling longevity risk across all retirees in the plan means that the plan needs only to accumulate sufficient funds to pay for the average retiree's life-span in the plan. In contrast, an individual with a 401(k) has to save an amount sufficient for their maximum life expectancy: Saving only enough for the average life-span could leave retirees without sufficient income in their later years.[13]

These advantages mean that a retirement plan with these features would cost an estimated 46 percent less than a 401(k) to provide the same level of retirement benefit, according to research by the National Institute on Retirement Security.[14] To put this percent savings in dollar terms: A worker earning $50,000 before retirement would need to contribute an estimated $5,200 less in the year before retirement and thousands less in each of the other 29 working years they made retirement contributions to save enough for a secure retirement with a collective defined contribution plan compared to a 401(k).[15]

These features also help reduce the risk of saving for retirement when compared to a 401(k).

A long investment horizon helps mitigate the risk that the market performs poorly while a worker is saving for retirement. While an individual career may seem like a long time horizon for retirement investing, the chance that the market will perform poorly during the time when a worker is most aggressively invested in the market is still quite great compared to the longer timeframe that the intergenerational pooling of the CDC allows. A shorter timeframe increases the chance an individual will experience a period of low growth. For example, the lowest average annual return on the Dow Jones Industrial Average over a 75-year period was 3.05 percent compared to a low of –0.04 percent annual return for investments over a period of 30 years.[16]

Further, the risk that an individual in a 401(k) is hurt by a big drop in the market is much greater than the risk borne by participants in a collective defined contribution plan. That is because investment timing risk can be particularly acute for an individual but is less critical for a pooled investment fund.

Between December 2007 and June 2009 (the duration of the Great Recession), for example, workers who were near retirement, aged 55 to 64, and had a 401(k) for 20 to 29 years, saw their account balance decrease by 17.4 percent on average—and though account balances have recovered slightly since then, they are still down significantly.[17] In contrast, estimates suggest that because of investment losses suffered during the Great Recession, hybrid pensions in the Netherlands—where the hybrid model is common—may need to be reduced by much less.[18]

In short, hybrid models with professional money management, long investment time horizons, and the ability to spread risks across multiple generations are a good way to manage the tradeoffs inherent in retirement planning because they reduce costs and risks and make a secure retirement more likely.

The pension system of the future should include a hybrid model to ensure all workers have a cost-effective and secure way to save so that Americans can maintain their standard of living in retirement and retire with dignity.

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Response by Andrew G. Biggs, Ph.D., to Questions of the HELP Committee*

Chairman Harkin, Ranking Member Enzi and members of the committee: Thank you for the opportunity to testify at the roundtable with regard to Pension Modernization for a 21st Century Workforce. I have structured my written testimony as answers to the questions posed by the Chairman and Ranking Member.

Question 1. Defined benefit pensions have provided a secure retirement for millions of middle class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st Century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. A defined benefit (DB) pension plan offers certain important advantages: simplicity and predictability of benefits, protection against market risk, and insurance against outliving your retirement assets, all of which are highly valuable to employees. Of course, these benefits to employees inevitably come at a cost to em-

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*The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

ployers, particularly smaller businesses, who may be ill-suited to managing market and longevity risks.

Moreover, DB pensions carry certain disadvantages in a modern economy. In particular, DB pensions lack portability and are discriminatory against short-term employees, who often are the young, mobile professionals that high-tech businesses seek to attract. There is evidence that a significant part of the shift from DB to defined contribution (DC) pensions was driven, not by businesses, but by the employees businesses seek to attract.[1] In addition, certain individuals may desire the greater liquidity that DC pensions allow for relative to DB plans.

A pension system for the 21st Century will attempt to capture the advantages of DB pensions while avoiding their disadvantages. It will be:

- *Streamlined*: Because complexity discourages participation and encourages mistakes.
- *Low-cost*: Because higher administrative costs eat into employee savings. I understand the desire to provide ordinary savers with "professional money management," but I fear that the extra costs are rarely justified by higher returns and, in the case of more exotic investment strategies, carry risks that often are ill-understood.
- *Convertible to a lifetime income*: Most economists hold that annuities are extremely valuable relative to lump sum pension payouts, because they efficiently manage against the problem of not knowing how long one's retirement savings must last. It remains a puzzle why so few Americans choose to purchase annuities; the expected causes, such as administrative costs or the presence of Social Security, which already pays benefits as an annuity, do not provide a full explanation.
- *Financially transparent*: One method by which governments implicitly encourage pensions, either for State/local government employees or through the Pension Benefit Guaranty Corporation (PBGC), is by allowing them to operate under accounting precepts that differ from how private financial markets would value liabilities and risk. One example is allowing pensions to use higher discount rates to value their liabilities. These efforts, however well-intentioned, are dangerous both to the plans and to taxpayers and should not be tolerated. If the government wishes to subsidize pensions it should do so explicitly through appropriations, not by facilitating accounting arbitrage that encourages underfunding and excessive risk-taking. Policy efforts to encourage retirement income security should be *very* careful not to go down this road.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. Pensions, both DB and DC, can carry significant regulatory and administrative burdens. While large firms can bear these costs, for smaller employers they may be prohibitive.[2] Reducing the cost and complexity of pension provision may encourage more widespread adoption.

Reducing employer risk in provision of DB pensions or similar types of benefits would presumably encourage employers to offer such plans. However, we should be wary for two reasons. First, because DB pensions have shrunk despite the fact that most economists believe that the pension insurance provided by the PBGC is already significantly under priced. In other words, we have a natural experiment in the degree to which subsidies can increase DB pension coverage. Clearly these were not sufficient to maintain DB plans even in larger employers, much less expand coverage among small employers.

And second, the government is capable only of transferring risk, *not* of eliminating it. If employers are relieved of risk with regard to financing DB pension plans, that risk is simply shifted onto taxpayers. Simply because Federal budget rules do not adequately account for the cost of risk does not mean it does not exist. In the wake of Fannie Mae and Freddie Mac, of TARP and of the General Motors bailout, the potential cost of contingent liabilities should be foremost in the minds of policymakers. They should consider costs to the taxpayer of a policy not based on what is expected to happen, but on cases in which things go wrong.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

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[1] Aaronson, Stephanie, and Julia Coronado. 2005. "Are firms or workers behind the shift away from DB pension plans?" Federal Reserve Board Finance and Economics Discussion Series Working Paper No. 2005–17. Washington, DC: Federal Reserve Board of Governors.

[2] See Perun, Pamela J. and Steuerle, C. Eugene. "Why Not a 'Super Simple' Saving Plan for the United States?" The Urban Institute. May 2008.

Answer 3. A pension plan should have a variety of characteristics. First, adequate levels of saving, although these may differ significantly from person-to-person. The amount a person should save for retirement may differ based upon their income, their marital status, the number of children they have, and other factors. Unfortunately, there is no simple rule that will dictate a correct saving rate for each person and we should be wary of policy solutions that do not allow flexibility in this regard.

Second, simplicity of design. I have shown in other work that many Americans, even those on the verge of retirement, have very little idea what they will receive from Social Security despite receiving annual benefit statements.[3] This is due, I believe, to excessive complexity of the Social Security benefit formula. Traditional DB pensions are simpler than Social Security and this simplicity should be retained.

Third, lifetime income. Management of retirement income cash-flows is difficult in the face of uncertain life spans. A DB plan provides annuitization automatically, while a DC plan may do so through the purchase of annuities with account balances at retirement. Alternatively, individuals might purchase deferred annuities on an annual basis, thereby building up a pseudo-DB benefit within a DC structure. In whatever context, however, greater attention to managing the decumulation phase of retirement saving may be helpful to middle income households for whom Social Security is not the major source of retirement income.

RESPONSE BY JOHN ADLER TO QUESTIONS OF THE HELP COMMITTEE

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. The biggest problem with our current retirement system for Americans who work in the private sector is that tens of millions of people have very limited prospects for a secure stream of income besides Social Security that lasts the rest of their lives. The three-legged stool of yore now exists only for the top quartile of American retirees. For the middle 50 percent of retirees, Social Security makes up 74 percent of their income, and Social Security comprises 87 percent of income for the bottom quartile. The replacement of the traditional pension system by defined contributions plans such as 401(k)'s has failed to provide most working Americans with enough retirement income to maintain their standard of living in retirement. As Alicia H. Munnell, director of the Boston College Center for Retirement Research, said in the *New York Times* on September 12, "No matter how much you try to spruce up the 401(k)'s, they're never going to provide enough retirement income."

We need a retirement system that diversifies the income available to American workers so that they can have a secure, adequate, lifelong stream of income to supplement Social Security. This system should be the shared responsibility of employees, employers, and the government, with each making contributions (in the form of tax deductions or credits in the case of the government), and with each having representatives on the governing board of the entity or entities with oversight of the plan. These contributions should be phased in to a mandatory minimum level that is adequate to provide for enough income replacement after a lifetime of work in combination with Social Security to maintain workers' standard of living throughout their retirement. Employees and employers should be able to voluntarily contribute more than the required minimum, or increase contributions through collective bargaining, with reasonable limits on tax-advantaged contributions. The plan should be completely portable. The assets should be pooled and professionally managed to minimize costs and risk, and maximize economies of scale. Finally, the assets should not be subject to early withdrawal or loans, should be payable only at retirement or permanent disability, and should be annuitized.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. Clearly, businesses of all sizes are seeking to minimize their exposure to risk when it comes to retirement benefits. The story of businesses freezing and shedding traditional pensions is by now old and well-known. SEIU continues to believe that well-managed defined benefit pension plans are the best way for workers

[3] Biggs, Andrew G. "Improving the Social Security Statement." (October 2010). Financial Literacy Center Working Paper No. WR–794–SSA.

who work for extended periods of time for one employer or one skilled industry to achieve retirement security. To that end, the funding rules of the Pension Protection Act (PPA) should be reformed in 2014 to enable existing defined benefit plans to recover from the investment losses of the financial crisis of 2008. At the same time, we recognize that many companies do not want to participate in defined benefit plans—be they single-employer or multi-employer—and many low-wage workers change employers and industries several times over the course of their worklives. In addition, our own experience is that it has become nearly impossible since the 2008 financial crisis to convince new employers to agree to participate in defined benefit pension funds, both because of contribution rates that have skyrocketed in the wake of steep declines in investment values and PPA-driven rehabilitation plans, and concerns about potential withdrawal liability these employers would face. In the face of these concerns, we are interested in finding approaches that will both enable us to sustain our existing defined benefit plans while at the same time enable non-participating employers to provide their employees with a traditional pension benefit or something approximating such a benefit.

Undoubtedly, reducing employers' risk and plan complexity will make it easier and more attractive for them to provide such benefits. We believe that we need solutions that enable employers' contributions to be predictable and stable, without the volatility that has marked employers' contributions to DB plans in the wake of PPA and the 2008 market crash, while at the same time containing the investment and longevity risk for workers. We need a system that is easy to explain, with advantages that are easy to explain to employers as well as the public at large.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. SEIU represents 2.1 million members who work in healthcare, property services, and public services. Approximately 35 percent, or more than 700,000, have no access to a retirement plan at work. These include home care workers, child care workers, security officers, janitors, and others. These members tend to be in low-wage occupations where they are living paycheck to paycheck, without significant savings, and with little ability to shoulder the burden of retirement savings on their own.

Many of these members, as well as the nearly 50 percent of all American workers without access to a retirement plan at work, are facing the choice of working until they die, or retiring into poverty or near poverty. They need a pension plan that will ensure that after a lifetime of work, they can retire with a secure income stream that enables them to maintain their standard of living as long as they live.

Since most employees in the 21st century no longer work for one employer for the majority of their working lives, the plan needs to be portable and universal, with immediate vesting, so that employees' accounts receive contributions throughout their working lives. We strongly believe that accounts must be pooled and professionally managed and invested, in order to reduce administrative costs and investment management expenses, and to spread investment and longevity risk among many participants.

All employers and employees should make pre-tax contributions to the system up to reasonable income limits. These contributions should start at a low rate when the program first takes effect and gradually phase in over a number of years to achieve the level needed to build an adequate retirement benefit with reasonable investment assumptions over a workers' lifetime. The Federal Government should support employee contributions for low- and moderate-income earners through refundable tax credits.

RESPONSE BY KAREN FRIEDMAN TO QUESTIONS OF THE HELP COMMITTEE

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for Americans?

Answer 1. Chairman Harkin and Ranking Member Enzi, thank you for inviting me to this roundtable today and bringing together such a diverse group of experts to develop creative solutions to solving the retirement security crisis facing today's and tomorrow's retirees. I am here to represent both the Pension Rights Center, the Nation's only consumer organization devoted exclusively to promoting and protecting the retirement rights of workers and retirees and their families; and Retirement USA, a campaign working for comprehensive and effective retirement solutions. We thank you both for your strong leadership on retirement issues.

While those on this panel may not agree about everything, we are all here because we are committed to the importance of retirement security. I believe that by listening to each other, finding common ground to achieve our shared aims, and working together, we can shape measures to ensure that hard-working Americans will be able to retire with a strong supplement to Social Security today and tomorrow. I look forward to a vigorous and productive discussion.

I want to turn now to the first question you asked us to address.

Question 1. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for Americans? And what is the role of the defined benefit plan?

Answer 1. I want to start with defined benefit plans. As we know, such plans—particularly traditional defined benefit plans—have been on a steady decline among private-sector employers. However, I want to stress how important these plans are to the individuals still covered by them and their importance to economic growth. First, approximately 20 percent of all workers continue to be covered by defined benefit plans. That is a large slice of the population, and they generally work well for those people. Indeed, defined benefit plans are the lowest cost and most efficient means of providing retirees with guaranteed income for retirement.

Defined benefit plans also provide one of the most important sources of patient capital, investing for the long-term. According to the National Institute on Retirement Security, the steady benefits provided by these plans are especially important in stabilizing local economies during economic downturns because retirees can keep spending their pension checks, knowing that more are coming.

For these reasons, both the Pension Rights Center and the organizations represented by Retirement USA believe that we should do everything possible to preserve the defined benefit plans that already exist and to encourage new forms of these plans or plans that have these features.

However, with the decline of traditional defined benefit plans, we need creative ways of developing new plans that mimic many of these plans' features. That's why the Center launched Retirement USA with an array of 27 other organizations—including the AFL–CIO, the Service Employees International Union, and the Economic Policy Institute—to advocate for a new pension system that is universal, secure, and adequate (hence, the "USA"). This new system, in conjunction with Social Security, will provide people with sufficient income in retirement and allow them to continue to maintain the same standard of living that they enjoyed while still in the workforce.

After studying numerous systems and proposals found here in the United States and in other countries, Retirement USA developed **12 principles for a new private retirement system**. These principles borrow from the best parts of defined benefit plans and 401(k) savings plans, and include some additional features.

We have three overarching principles that we believe should guide the reshaping of our pension system for future generations of workers. These are:

Universal Coverage. *Every worker should be covered by a retirement plan.* A new retirement system that supplements Social Security should include all workers, unless they are in plans that provide equally secure and adequate benefits.

Secure Retirement. *Retirement shouldn't be a gamble.* Workers should be able to count on a steady lifetime stream of retirement income to supplement Social Security.

Adequate Income. *Everyone should be able to have an adequate retirement income after a lifetime of work.* The average worker should have sufficient income, together with Social Security, to maintain a reasonable standard of living in retirement.

Additional principles include:

Shared Responsibility. Retirement should be the shared responsibility of employers, employees, and the government.

Required Contributions. Employers and employees should be required to contribute a specified percentage of pay, and the government should subsidize the contributions of lower income workers.

Pooled Assets. Contributions to the system should be pooled and professionally managed to minimize costs and financial risks.

Payouts Only at Retirement. No withdrawals or loans should be permitted before retirement, except for permanent disability.

Lifetime Payouts. Benefits should be paid out over the lifetime of retirees and any surviving spouses, domestic partners, and former spouses.

Portable Benefits. Benefits should be portable when workers change jobs.

Voluntary Savings. Additional voluntary contributions should be permitted, with reasonable limits for tax-favored contributions.

Efficient and Transparent Administration. The system should be administered by a governmental agency or by private, non-profit institutions that are efficient, transparent, and governed by boards of trustees that include employer, employee, and retiree representatives.

Effective Oversight. Oversight of the new system should be by a single government regulator dedicated solely to promoting retirement security.

We hope that these principles will serve as a guidepost to evaluate and strengthen any new proposals.

Recently, the Center has been working with business groups to come up with new risk-sharing models. Earlier this year we co-sponsored a conference, "Reimagining Pensions," with the Urban Institute, and Covington and Burling, a law firm representing some of the largest corporations in America. The conference explored new pension designs to share and spread risk between employees and employers, and among generations. In all, we looked at eight proposals, including flexible hybrid plans, simplified defined benefit plans, and multiple employer plans.

Senator Harkin, your USA Retirement Funds proposal meets most of our principles and takes an innovative, fair, and realistic approach to risk-sharing. By setting up a system of privately run pension plans, where the employer's responsibility is to write a contribution check for a modest amount to the plan administrator, USA Retirement Funds relieve employers of administrative and fiduciary burdens, and should make the plan attractive to employers. By providing low fees, pooled investments, and a lifetime benefit at retirement age, they allocate investment and mortality risk in sensible ways among employees. They are, we believe, a significant improvement over today's 401(k) plans, which place all of the responsibility and risk on individual employees. We believe USA Retirement Funds are a serious model that can help millions of Americans prepare for retirement.

It should be noted that, while we favor new creative approaches to ensure that all Americans enjoy a decent standard of living in retirement, we are not advocating replacing the system that we now have. Rather, we want to augment what currently works with meaningful retirement-savings opportunities for approximately 50 percent of the workforce that are shut out of the system. With your leadership, Senators Harkin and Enzi, I know we can do it!

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. For 7 years, from 2001–7, I coordinated a common-ground initiative called the Conversation on Coverage, which brought together 45 experts from business, financial institutions, unions, retiree groups, and other constituencies to discuss ways of increasing pension coverage—especially for lower wage workers. We developed four concrete proposals—a few of which were especially suited for small- and medium-sized businesses.

Let me share what I learned from this common-ground dialog. Studies show—and the participants of this dialog confirmed—that small businesses would be more likely to start a plan if administrative costs, complexities, and fiduciary responsibility were reduced and if employer contributions were voluntary. One plan developed especially with small businesses in mind is called the Model T which is a simplified plan with automatic enrollment. I know, Senator Enzi, that you have been very interested in new multiple employer approaches, and I would be happy to share with you and your staff more about the findings.

I also learned that there may be ways of structuring defined benefit plans to make them easier to be adopted by smaller businesses. The Conversation on Coverage provided an example, the Plain Old Pension Plan or POPP. In short, the POPP provides a straightforward career average defined benefit through a plan that would have predictable employer funding—which is one of the biggest concerns employers have in adopting defined benefit plans. It also enables owners to give themselves, and other longer service employees, benefits for the years worked before the plan was established.

Also, Senator Harkin, it seems that the structure you developed for the USA Retirement Funds is consistent with addressing many of the concerns of small businesses. Your Retirement Funds would be run by financial institutions, taking the burden off of small businesses, and would also automatically enroll participants into the plan, unless they opt out. This, it seems, would be highly appealing to small businesses.

I want to raise one important concern regarding fiduciary issues that I learned during discussions with our partners in both Retirement USA and the Conversation on Coverage. Under current law, employers have the fiduciary responsibility of choosing a plan provider and also monitoring investments. Relieving employers of such responsibilities raises a bevy of complex issues and possible conflicts of interest. It is very important that, if new arrangements transfer fiduciary duties on to third parties, there will be effective government regulation. Without such regulation and oversight, there is room for enormous amounts of self-dealing and other conflicts of interest.

Since small businesses represent the fastest growing employment sector in the economy, finding creative ways to encourage these employers to provide secure benefits is of paramount importance.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. Public opinion polls reflect America's mounting anxiety about retirement. In a recent Gallup poll, the top financial concern for most Americans was not having enough money for retirement—surpassing concerns about paying for health care and paying the mortgage.

We hear every day from people who can't make ends meet. Folks like Shareen Miller, a home health care aide who makes only $12 an hour and can't put enough away for retirement. Women like Karen O'Quinn who never worked for a company that offered a pension or savings plan and had to use all her savings to take care of her kids and her health care.

What employees want is income that is sufficient to supplement Social Security and that will enable them to live with dignity in retirement. What they need is a vehicle where both employers and employees contribute and, if they are lower income, that includes a government-subsidized contribution. The money that is contributed to that vehicle should be professionally managed because most Americans do not have the time, education, and experience to create an investment portfolio that provides the right combination of risk and return. The savings in a retirement plan should be more or less locked in until retirement and should pay benefits over the lifetime of the employee and their spouse or life partners.

Having a good retirement is part of the American dream. And what people want is to be able to continue to know that they can take care of themselves and also contribute to society.

RESPONSE BY RICHARD HUDSON TO QUESTIONS OF THE HELP COMMITTEE

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. The Defined Benefit plan is the best way to provide retirement security for Americans. The current ideas need to be revamped though. Companies should not be taking significant investment risk with assets in the pension plan and certainly should not be taking any risk with money needed for retiree liabilities.

Insurance companies have been able to provide annuities for many years with little trouble, the reason is they invest in a way to control cash-flow risk and count on risk pooling to reduce the overall level of mortality risk they are subjected to.

Defined Contribution plans are favored by employers as they shift all the risk to the plan participants. What is not clearly understood is that Defined Contribution plans introduce an additional level of risk for the participants. This additional risk is mortality or longevity risk—participants as individuals can only avoid this risk by pooling via an insurance contract which is a hard choice not many take and can be very expensive. In a Defined Benefit plan the mortality risk is pooled amongst all the employees of the plan. This risk pooling helps reduce the level of risk.

In addition, when employers shift to a DC plan, the older workers lose out significantly since they don't have time to accrue large enough accounts to replace the lost accruals from the Defined Benefit plan. Also, in general, participants do not fully understand how to invest and as a result many take the safest option available which reduces the long-term investment income in their accounts. Another problem with 401(k) and similar plans is that the investment vehicles offered have higher investment fees and investment bookkeeping fees that would be found in large DB plans.

The current Defined Benefit plan system can survive if expectations are modified and responsible parties are made aware of the risks and understand how to mitigate underlying risks.

We have been successful in assisting some clients to create new defined benefit plans or continue in the defined benefit arena with a better understanding of long-term expectations.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. The employers' risk and plan complexity can be dealt with through proper plan design. The main issues we face in assisting our clients are:

1. Will the new designs we are developing for our clients receive a favorable determination letter from the IRS? It would help for newly created pension plans to receive priority in the IRS review process over current plans who are re-applying for a determination letter. Once we get a couple of these "hybrid" plan designs approved, employers will be more confident in the design concept and not have to worry about whether or not contributions made to these plans will be deductible.
2. The PBGC premiums are reaching levels that make sponsors take pause in thinking about retirement plans. If a plan sponsor does the right thing and designs a pension plan with policies in place to mitigate risk, the likelihood of needing PBGC insurance is very low. But, they do not receive a break from the PBGC premiums. In actuality, if they freeze their current plan and establish a new plan with lower risk and lower benefit accruals, the amount of their retirement benefits decline but the PBGC premiums double. The focus should be on variable rate premiums—where the risk is—and possibly lower the flat rate premiums.
3. Some multi-employer plans are suffering under the weight of liability associated with past withdrawn or bankrupt employers. This is causing a tremendous amount of strain on these plans as they need to reduce benefit levels or even freeze future accruals to pay off the liability for these "orphan" liabilities.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. The participants need to know they will not outlive their assets. Defined Benefit plans provide a level income for life so retirees can plan their finances. They know what they will have so they know what they can spend. This makes them more comfortable and allows them the freedom to spend money without being anxious about running out of income. The efficiency of an annuity is not well-understood and the benefit of an income for a long life is overshadowed by the cost of not leaving a residual balance of retirement savings to one's heirs. To illustrate the efficiency of an annuity as an example, if we plan to live on $2,000 per month and take a 10 percent risk of out-living our savings we would need $340,000 to retire at 65 if we were confident of earning 6 percent per year through our investment skill. Contrast that with the cost of an annuity for $2,000 per month—$320,000 (assuming 3 percent investment earnings) which has no risk of being outlived.

Participants also need the plan to have stable funding during the accrual years. When the cost of funding the plan gets too high employers switch to DC plans. Defined Benefit plans have smaller accruals in early years and larger accruals in later years. Defined Contribution plans have relatively larger accruals in early years (because of compounding interest) and smaller accruals in later years. If an employee works for an employer for many years earning the smaller accruals, they need to be rewarded with the higher accruals that come at the end of their career. When an employer switches to a Defined Contribution plan, they are hurt again by now getting smaller relative accruals in the DC plan which significantly hurts their overall retirement benefit. Therefore, the plans need to be established for long-term sustainability in mind.

Defined Contribution plans provide participants with a lump sum of money which is likely not enough to retire on. There are several reasons for this. Participants do not save enough nor do they start to save early enough. They also do not have the investment knowledge to properly invest their accounts. Individuals in these plans feel like they must continue to work longer, save more, and spend less to achieve their retirement goals. Since the limits on how much an individual and employer can contribute to a Defined Contribution plan are significantly less than Defined Benefit plans, the ultimate retirement benefits will be less. Also, employers tend to switch to DC plans to save money, so even if deductions were not a problem it is likely that the contribution amounts would still be insufficient.

Some plans are looking at providing lifetime income benefits in DC plans through an annuity purchase but this is very expensive for participants if the annuity is purchased through an insurer. A Defined Benefit plan handles annuities more efficiently.

Response by Susan L. Breen-Held to Questions of the HELP Committee

INTRODUCTION

My name is Susan Breen-Held. I am a pension actuary at the Principal Financial Group®. I have been with The Principal® for 33 years; the last 30 have been spent consulting with plan sponsors on the design and funding of defined benefit plans.

The Principal is a global investment management leader including retirement services, insurance solutions and asset management. Retirement is our core business and largest operating segment.

For more than 70 years we have helped millions of people save for retirement. We are the No. 1 provider of defined benefit plans, serving more than 2,400 defined benefit plans with nearly 333,000 eligible participants.[1] We are also one of the largest recordkeepers of defined contribution plans with nearly 30,000 defined contribution plans nationally and more than 3.3 million participants,[2] representing more than $14.5 billion in assets.[3]

We continue to support American workers as they enter retirement, providing monthly income annuity payments to more than 254,000 retirees.[4]

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. Thank you for this opportunity to discuss ways to help ensure adequate retirement income for all Americans by improving the employer-based retirement system.

I speak today on behalf of our core constituency: small and medium-sized employers, who are the economic backbone of this Nation.

While the question focuses on traditional defined benefit plans, some of my comments will also address defined contribution plans. Both are critically important sources of retirement income.

We believe the soundest way to help ensure adequate retirement income for all Americans is through a holistic approach: strengthening each part of the Nation's retirement system.

The good news is we have a very firm foundation upon which to build. We don't have to start over nor should we. Instead we should build on what's working and draw from the lessons we've learned as the system has evolved over time.

What we have learned is that voluntary employer-sponsored plans, and defined benefit plans in particular, are one of the most efficient ways to provide retirement benefits. The factors that have fueled success include:

- The flexibility of the system that meets the varying needs of employers.
- The stable, guaranteed benefit from defined benefit plans that is a valuable commodity to the participants.
- The features in defined contribution plans that help make it easier and more enticing to save such as automatic enrollment and increases, fiduciary oversight, worksite guidance and education, tax deferrals, and savings incentives for both the employer and the employee.

Among the factors that challenge the system are complexity, administrative burden, cost, global competition, economic instability and human behavior.

We need to make sure that any changes focus on alleviating the challenges and removing the barriers without inadvertently removing or weakening the features and incentives that are working well today.

Here are some high level recommendations to enhance both the defined benefit pension system and the defined contribution system. Some of these ideas are based on results from "The Principal Retirement Readiness Survey—2011,"[5] a major survey we conducted of 1,305 small and medium-sized employers. Some of the respondents offered a defined contribution plan and some did not. (See attached)

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[1] PLANSPONSOR DB Administration survey, April 2012.

[2] Based on a number of recordkeeping plans, PLANSPONSOR Recordkeeeping Survey, June 2012.

[3] As of June 30, 2012.

[4] Ibid.

[5] The Principal Financial Group Retirement Readiness Survey commissioned by The Principal conducted by Harris Interactive online. Data was gathered from May 17 through June 17, 2011 from 1,305 employers.

Make the system simpler for employers and workers.

- Simplify the rules, plan designs and regulations to make it easier for employers to establish and operate retirement plans. The complexity and administrative burden drives up costs.
    - In our Retirement Readiness Survey, nearly a third of small employers we surveyed said the costs of establishing and administering a plan are reasons they aren't offering one.
- For defined contribution plans: make it easier and more attractive to increase the use of automatic enrollment features at higher contribution levels which nudge workers into saving at what we believe are more adequate levels.

Give to employers more reasons to voluntarily offer a retirement plan.

- As onerous as defined benefit plans can be, this is critical.
- Small employers have all they can do to keep the business running. If they are going to voluntarily invest time and money to offer a retirement plan, they need to know it will benefit the business and the owners need to receive some benefit as well.
- We know that incentives work for defined contribution plans. In our Retirement Readiness Survey:
    - 92 percent of the employers we surveyed say tax incentives are important in their decision to offer a defined contribution plan.
    - 75 percent say tax deferral incentives are the most attractive retirement plan feature to employees.
    - More than 80 percent say participation and savings would decrease if the incentives were removed.
    - Just over half of employers not offering a plan (53 percent) are not aware of the startup tax credit given to employers who start a DC/401(k) plan.
    - Only 17 percent are aware of how the startup tax credit works.

Address the challenge of retirement income.

- The vast majority of the employers in our Retirement Readiness survey agree that placing retirement income illustrations on benefits statements would be helpful but two-thirds are concerned about the liability if employees don't end up with the amount they projected.
- Educating employees about retirement income will help them better value the guaranteed income provided by a defined benefit plan.
- Providing a safe harbor or regulatory guidance that the retirement income projection is an estimate and not a guarantee will help alleviate fiduciary concerns.

I can elaborate on these recommendations as our discussion continues.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. Plan sponsors tell us one of the biggest problems with defined benefit plans is volatility caused by market interest rate fluctuations. This volatility has a significant negative impact on funding. When interest rates go down, funding must increase, which puts tremendous pressure on the capital needed to keep the business operating. Many plan sponsors have coped with funding volatility and the resulting heavy cash requirements by freezing their defined benefit plans. That is not the result any of us want.

The industry has helped address some of the volatility with different ways of managing investments. Congress helped address volatility with a recent law, "Moving Ahead for Progress in the 21st Century Act," P.L. No. 112–141,[6] that provides interest stabilization. It allows sponsors to reference a longer term interest rate that would be less affected by market swings. This measure is yet another positive step back to a longer view of pension plan funding. The measure also provides the counter-cyclical funding that sponsors need requiring lower contributions during difficult economic times and higher amounts in better times.

However, the law doesn't go far enough. It doesn't offer the same protection for future years. Restoring the 10 percent corridor for all years, as was originally proposed, would strengthen protections for sponsors and also generate tax revenues in the near term. Relieving volatility concerns helps support existing plans and could spur creation of new ones.

[6] "Moving Ahead for Progress in the 21st Century Act", P.L. No. 112–41, enacted July 6, 2012.

In addition to expanding the new law, we offer three other steps that we believe would encourage small employers to maintain or create defined benefit pension plans.

First, give employers a reason to offer defined benefit plans.

- Deciding whether to offer a retirement plan is a business decision. For a smaller business to invest the time and money to establish or maintain a plan, there must be a benefit to the business and to the employer.
- The current structure provides only a minimal benefit to the employer and other highly compensated employees.
- The current compensation and total benefit limits allow the defined benefit plan to replace only a small portion of the decisionmakers' or other highly compensated employees' income. Thus they have little incentive to take on the risk of sponsoring or maintaining a defined benefit plan.
- We recommend raising the compensation and benefit limits so that the employer and highly paid employees have more of a stake in the defined benefit plan.
- We also recommend waiving all compensation limits in the first 5 years after defined benefit plan's creation. This would provide an incentive to increase the number of defined benefit plans in existence, expand the working population covered by those plans and help assure that more employees have more adequate retirement income.
- These steps could be tied to features that would benefit the rank and file such as immediate vesting or benefit accruals.
- We've seen this working very effectively in the defined contribution world where safe harbor rules allow the employer to establish contribution levels that provide reasonable savings opportunities for both highly compensated and non-highly compensated employees.
- We see strong positive results from cash balance plans that can provide incentives to owners and higher income employees.
    - The average employer contribution to retirement accounts where companies have both a 401(k) and a cash balance plan is 6 percent of pay, compared to 2.3 percent of pay in companies with only a 401(k).
    - This kind of arrangement is so attractive to employers that despite the severe economic slump between 2008 and 2010, there was a 38 percent increase in new cash balance plans.[7]
    - We need to provide similar incentives to traditional defined benefit plans.

Second, reduce administrative costs.

- The new law I referenced earlier is expected to significantly increase what is already a burdensome number of calculations for defined benefit plans.
- We recommend reducing the number of different calculations that are required for **small** plans, which are generally defined at 100 lives or less.
- This could be accomplished by exempting small plans from some testing or lengthening the time between tests, for example from every year to every 3 years.
- Limit the amount of government reporting for the smallest of plans. This would be an enormous help to these smaller organizations.
- These ideas could reduce the sponsors' administrative costs while posing little additional risk on the Pension Benefit Guaranty Corporation (PBGC).
- One of the last things these employers need is an increase of their PBGC premiums. Such an increase would only serve as a barrier—and for many smaller employers an insurmountable one—to maintaining and creating defined benefit plans.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. First and foremost, employees need the defined benefit plan to be there and allow continual benefit accrual. A traditional pension plan provides a foundation for a total retirement program, enhancing the savings in a defined contribution plan and supplementing Social Security.

One way to keep the defined benefit plans alive is to make sure that government agencies provide clear and timely guidance for the laws that Congress enacts. This allows sponsors to react with confidence and in a timely fashion to design and operate plans. This committee's influence in this area has proven to be invaluable to plan sponsors in the past, and is much appreciated.

Plan participants themselves need a better understanding of the advantages and value of defined benefit plans. The more participants appreciate a defined benefit

[7] 2012 National Cash Balance Research Report, Kravitz, Inc.

plan, the more the plan can benefit the business as an attraction and retention tool which can help drive demand for continuing or establishing a defined benefit plan.

- Participants have a much greater awareness of defined contribution plans because they are easier to understand and have been more widely promoted.
- This isn't the case with defined benefit plans. Participants don't have to take action to participate nor do they receive much education about defined benefit plans. In the past, defined benefit plans have tended to be invisible except to those employees approaching retirement.
- We are beginning to see the first signs that young people increasingly value defined benefit plans. As an industry we need to build on this trend and focus greater attention to educating participants on the value of defined benefit plans.

A word about defined contribution plans.

Because most Americans with a defined benefit plan also have a defined contribution plan, providing an **income replacement orientation** to defined contribution plans only serves to increase appreciation of defined benefit plans while at the same time increasing the chances of providing more adequate retirement income.

The next generation of defined contribution plans is borrowing from some of the best features of defined benefit plans. It begins with a better definition of what it may take to achieve a more secure retirement.

- We define true retirement readiness as having enough savings to replace 85 percent of pre-retirement income.
- In order to save enough to meet that goal, our analysis indicates Americans need to save, on average, between 11 and 15 percent of their income over the course of a career—including employer contribution from either a match or defined benefit plan.
- In an analysis we conducted, which measured the impact on retirement account balances of three key variables: investment performance, asset allocation and the amount the participant is saving, we found that while investment performance and asset allocation are important, **in the long run the amount of savings has the biggest impact on the ending account balance.**[8]
- We are encouraging plan sponsors to redesign their plans in a way that sets participants up to save successfully. We can do some of this now, but we need help from Congress and regulators to encourage sponsors to take these actions.

Here are the five plan design features we believe can lead to true retirement readiness:

1. Offer automatic enrollment—with at least a 6-percent default deferral rate.

- Our analysis[9] of participants in plans through The Principal shows 6 percent drives better saving behavior without hurting participation.
  - Only 19 percent opted out at 6 percent compared to 15 percent opting out at 3 percent.
  - When 6 percent default rate is combined with an employer match, 61 percent of participants reached an overall savings rate of more than 11 percent of pay.

2. Couple automatic enrollment with an annual automatic escalation of the deferral rate—and make it the default.

- Automatic enrollment alone likely won't encourage participants to increase their salary deferrals over time.
- Automatic escalation harnesses the power of inertia.
  - Our analysis[10] shows that 80 percent of participants use automatic escalation when it's the default while only 6 percent use it when it's a feature they have to choose.

3. Apply automatic enrollment to all employees at least one time and consider re-enrolling all employees periodically.

- This ensures that more than just new employees reap the benefits of automatic enrollment.

Congress can encourage these auto savings changes by providing additional incentives for employers who add auto escalation and by removing the 10 percent cap on default deferrals.

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[8] *"Pursuing 'Retirement Plan Success' During Participants' Accumulation Years"* The Principal Financial Group, April 2010.
[9] Analysis of participants in plans through The Principal 12/31/2010.
[10] Analysis of participants in plans through The Principal 12/31/2010.

4. Employers can re-structure the employer match in a way that requires participants to contribute more in order to get the full match but doesn't change the employer's cost.

- Participants tend to save up to the employer match or the automatic enrollment default rate and not beyond.
- Our analysis [11] shows participants contribute more when employers stretch the target match rate and it has not hurt participation and participants defer up to the higher level.

5. Professionally managed investment options: offering target date or target risk investment options as the default investment provides built-in diversification and simplicity for participants who seek a do-it-for-me choice.

Plans need to focus education on retirement income needs.

- **Illustrating projected monthly income in retirement on benefits statements** can be a savings motivator. Learning that a $50,000 balance at age 65 would amount to only about $275 a month [12] for life can be a real wakeup call.
- **But as I said earlier, employers have grave concerns about liability if the ultimate savings falls short of the projections.**
- Employers need regulatory guidance that they won't be liable.

I appreciate the opportunity to appear before you today. We look forward to working with you as you consider ways to help protect and expand defined contribution plans and help Americans have a more secure lifetime income at retirement. I would be happy to answer any questions you may have.

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ATTACHMENT.—RETIREMENT COVERAGE AND ADEQUACY: PERSPECTIVE AND SOLUTIONS FROM SMALL AND MEDIUM-SIZED EMPLOYERS

INTRODUCTION

Employer-sponsored 401(k) plans and other worksite retirement plans have helped millions of workers save trillions of dollars. These plans have proven to be resilient even in challenging times. But more is needed. More Americans need access to worksite retirement plans. Those who do have access to plans need to save more. Those factors, combined with recent economic volatility and burgeoning baby boomer retirements, have spurred calls for changes to the voluntary retirement system.

At the same time as tax reform and deficit reduction discussions take place in Washington, DC, the retirement savings system has been caught in the cross hairs. Some proposals include reducing or eliminating current tax incentives offered to employers sponsoring qualified defined contribution (DC) retirement plans and participants in those plans.

It is critical that any proposals to change the voluntary retirement system be evaluated against whether they would solve or prolong the key challenges to retirement savings in America:

- Expanding coverage of employees in employer-sponsored retirement plans,
- Increasing retirement savings to adequate levels, and
- Securing income to last through retirement.

Because worksite retirement plans are set up *voluntarily* by employers, the Principal Financial Group® believes it is critically important to understand how employers feel about the state of the retirement system today and how proposed changes would affect their decisions about offering and making changes to their retirement plans. In particular, it is important to hear from smaller employers because they are the economic backbone of the Nation.

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[11] Analysis of participants in plans through The Principal 12/31/2010.

[12] Principal Financial Group Income Annuity Quote for a 65-year-old, unisex pricing, with installment refund, August 30, 2010.

To bring their voices to Washington, DC, The Principal® commissioned the *2011 Principal Financial Group Retirement Readiness Survey*, a major survey of small- and medium-sized employers, conducted online by Harris Interactive.[1] Employers who currently do not offer a defined contribution retirement plan, and employers who do offer defined contribution plans, serviced by The Principal, were included in the survey. The Principal provides services to nearly 40,000 employer plan sponsors with over 3 million eligible participants,[2] and we are a retirement leader with more than 70 years in the retirement industry.

Findings from the survey clearly demonstrate that:

- Reducing or eliminating current tax incentives would significantly hamper voluntary plan sponsorship and retirement savings in 401(k) plans.
- Simplifying rules to operate a plan and educating employers about incentives and benefits would remove barriers and encourage more plan formation.
- Plan sponsors understand participants need to save more and are willing to make voluntary changes in plan design that would encourage greater retirement readiness among participants.
- Plan sponsors are willing to address retirement income challenges but need regulatory clarity.

This document outlines key findings from the data, along with our recommendations for addressing the Nation's retirement challenges.

EXPANDING COVERAGE OF EMPLOYEES IN EMPLOYER-SPONSORED RETIREMENT PLANS

Tax Incentives Work and Reductions Would Hamper Plan Sponsorship and Savings

Despite the fact that the 401(k) system was originally designed as a supplement to retirement savings, the majority of plan sponsors state that the current 401(k) system is effective and tax incentives are important factors in their decision to offer a plan.

- Nearly two out of three plan sponsors (61 percent) say the current 401(k) system is effective to extremely effective in helping employees achieve adequate retirement savings. Only 3 percent of plan sponsors say the current 401(k) system is not at all effective in helping employees achieve adequate retirement savings.
- Virtually all plan sponsors (92 percent) and over half (52 percent) of employers who do not offer a plan say the ongoing **tax deferral for employees** is important in their decision to offer a DC/401(k) plan.
- Approximately four out of five plan sponsors (79 percent) and half of employers who do not offer a plan say the **ongoing tax incentive given to employers** is important in their decision to offer a DC/401(k) plan.

Many employers state that *reducing* tax incentives would cause employee participation levels, employee contribution levels, and their own desire to offer a plan to decrease significantly.

- Three-quarters of plan sponsors say the most attractive feature to employees is the pre-tax deferral.
- When asked about the specific proposal to lower the limits on what employees can save on a tax deferred basis within 401(k) plans to 20 percent of compensation or $20,000 annually:
  - 83 percent of plan sponsors registered an unfavorable opinion of that proposal.
  - Close to 7 in 10 (68 percent) of plan sponsors say they are most concerned about the proposed change because employees are already not saving enough for retirement.
  - 54 percent say employee tax deferred limits should be raised not lowered.
- When asked about general reductions in the amount of 401(k) plan contributions employees are allowed to deduct:
  - Almost half (44 percent) of plan sponsors say employee participation would decrease.
  - Two-thirds (67 percent) of plan sponsors say employee contribution levels would decrease.
  - 23 percent of plan sponsors say that their desire to continue to offer the retirement plan would decrease.

[1] Unless noted otherwise, all statistical information in this document is from the *2011 Principal Financial Group Retirement Readiness Survey* commissioned by the Principal Financial Group conducted by Harris Interactive online. Data was gathered May 17 through June 17, 2011 from 1,305 employers.

[2] As of September 30, 2011.

- Over a quarter (27 percent) of employers not offering a plan say it would decrease their desire to start offering a defined contribution plan to their employees.

Employers say that *eliminating* the ability for employees to deduct any amount of the 401(k) plan contributions from taxable income would cause employee participation levels, employee contribution levels and their own desire to offer a plan to decrease even further.

- More than 8 out of 10 plan sponsors state that employee participation and contribution levels would decrease (85 percent and 86 percent respectively).
- Nearly two-thirds (65 percent) of plan sponsors say their desire to continue offering the plan would decrease.
- 36 percent of employers not offering a plan say it would decrease their desire to start offering a defined contribution plan to their employees.

To complement the survey findings, we analyzed the block of 401(k) and 403(b) plans we service, and our analysis [3] found that the majority of those deferring the maximum amount into these plans are pre-retirees (age 50+) and are nearly evenly split between highly compensated (earned more than $110,000, the 2011 indexed compensation guideline) and non-highly compensated.

- Participants age 50+ represent 61 percent of all participants currently deferring the maximum amount allowed.
- In the plans we analyzed, nearly 50 percent of those employees age 50+ and deferring the maximum amount are classified as non-highly compensated.

OUR POSITION: Preserve existing tax incentives and contribution limits. Increase the limit for catch-up contributions.

We urge Congress to carefully consider the unintended negative consequences of decreasing or removing current tax incentives for voluntary retirement programs.

- This survey demonstrates that reductions or elimination of current tax incentives would substantially impede savings and decrease the number of employer-sponsored plans, resulting in a detrimental impact on overall retirement security for Americans and the economy as a whole.
- In addition, based on the further analysis [3] we completed to identify groups of participants who are currently deferring the maximum into 401(k)/403(b) plans that we service, we find that reductions in tax incentives would greatly impact non-highly compensated workers and pre-retirees: the very people that many in Congress are trying to protect.

Contribution limits are especially important for those nearing retirement. Because they may not have had access to defined contribution plans for their entire working careers, pre-retirees are deferring more to catch up. To help them save more in the years before retirement, we recommend Congress increase the limit for catch-up contributions.

MANDATORY PLANS: NOT THE ANSWER

In general, employers do not favor mandated retirement savings and report it may have a negative impact on the retirement system.

- Only 27 percent of plan sponsors and 32 percent of employers not offering a plan agree with the statement that all employers should be mandated to offer some type of workplace retirement plan for employees.

BENEFITS AND BARRIERS TO OFFERING RETIREMENT PLANS

Survey findings suggest there is a disconnect between employers who are plan sponsors and those who are not, regarding the key benefits and challenges of offering a DC retirement plan. Current plan sponsors recognize the value of a 401(k) plan to their overall business strategy and cite regulatory requirements as key challenges.

- The majority (84 percent) of plan sponsors say their DC/401k plan is a key part of their company's benefit strategy.
- More than a third (36 percent) say their DC/401(k) plan helps them compete for talent.
- More than half (52 percent) said allowing all employees, including highly compensated, to defer up to Internal Revenue Service limits would make it easier for employers to operate their plans. Under current safeguards, plan sponsors may need

[3] Analysis complete on a total of 8,446 401(k) and 403(b) plans serviced by The Principal with over 65,500 participants reaching the maximum deferral limits in 2010.

to make additional contributions to non-highly compensated employees in order to allow this.

• Nearly half of plan sponsors say easing reporting requirements (47 percent) and compliance burdens (42 percent) would help with plan operation.

Employers not offering a retirement plan appear to be unaware of key business benefits and tax advantages of offering a DC/401(k) plan.

• The most common reason given for not offering a retirement plan is employees prefer wages, (31 percent) followed by it costs too much to set up and administer (27 percent). Another quarter of employers indicate the required company contributions are too expensive.

• Just over half of employers not offering a plan (53 percent) are not aware of the startup tax credit given to employers who start a DC/401(k) plan. Only 17 percent are aware of how the startup tax credit works. However, more than a third (35 percent) said the credit would be a strong incentive when considering to offer a DC/401(k) plan.

• The top three factors—all selected by a third of employers—that would cause employers to consider offering a retirement plan include:

  • An increase in company revenue.
  • A plan with no required employer contributions.
  • Greater tax advantages for owners/key employees.

These responses suggest that these employers who do not sponsor plans are not fully aware of plan design alternatives that currently do not require an employer contribution. In addition, they suggest that increasing tax incentives to employers for sponsoring retirement plans may increase willingness to sponsor a plan.

OUR POSITION: Simplify rules, plan designs and regulations to make it easier for employers to offer and plan sponsors to operate retirement plans. Promote the benefits of offering a plan.

To make it easier to operate retirement plans and improve plan design, we recommend new rules to reduce bureaucracy and administrative requirements for plans that adopt safe harbor and automatic enrollment designs. For example, simplifying annual notice requirements to employees could save a great deal of time and money for employers.

To encourage more employers to offer plans, educate employers on the business benefits of offering a retirement plan, including the valuable role they play as a key part of a company's benefit strategy. Almost 7 out of 10 (66 percent) employees rate their defined contribution plan as an important to very important benefit to them.[4] These employers also need to be made aware of creative plan design solutions that can maximize savings in an efficient manner. Plan designs are available that do not require employer contributions, and employer matching formulas can be designed within the employer's contribution budget while still encouraging employee deferrals.

The Department of Labor can also help by promoting the Small Business Tax Credit for Start-up Expenses to employers considering to offer a DC/401(k) plan. Additionally, we recommend Congress consider the following enhancement to the Small Business Tax Credit for Start-up Expenses:

• Increase the percentage of startup costs eligible for credit.[5]

• Extend the time period for credit and add a tax credit for small employers who provide a contribution or match.[6]

INCREASING RETIREMENT SAVINGS TO ADEQUATE LEVELS

Plan Sponsors Are Aware Participants Need to Save More and Are Willing to Make Changes

Whether currently sponsoring a plan or not, on average, employers believe that employees should be saving approximately 12–16 percent of pay over the course of a career (including employer match/contributions) in order to have adequate income in retirement.

• Employers who sponsor plans say employees should save an average of 12 percent of pay in order to provide adequate income during retirement, including employer contributions.

[4] Principal Financial Well-Being Index, Third Quarter 2011.
[5] The current percentage of startup costs eligible for credit is the lesser of 50 percent of start-up costs or $500.
[6] The current time period for the credit is 3 years.

• Employers who don't currently sponsor a plan say employees should be saving an average of 16 percent of pay.

Many plan sponsors would be willing to modify their defined contribution plan features if they were shown research that such modifications would increase employee participation or retirement savings levels.

• Over one out of five plan sponsors (22 percent) who do not have automatic enrollment would be more likely to add automatic enrollment if shown research that shows it increases employee participation rates.
• 40 percent of plan sponsors offering automatic enrollment would consider a 6 or 8 percent default deferral rate for employees who are auto enrolled in the plan.
• 32 percent of plan sponsors who have automatic enrollment and automatic escalation would be willing to implement a 6 percent default rate/1 percent annual auto increase up to 15 percent if they were shown research that indicates participants would not opt out of the plan. Only 12 percent of these plan sponsors said they would not consider this design.
• Two-thirds of plan sponsors would be willing to improve education to promote savings levels of at least 11–15 percent of pay (including employer match) if shown research recommending plan participants save at least that amount throughout their entire working career.

OUR POSITION: Promote adequate savings levels and encourage use of plan designs that increase participation and savings.

The most challenging question facing participants is how much to save to have adequate income in retirement. We advocate basing that answer on a target income replacement ratio. In other words, saving enough to replace a percentage of projected pre-retirement income. We suggest a target income replacement ratio of 85 percent of pre-retirement salary as the standard for determining if an individual is on track. This figure is based on our analysis that, on average, an individual will need an 85 percent replacement ratio to generate sufficient income for retirement, especially with the high cost of health care.

Our analysis further shows that to reach that 85 percent income replacement ratio target—which includes Social Security benefits, personal savings and employer-sponsored contributions via retirement plans—an individual needs to achieve a savings rate **over their working life** of between 11 and 15 percent of pay (including employer contributions).[7]

This savings range will be higher or lower depending on several factors, including the age at which retirement savings begins and whether other assumptions,[7] including market performance, are met. Our current market performance assumption of 8 percent is developed by Ibbotson Associates based on 30 years of historical performance of various industry benchmarks, and is considered a long-term view of the marketplace, which we believe is appropriate for long-term retirement savings. Ibbotson updates projections annually, at which time we re-assess our assumptions.

There are plan design changes plan sponsors can make now to help motivate participants to save more effectively. In our 2011 white paper, *Our View on Retirement Readiness: How to move from a "popular" plan to a successful plan*, we outline design changes that enable employees to boost contributions and participation. Those plan designs include:

• Redesigning employer matching formulas to encourage higher employee deferral levels. The following chart[8] illustrates three different employer match formulas for the same employer dollar expenditure. The average overall deferral by participants increases as the employer match formula is stretched.

[7] The savings rate estimate of 11–15 percent of pay (including employer contributions) is calculated based on a goal of replacing 85 percent of salary, while drawing 4 to 5 percent of the retirement funds annually and assumes a 40-year span of accumulating savings, as well as the following:

• Retirement at age 65;
• Social Security providing 40 percent of replacement pre-retirement income;
• Long-term annual market returns of 8 percent;
• Annual inflation rate of 3 percent; and
• Annual wage growth of 4 percent over 40 years in workforce.

[8] Principal Financial Group Analysis, Dec. 2010. Data based on a group of 6,560 contracts that show a stated match formula.

Match formula	Maximum employer amount (percent)	Average overall deferral (percent)	Total contribution to the plan (percent)	Average participation rate (percent)
100 percent on deferrals of up to 2 percent of pay	2	5.3	7.3	66
50 percent on deferrals of up to 4 percent of pay	2	5.6	7.6	67
25 percent on deferrals of up to 8 percent of pay	2	7.0	8.8	65

- Redesigning automatic enrollment features by:
  - Setting an appropriate default rate of at least 6 percent,
  - Coupling automatic enrollment with auto-escalation, and
  - Re-enrolling all employees each year.

Concerns are often raised when considering to increase the default deferral rate that the result will be substantially higher numbers of employees opting-out of automatic enrollment entirely. However, based on analysis we have completed, it indicates that when plan sponsors set a higher automatic enrollment default rate it can result in higher savings rates without negatively affecting participation.[9] Additionally, we found:

- Nearly twice as many participants (61 percent) reach an overall savings rate greater than 11 percent when their employers' plans default them to 6 percent versus 3 percent (32 percent).[10]
- Participants have the option to opt out of the plan or the automatic deferral rate. However, automatic enrollment at 6 percent increased opt outs from the plan by just 4 percentage points over the 3 percent auto enrollment level.[11]

Congress can help encourage re-designed automatic enrollment features that encourage savings:

- Update existing automatic enrollment arrangements to encourage setting a default deferral level higher than 3 percent.
- Remove the 10 percent cap on default deferrals and auto escalation in the Qualified Automatic Contribution Arrangement.
- Provide an additional tax incentive for employers who use auto escalation that could be used to help provide the match above a certain amount if auto escalation is used.

For employers with plans that are not a good fit for automatic enrollment, such as employers who have high turnover or a high number of seasonal employees, there are other plan design changes that can help break through the inertia that prevents individuals from enrolling in plans or not maximizing savings. These designs may include changes to entry and vesting requirements and limiting withdrawal options.

Finally, we are working with financial professionals to help plan sponsors with a more effective measure of retirement plan success. Rather than the traditional method of looking at participation rates, we encourage plans sponsors to look at plan income replacement ratios as a more accurate measure of whether a plan is helping employees save successfully for retirement.

SECURING INCOME TO LAST THROUGH RETIREMENT

Plan Sponsors Need Regulatory Clarity to Address Retirement Income Challenges

Plan sponsors say their employees are unprepared to manage their money in retirement, though there is less agreement on the employer's role in helping employees with retirement income management.

- Only 15 percent of plan sponsors say their employees are prepared to manage their money in retirement.
- Nearly one-third (30 percent) of plan sponsors state they should play a role in helping employees turn retirement savings into retirement income, while a little over a third (38 percent) say they should not play a role. The remaining (31 percent) of plan sponsors are not sure if they should play a role.

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[9] Principal Financial Group Analysis, Dec. 2010. Data based on a group of 115,728 participants in active auto-enroll contracts with a default deferral percentage of 3 percent.

[10] Principal Financial Group Analysis, Dec. 2010. Data based on a group of 44,782 participants.

[11] Principal Financial Group Analysis, Dec. 2010. Data based on a group of 203 retirement plans that offer automatic enrollment at a 6 percent default rate.

• The majority of plan sponsors (79 percent) are not in favor of the government mandating that all employees must put a portion of their retirement savings into an annuity.

• While the majority (75 percent) of plan sponsors say that requiring retirement income projections on defined contribution employee statements would be helpful, two-thirds are concerned that the assumptions made in calculating income projections may be wrong and that the employer could be liable if employees do not receive this amount.

Employers support making financial literacy education more available.

• Three-quarters (76 percent) of plan sponsors and 67 percent of employers who do not sponsor a plan agree that financial literacy education should be made more available to employees.

• early three out of five plan sponsors (57 percent) say retirement plan providers should be the entity to provide financial literacy education, followed by schools (13 percent).

OUR POSITION: Publicize and promote savings levels for adequate retirement income. Enhance each part of the retirement system.

Many individuals simply do not have a realistic understanding of how much money they need in retirement or how much they can spend before they run out of income from their savings. To address this need, the industry must work with plan sponsors through education strategies to promote savings at sufficient levels such as 11–15 percent or more of pay over a working career.

We also advocate broader use of retirement income illustrations on benefit statements to drive home how long savings are estimated to last in retirement and help change how employees think about saving for their futures. Approximately 75 percent of the retirement plans we service use such illustrations.[12]

We have asked the Department of Labor to address employer concerns about their potential liability and encourage these illustrations as a best practice by:

• Providing regulatory guidance that the retirement income illustration is an estimate and not a guarantee to alleviate fiduciary concerns for plan sponsors.

• Encouraging employers to voluntarily provide education about and access to income annuities at the worksite by clarifying ERISA regulations to alleviate fiduciary concerns.

Voluntary worksite retirement plans like the 401(k) plan are only one component of the retirement system. To tackle the key challenges to retirement savings, all facets of the system must be addressed.

We encourage legislators to support existing defined benefit plans with funding rules that help provide predictability. Lawmakers should also carefully consider the potential negative impact of any changes to Pension Benefit Guaranty Corporation (PBGC) premiums.

We must also take action now to ensure solvency of Social Security benefits. Addressing Social Security solvency sooner rather than later will help lessen the number of changes needed and minimize the negative effect on the security of Americans. We believe a combination of benefit adjustments and tax changes could be made now to reduce the current financial imbalance and spread the sacrifice across generations.

Finally, there is a clear need to expand financial literacy. Employers look to the financial industry to take the lead in providing financial literacy in the workplace. Any solution needs to include a renewed commitment to financial literacy from elementary school through the working years.

CONCLUSION

The Nation's retirement savings challenges can be overcome. It is critical that any steps taken to address those challenges preserve and build on the firm foundation of the current voluntary worksite retirement system. That is why it is so important to take into account how proposals would impact the employers who voluntarily set up and operate these plans. The financial services industry will continue to take steps to improve plan design to better ensure retirement readiness, but it is clear that regulators and legislators can play a role in encouraging more employers to sponsor plans and employees to save more in those plans. Working together, we can help ensure a more secure future for American workers.

[12] Principal Financial Group Analysis, Aug. 2011. Data based on a group of 29,000 retirement plans that allow income projections to be displayed and have provided required 415 salary information for participants.

SURVEY METHODOLOGY

This survey was conducted online within the United States by Harris Interactive on behalf of the Principal Financial Group from May 17–June 17, 2011 among 507 U.S. adults aged 18 and older who are employee-benefit decisionmakers for companies with 10–500 employees and do not currently offer defined contribution retirement plans. Seven-hundred and ninety-eight employee-benefit decisionmakers for companies with 3–1,000 employees that do offer defined contribution retirement plans were also surveyed. These decisionmakers were selected from a Principal Financial Group client list, and their data was not weighted. This online survey is not based on a probability sample and therefore no estimate of theoretical sampling error can be calculated. For complete survey methodology please contact Sarah Ehlinger at Ehlinger.Sarah@principal.com.

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RESPONSE BY ALIYA WONG TO QUESTIONS OF THE HELP COMMITTEE

SUMMARY

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as State and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the Nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—is represented. Also, the Chamber has substantial membership in all 50 States.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

The U.S. Chamber of Commerce would like to thank Chairman Harkin, Ranking Member Enzi, and members of the committee for the opportunity to participate in today's Roundtable discussion on Pension Modernization for a 21st Century Workforce. I am Aliya Wong, executive director of retirement policy for the U.S. Chamber of Commerce. 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.

The topic of today's hearing—Pension Modernization for a 21st Century Workforce—is of significant concern to our membership. Businesses in America, large and

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[14] As of June 30, 2011.

small, maintain a long-held commitment to providing voluntary benefits that support the welfare of their workers. Retirement security in particular is a significant focus of voluntary benefit offerings. As Americans live longer, healthier lives, retirement security becomes a greater concern. The private employer-provided retirement system has contributed greatly to the current retirement security of millions of Americans.

While the focus of today's Roundtable is on defined benefit plans, I would be remiss not to mention the success of the entire private retirement system which also includes defined contribution and individual account plans. Today, 82 million households have defined benefit plans, defined contribution plans, or individual retirement accounts. These households have a combined $17.9 trillion earmarked for retirement.[1] Moreover, income from defined benefit and defined contribution plans represented 19 percent of retiree income in 1975; whereas, by 2009, it accounted for 26 percent of retiree income. The number of retirees receiving retirement income from employment-based plans has also grown, from 20 percent of retirees in 1975 to 31 percent in 2009.[2] Much of this growth can be attributed to defined contribution plans. Since 1975, the number of defined contribution plans has almost quadrupled, from 207,748 to 659,530 in 2007.[3] In 1992–93, 32 percent of workers in private industry participated in a defined benefit plan, while 35 percent participated in a defined contribution plan.[4] According to the 2008 National Compensation Survey, private industry workers' participation in defined benefit plans decreased to 21 percent, while participation in defined contribution plans increased to 56 percent.[5] These numbers show that participation in the entire retirement system is steadily increasing.

In April of this year, the Chamber issued a white paper entitled "Private Retirement Benefits in the 21st Century: A Path Forward" in response to concerns about retirement security. The paper was developed with members of the Chamber's Employee Benefits Committee to offer guidelines on initiatives and reforms that will continue to bolster the voluntary employment-based retirement benefits system and retirement security for workers. The answers to the Roundtable questions below reflect the ideas and positions contained in the white paper as agreed upon by our membership.

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. In order to meet the challenges of the global economy and the need to provide retirement security, it is important that the private system remain voluntary, flexible, and include incentives for saving. In addition, we believe that any changes to the current system should focus on simplicity, and encourage innovation.

The Chamber believes that the key element of the private retirement system is its voluntary nature. While there is widespread agreement on the importance of retirement savings and programs, not every employer is able to offer a retirement program. Employers that have extremely small profit margins cannot afford mandatory benefits without losing employees. In addition, concerns about liability and administrative burdens could also negatively impact the productivity of business.

No single plan design is perfect for every company or every worker. Therefore, the private retirement system has encouraged innovation in plan design, and many employers have more than one type of plan as part of their retirement program. One

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[1] Investment Company Institute, Retirement Assets Total $17.9 Trillion in Fourth Quarter 2011, April 2, 2012, *http://www.ici.org/research#retirement__research*. These figures also include assets held in government-sponsored plans because there is overlap in participation between private and government plans and participation in government plans is also an important part of retirement security.

[2] Investment Company Institute, Helping Working Americans Achieve a Financially Secure Retirement: How the 401(k) System Is Succeeding, July 2011, *http://www.ici.org/pressroom/speeches/11__pss__ayco__401k*.

[3] U.S. Department of Labor, Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables, December 2011, p. 1, *http://www.dol.gov/ebsa/pdf/historicaltables.pdf*.

[4] Allan Beckman, "Access, Participation, and Take-up Rates in Defined Contribution Retirement Plans Among Workers in Private Industry, 2006," Bureau of Labor Statistics, December 27, 2006, *http://www.bls.gov/opub/cwc/cm20061213ar01p1.htm* (accessed August 11, 2010).

[5] Bureau of Labor Statistics, "Percent of Workers in Private Industry With Access to Retirement and Health Care Benefits by Selected Characteristics: 2008," *http://www.census.gov/compendia/statab/2010/tables/10's0639.pdf* (accessed August 11, 2010).

of the great successes of the private retirement system has been the ability of employers to implement new plan designs to accommodate changing demographics and evolving workforce needs. Innovation in plan design has encouraged employers to continue to participate in the private retirement system.

For employers that choose to implement retirement programs, flexibility and choice are key considerations. The mix of types of benefit plans in the future will be diverse—defined benefit, defined contribution, multiemployer, and hybrid plans. Demographic and competitive needs will spur the creation of plan designs that we have not even begun to contemplate. Consequently, it is more important than ever to ensure that there are no statutory, practical, or political barriers to innovation that would discourage participation in the private retirement system.

In addition to innovations in plan designs, we are witnessing an evolution of another type. Retirement in America is changing, a fact that can be attributed both to hard economic times and evolving views of what retirement should be. Many of today's older workers see retirement as a whole new life chapter rather than a time to wind down. There is no longer a monolithic vision of retirement. Therefore, flexible laws are needed to continue to serve retirees who no longer work while also encouraging those who are able and willing to continue to work.

While we work to enhance the current private retirement system and reduce the deficit, we must not eliminate one of the central foundations—the tax treatment of retirement savings—on which today's successful system is built. Employer-sponsored retirement plans have introduced tens of millions of American workers to retirement saving. Eliminating or diminishing the current tax treatment of employer-provided retirement plans would jeopardize the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. There is no silver bullet that will resolve the issues of retirement coverage and savings. Small businesses members have stated that the Chamber cannot over-emphasize the need for simplification and a reduction in unnecessary regulatory requirements in the current retirement system. Small businesses are focused on running a business; therefore, anything that avoids increasing their liability and decreases their administrative burdens is important. In addition, stability, predictability and consistency among the regulatory agencies would go a long way toward encouraging greater participation in the private retirement system. We have several suggestions for making traditional pension benefits more attractive. Nonetheless, even with greater incentives and changes to defined benefit plans, we do not believe that traditional pension plans will be appropriate for every employer or employee. For example, the average job tenure is now less than 5 years. In certain industries—particularly retail—turnover rates are significantly higher. As such, a traditional pension plan would not be appropriate.

• *Reform Single-Employer Defined Benefit Funding Requirements.* The number of defined benefit plans has been declining. Plan sponsors face a number of challenges, the greatest of which is the need for predictability and flexibility. Since 2002, Congress has passed five laws that address defined benefit funding. For more than a decade, the legality of hybrid plans was unresolved, and plan sponsors of those plans were unable to get determination letters. Since the recent financial crisis, inflexible funding rules have created unexpected financial burdens for plan sponsors. All of these scenarios have had a negative impact on the employer-provided retirement system. Therefore, the Chamber urges Congress to keep in mind the need for predictability and flexibility to ensure that employers can continue to maintain plans that contribute to their workers' retirement security.

Policymakers can take several steps to encourage sponsorship of defined benefit plans. To improve defined benefit plan funding, the law should allow for unlimited prefunding up to the amount of projected future benefits in the plan. Additionally, the Internal Revenue Service (IRS) should eliminate the tax penalty for the reversion of assets in a pension plan after all promised benefits have been paid out to participants.

• *Clarify the Hybrid Plan Rules and Regulations.* The Chamber views hybrid plans as an important part of the private retirement system. Therefore, the Chamber worked for several years toward the confirmed legality of hybrid plans in the Pension Protection Act (PPA) (and as amended by the Worker, Retiree, and Employer Recovery Act of 2008). However, because of the previous controversy surrounding hybrid plans, they are less widespread than they should be. Therefore, we believe that the rules provided under the PPA and the ensuing guidance from the Treasury and the IRS should provide plan sponsors with enough certainty to establish and maintain hybrid plans and to allow for greater participation in these plans. Specifically, we urge the Treasury and IRS to set forth a clear and rational approach to PPA compliance for Pension Equity Plans. More broadly, because of the complexity of hybrid plans and their regulation, additional guidance is critical to ensure that plan sponsors have enough clarity and flexibility to adopt and maintain hybrid pension plans with legal certainty.

• *Streamline Notice Requirements and Allow for Greater Use of Electronic Disclosure.* Consolidating and streamlining certain notice requirements would make retirement plan sponsorship more attractive for business and for small businesses in particular. Currently, plan sponsors and participants are overwhelmed by the disclosure requirements. This feeling is particularly acute for small businesses that may not have a human resources department to focus on notice requirements. Furthermore, the notice requirements do not occur in a vacuum—employers are required to provide many other notices outside of the ERISA context. A thorough congressional review could identify many ways of relieving unnecessary administrative burdens of little or no utility while ensuring that participants receive information that is meaningful and relevant.

In addition to consolidation and elimination, it is important for regulators to recognize the benefit of electronic delivery, which is faster, cheaper, and better than any other form of delivery. We believe that it is critical for the Department of Labor, Department of the Treasury, and the Pension Benefit Guaranty Corporation (PBGC) to create a single, uniform electronic disclosure standard and we recommend that all of the agencies change their standards to encourage the use of electronic delivery and to allow, for plan sponsors that wish, electronic delivery to be the default delivery option for benefit notices. The Chamber believes that modernizing the restrictive rules on electronic delivery is a critical element in the larger task of reforming employee benefit plan notice and disclosure requirements. These changes can allow important information to be provided without being submerged in an avalanche of rarely used information.

• *Create Greater Transparency in Accounting Standards for Employer-Provided Benefit Plans.* Under Sarbanes-Oxley, the Securities and Exchange Commission designates an accounting standard-setter and sets its budget. The Financial Accounting Standards Board (FASB), a quasi public-private organization, has been designated as this accounting standard-setter. The Chamber fully supports independent standard-setting. However, dialog and input from stakeholders is important to the process, and we believe that process improvements, such as transparency and cost-benefit analysis, are needed to ensure appropriate levels of input.

Various accounting rules and practices in the past have discouraged the continuation of defined benefit pension. Despite the best efforts of policymakers to create an environment that encourages more assertive action in these areas, these efforts can be significantly affected or undone by the actions of FASB. The negative impact of FASB standards has been seen in the area of retiree health care plans, single-employer defined benefit plans, and, most recently, multiemployer defined benefit plans. To ensure that employers are not unintentionally discouraged from participation in the retirement system, it is necessary to address the accounting practices associated with voluntary benefit plans.

• *Give Small Businesses a Dedicated Voice on Advisory Councils.* Small businesses play an important role in the debate over the effectiveness of the voluntary employer-provided system; therefore, it is important to increase their representation in the debate. The advisory councils to the DOL, IRS, and PBGC are important sources of input to those agencies. However, none of them have a seat specified for small business. An important way to increase the voice of small business in the discussion of the employer-provided system is to have a small business representative on each of these advisory councils.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. Much like employers, employees also need flexibility and innovation. While asset accumulation has long been the focus of retirement planning discussions, the decumulation of those assets in retirement has become an important consideration. As people live longer in retirement, they must consider ways to manage assets to provide a steady retirement income stream. Policymakers, industry, and employers are increasingly focused on ways to help individuals convert their accumulated savings into retirement income streams (including guaranteed options and systematic withdrawals) that will see them through a retirement that could last more than 30 years. The Chamber supports greater education for participants, innovation among products, and flexibility for employers to try new products and programs.

• *Phased Retirement.* Given current unemployment numbers, it is difficult to imagine an employment shortage. However, because of the demographics of our population, we can expect employment strains in certain industries and regions. Although there is no official definition of phased retirement, it generally refers to any arrangement whereby a worker at or near regular retirement age continues to work, but at a reduced schedule, a reduced salary, reduced responsibility, or a combination of all three. Sometimes the phased retiree will continue receiving health benefits or will begin receiving a pension. Many phased retirement arrangements are informal, but some employers—particularly universities—have formal phased retirement programs.

Employers looking at a possible brain drain want to keep their experienced and skilled workers in order to remain competitive. However, several barriers exist to phased retirement. Legal barriers restrict when benefits can be paid out. Fiscal barriers include the costs associated with employing older workers, such as increased pension payments and higher health care coverage costs. Policy and practical barriers include how accruals should be calculated during phased retirement or how to apportion the payout. These barriers have prevented many employers from implementing phased retirement programs. In summary, we believe the following principles are necessary in discussing any phased retirement policy:

- Continue to treat phased retirement programs and practices as discretionary arrangements;
- Legislative and regulatory modifications required (for example, to the anti-cutback rules and the non-discrimination rules);
- Allow, but not require, employers to continue to offer health benefits.

• *Encourage Additional Distribution Options.* To encourage continued innovation and growth of financial products, it is important that lawmakers approach decumulation issues in a product-neutral manner. Public policy in this arena should encourage education on the various distribution options and to encourage product innovation to meet the varied needs of savers and retirees. Employers should not be required to offer specific distribution options in their retirement plans. Rather, lawmakers should encourage and incentivize employers to implement additional payout options beyond the lump-sum option.

• *Encourage Employers to Offer Voluntary Products.* There are a number of voluntary products that participants might find helpful in managing retirement assets. However, not every product will be appropriate or necessary for every participant. Therefore, we recommend that employers be able to make these products available to their workers in the most efficient and flexible way possible, such as through a cafeteria plan or with 401(k) plan savings.

- *Retiree Health Care.* Rather than requiring that employers offer specific products or implement retiree health plans, the Chamber recommends that plan sponsors be allowed to offer insurance products and retiree health savings accounts through cafeteria plans. This step would provide important tools for employees to manage future costs in retirement. It could also reduce retiree reliance on State and Federal Government support systems.
- *Long-term Care Insurance.* The increase in life expectancy is spurring a need for long-term care. Encouraging the purchase of long-term care policies could have far-reaching benefits. It would reduce the extreme financial burden of long-term care costs to individuals and their families, and to government support systems. To help pay for long-term care insurance premiums while they are affordable, employees should be able to access 401(k) plan assets during their working years. Another alternative is to encourage employers to offer long-term care insurance through a cafeteria plan on a pretax basis.
- *Longevity Insurance.* The increase in life expectancy also increases the chances that retirees will outlive their retirement income. To avoid this situation, a retiree could purchase longevity insurance, a form of deferred annuity with a payment start date that begins at a later age in retirement. One way to encourage the purchase of longevity insurance is to exclude money used to buy the product from the required minimum distribution rules. Also, as with long-term care insurance, longevity insurance could be purchased through a cafeteria plan or with 401(k) plan savings.

In conclusion, the Chamber encourages action by policymakers that will maintain the success of the current system and ensure that employer-provided plans continue to play an important role in retirement security. We look forward to working with this committee and Congress to forward ideas that will encourage further participation in the employer-provided system rather than driving employers out of it. Thank you for your consideration of this statement.

RESPONSE BY JIM DAVIS TO QUESTIONS OF THE HELP COMMITTEE

Question 1. Defined benefit pension plans have provided a secure retirement for millions of middle-class Americans, but it is clear that the traditional pension system is in decline and that existing defined benefit pension models may not be well-suited for some of our 21st century workforces. What should our pension system look like to meet the challenges of the global economy and the need to provide retirement security for working Americans?

Answer 1. The goal of any pension system should be to provide for a safe and secure retirement.

A pension plan should be mandatory. If voluntary worked, we would not find ourselves in this dire situation.

It should be professionally managed. Investing for retirement requires a very consistent, disciplined effort applied without emotion.

Funds should be allocated over a wide variety of investments in order to minimize risk.

A modern pension system should be predicated on the reality that we now live in a global financial system.

An employee should have 1 year of service at their employment location in order to be eligible to receive a pension. The pension plan should be subject to a 5-year vesting schedule.

Question 2. What would make it easier and attractive for businesses—especially small businesses—to provide their employees with a traditional pension benefit? Would reducing the employers' risk and plan complexity help?

Answer 2. Employers want a system that makes it easy to participate in without additional burdensome and time-consuming paperwork.

Employers do not want it to be so costly that it makes their business uncompetitive.

Employers want a competent fiduciary to manage the funds so that they are not forced to spend time managing a plan. Employers do not want to make allocation decisions for which they are not capable. Employers do not want to own any pension plan.

Employers should expect to provide 3 to 5 percent of an employee's annual salary for a pension program.

Employers should be able to provide additional retirement benefits without costly testing or rules.

Question 3. What do employees need from a pension plan to ensure that they will have a secure retirement?

Answer 3. Employees want to have a pension plan that provides a supplement to their monthly income.

Employees want the peace of mind that comes from knowing their assets are safe and secure.

Employees need reassurance that measures have been taken to prevent the reoccurrence of the financial meltdown of 2008.

Individuals should not be left to fend for themselves. No matter how capable an individual may be in their particular occupation, they will not have the ability to make complex investment decisions.

Employees should match the percentage contributed by their employer.

Studies show that the happiest people are those that have good pensions.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

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