AMERICAN BENEFITS COUNCIL

TESTIMONY OF LYNN DUDLEY,
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AMERICAN BENEFITS COUNCIL

BEFORE THE

HOUSE OF REPRESENTATIVES
COMMITTEE ON EDUCATION AND LABOR
SUBCOMMITTEE ON HEALTH, EMPLOYMENT,
LABOR AND PENSIONS

FOR THE HEARING ON

"SECURING RETIREMENT COVERAGE
FOR FUTURE GENERATIONS"

THURSDAY, NOVEMBER 8, 2007

Mr. Chairman, thank you for the opportunity to appear before this Subcommittee. My name is Lynn Dudley, Vice President, Retirement Policy for the American Benefits Council. The Council is a public policy organization representing principally large companies and other organizations that assist employers of all sizes in providing benefits to employees. Our members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

Mr. Chairman, I commend you and Ranking Member Kline for your leadership in retirement policy. Your knowledge and commitment contribute enormously to a successful voluntary employer-based retirement system that provides a secure retirement for millions of workers and their families. I also commend you and the other Members of the Committee for shining the spotlight on the need to improve retirement coverage for future generations. The Council's members offer some of the most generous health and retirement benefits programs available to workers, but remain committed to addressing the continuing problem of coverage among employees of other organizations. Retirement plan coverage is integral to achieving personal financial security. Achieving personal financial security provides employees and their families the ability to successfully meet both their retirement and health care needs.

We urge you to continue to be active in fostering policies that encourage American employers to offer retirement programs to their employees. The voluntary employer-sponsored retirement system is a bright spot on the savings landscape. As of 2005 (the most recent year for which data is available), American families had accumulated more than $14 trillion in retirement. This tremendous pool of capital is an essential source of retirement income security for millions of Americans and a major driver of the U.S. economy. The nation's private sector defined benefit pension system provides coverage to one-fifth of all working Americans, totaling nearly $2.3 trillion in assets, and remains a cornerstone retirement program for many. Meanwhile, the defined contribution plan system has expanded over the last 20 years, now covering more than half of all working Americans, and represents a great source of retirement income security. Financial assets in 401(k) and similar defined contribution plans now total almost $3.3 trillion.

While individuals can save on their own without an employer-sponsored plan, savings rates are much higher when employees have the opportunity to save through an employer plan. Though there are proposals for designs that would create new universal retirement vehicles, the value of the role of the employer who has designed a plan with a specific workforce in mind should not be underestimated. While there is a certainly a role for personal non-workplace savings vehicles in achieving personal financial security, we firmly believe more can and should be done to promote the voluntary establishment and maintenance of retirement plans by employers.

In 2004, the Council released a long-term public policy strategic plan, Safe and Sound: A Ten-Year Plan for Promoting Personal Financial Security, which is attached to this testimony. It assembles in one document a comprehensive analysis of the dimensions of the health, retirement and demographic challenges facing our nation. The report sets forth very specific measurable goals for the retirement (and health benefits) system to be achieved by the year 2014. During the last Congress, we saw the passage of the Pension Protection Act which contained a number of very important changes to the rules governing retirement plans, many of which were advocated by the Council, including the permanence of EGTRRA dollar limits applicable to retirement plans, the promotion of automatic enrollment and automatic increase features and access to investment advice. Safe and Sound contains additional important recommendations we believe will lead to greater coverage of workers in employment-based retirement plans and increased savings by those that are covered.

Employment-Based Retirement Plans Increase Savings

The success of the employment-based retirement system at spurring employee savings, even when not supplemented by employer contributions or other employer-funded benefits, is largely attributable to the characteristics of the employment setting. For example, savings are greatly enhanced by the opportunity for payroll deduction. If workers can elect to have a portion of their pay regularly set aside for savings, rather than having to affirmatively make a decision to set aside funds, it is clear that more is saved. Further, pooling money in employer-sponsored retirement savings vehicles enables individual participants to benefit from economies of scale and to lower their transaction costs, thereby increasing asset accumulation and wealth.

That the system has been a success with respect to spurring savings is nearly indisputable. Of the $14 trillion in the U.S. retirement system in 2005, more than $5.5 trillion had been put aside through the use of private employer-sponsored retirement plans, including defined benefit and defined contribution plans. An additional $3.7 trillion had been collected through the use of federal, state and local government plans and individuals had accumulated more than $3.5 trillion in IRAs – amounts which are largely attributable to rollovers from employment-based plans. While some of these funds undoubtedly would otherwise have been contributed to other types of accounts, it seems apparent that much of the savings in the U.S. retirement system is new savings.

Many of the new individual savings programs that have been proposed are modeled on this idea and include payroll deduction and pooled money. Their proponents' goals, like the Council's, are to improve savings opportunities and coverage. Virtually all Council members already sponsor retirement programs that provide very meaningful benefits across the income spectrum. Any new savings vehicles need to complement the employer-based system. New ideas should not be structured so as to undermine the maintenance of retirement plans by employers and participation in employer-based plans by employees. Policymakers need to weigh the objectives of new proposals with an eye towards (1) whether they create new savings or pull savings away from existing retirement vehicles, (2) whether they create new administrative complexities, and (3) whether they replace savings features carefully designed for a particular workforce with savings features based on bureaucratic determinations far removed from the people they are intended to help.

American workers value their employer-sponsored retirement plans and so do American businesses. A recent survey by Watson Wyatt concluded that an attractive retirement plan plays a significant role both in attracting and retaining employees. Employers of all sizes have an interest in attracting and retaining workers and voluntarily offer retirement plans to meet these challenges. Additionally, evidence indicates that satisfaction with retirement plans increases worker productivity and improves shareholder returns. These are powerful business incentives upon which employers -- given a good regulatory and legal framework -- are likely to act.

It has been suggested that the size of the employer and the income range of the workers are often determinative of the employer's commitment to maintaining a plan. However, we believe employers of all sizes have reasons to attract and retain talented workers. It is simply that there are unique issues that affect small employers' decisions about retirement plans that have more to do with capital needs and stability in their business. Once stable, there is every reason to believe that small employers would be interested in maintaining a retirement plan for their workers. In addition, we find that plan sponsors provide retirement plans even where significant portions of their workforces have more modest incomes.

However, the voluntary retirement system involves a careful balancing of interests designed to encourage employers to maintain plans while ensuring that retirement savings are accumulated for the benefit of workers at all income levels. Generally, this entails not overburdening the sponsors with costs, complexities or administrative burdens and yet providing reasonably objective criteria for determining whether plans are providing widespread coverage. Increasingly, concerns about unanticipated liability are playing an important role in the decision as to whether to offer a retirement plan.

For many workers who are living from paycheck to paycheck, the savings created by employer contributions and other employer-funded benefits are their only savings. For others, matching contributions offer an important incentive to save more. Even for active savers, the convenience of payroll deduction encourages greater savings. In one recent study conducted on behalf of the National Bureau of Economic Research (NBER), economists found that in addition to increasing retirement savings, employer-sponsored retirement plans significantly increase overall savings. The study even suggests that having a retirement plan may "induce an increase in the holding of other assets," thereby resulting in a further increase in total savings.

In this regard, the employment-based retirement system serves two essential public policy goals. It increases overall capital accumulation and wealth, and it enhances retirement security of American families. In both respects, the U.S. retirement system has been an enormous success.

Recent Law Changes Encourage Coverage

We believe the recent passage of the Pension Protection Act (PPA), including the permanence of EGTRRA contribution limits coupled with provisions promoting automatic enrollment and automatic increase designs, will significantly improve coverage amongst employees that have access to a retirement plan but do not take advantage of it and will increase the employees' savings levels. According to a recent survey conducted by Hewitt Associates, 36 percent of plan sponsors offered automatic enrollment to new employees in 2007, with more than half of the remainder very or somewhat likely to implement it within the year.

Expanding access to investment advice in the PPA was also an enormously important step. It will improve participation amongst employees who have access to a retirement plan and will contribute significantly to a culture of savings that helps employees remain committed to savings programs and increased savings levels. We applaud the leadership of Congress and this Committee in the efforts to expand access to investment advice while ensuring appropriate protections for employees using the advice. We also commend the sensitivity to the importance of limiting plan sponsors' exposure to fiduciary liability in connection with the provision of such advice in the workplace.

However, more can and should be done to expand the number of employers maintaining retirement plans and to encourage employers to remain in the system. This is not limited to small employers where there is less likely a retirement plan already being sponsored. Small start-up companies often do have the fundamental issues associated with worrying about sufficient capitalization and stability of their business. However, <u>all</u> employers are struggling with the current health care system. The health care issues are inextricably related to a successful employer-sponsored retirement system. Addressing the spiraling health care costs and quality issues will free resources of both employers and employees currently being drained to pay for health care. Finally, in addressing retirement plan coverage, the need for integrated savings and benefit vehicles that address growing longevity and retiree health needs cannot be ignored.

The nine aspirational goals contained in <u>Safe and Sound</u> to be achieved within 10 years, would greatly improve the benefit security of the American workforce, and would strengthen overall personal financial security. They include goals relating both to retirement income and goals relating to improving the ability of the individual to meet health care needs as they arise. While all of the goals and recommendations included within the report are important elements of the Council's vision for the future, I would like to focus specifically on two of them in this testimony.

Raise Financial Literacy

The first goal relates to enhancing financial literacy. Specifically, Safe and Sound states the following goal:, "by 2014, virtually all households will have access to some form of investment education and advice and 75 percent of households will have calculated the amount of retirement savings needed to maintain their standard of living throughout retirement, as well as the savings rate necessary to achieve this target."

One of the most basic elements of savings is understanding the need to save. Yet financial literacy is deficient across all generations and socio-economic levels. The National Council for Economic Education Studies (NCEE) reports that nearly two thirds of American adults and students do not understand basic economic principles such as "inflation."

One aspect of financial literacy is understanding how much one needs to save to reach one's retirement goals. The goal of 75 percent was chosen because it represented a significant increase from the peak level reported in the 2000 Retirement Confidence Survey conducted by the Employee Benefit Research Institute (EBRI). The 2007 Retirement Confidence Survey by the Employee Benefit Research Institute (EBRI) underscores the continuing need to promote financial literacy, noting that the majority of Americans – 57 percent – have not calculated how much money they will need to save in order to live comfortably in retirement. Of those individuals that have considered retirement, data from the survey suggests that many of these individuals may be underestimating how much savings they will need for a secure retirement. The calculation regarding the amount needed to save was chosen as a critical benchmark because it indicates that a worker has achieved enough financial literacy to begin retirement planning and is prepared to take steps to act on what has been learned.

Another aspect of financial literacy is managing the investment of retirement assets. Many lack the knowledge necessary to make prudent investment decisions. Even participants who are relatively knowledgeable may lack the time to make and update investment decisions in a consistent and well-informed manner. While the number of people who have access to investment advice is small, it is growing. According to a Hewitt Associates 2007 survey, 31 percent of the employers surveyed offer investment education (education regarding asset class allocation) and 30 percent offer third-party investment advice. However, of the employers who do not currently offer either "education" or "advice," 59 percent and 52 percent, respectively, indicated they were somewhat likely to begin offering it in 2007. We believe, however, that offering advice is a first step in a two step process. The participants have to avail themselves of the advice and then act on it. As regulations are issued in this area and more employers adopt investment advice, we look forward to continuing to work with policymakers to consider ways in which the government and employers can partner to encourage use of these important programs.

It is clear that savings would be materially enhanced if Americans were more financially literate. Listed below are initial policy recommendations drawn from Safe and Sound for achieving the goal of raising financial literacy.

Policy Recommendations:

- Support efforts to expand financial education. Provide public sector and private foundation funding to develop educational tools that can be used by employers, the government and other stakeholders in educating workers about saving, investment and income management principles. First and foremost, the value of participating in employer-sponsored and individual savings programs needs to be emphasized. Education efforts should also include information about the impact of debt and the trade-offs of spending versus saving. Fundamental is the amount needed to be saved and the level of replacement income likely to be needed. Education must include information about the longer life spans people are expected to have in the future, how working longer in the same or another job can enhance savings and how workers can financially prepare for longevity risk.

- Establish financial literacy educational requirements. Financial education should be a high school and college graduation requirement. More states need to be encouraged to adopt financial literacy requirements.

- Promote a focus on retirement planning. Include in the Social Security Administration annual statement mailed to workers information on how to calculate a rough estimate of the amount one needs to save that, when combined with one's projected Social Security benefit, will provide a replacement income of 70 percent of one's pre-retirement earnings (generally considered a benchmark goal of income replacement).

Increase the Share of Workers in Workplace Retirement Plans

Safe and Sound's second goal is to increase employer-sponsored retirement plan coverage and participation. Specifically the goal states that: "by 2014, 96 million (74 percent) of full-time and part-time private sector employees will participate in workplace retirement plans." According to the most recent federal data from a survey of employers, about 74 million full-time and part-time private sector workers in 2006 -- approximately 51 percent of 146 million workers—were covered by a workplace retirement plan.

If participation is to increase, more employers will have to offer retirement plans. This outcome, in turn, depends on devising innovative and flexible plans that are attractive to employers, especially small- and mid-sized businesses.

Defined benefit plans remain a critical part of how many large and mid-sized employers provide retirement security to their workers. All types of defined benefit plans, including hybrid plans, can play a role in increasing participation rates in workplace retirement plans. To the extent that new, innovative hybrid designs can attract more employers to offer defined benefit plans or plans with defined benefit type features, it can help increase both coverage and participation rates. In this regard, it is critical that workable regulations relating to defined benefit pension plans and hybrid plans that implement the intent of Congress in the Pension Protection Act be issued.

Enrolling more employees in defined benefit plans of various designs can provide more workers a guaranteed income in retirement. We are supportive of simplified designs that address employer concerns about volatility and administrative complexity in addition to efforts to support existing arrangements already covering millions of workers.

For many employers, the defined contribution plan design provides flexibility and allows for a more active role for employees in preparing for retirement. Recognizing that even sponsorship of a defined contribution plan is a significant commitment with respect to cost, administration and liability, the Council continues to be supportive of improving simplified defined contribution plans, such as SIMPLE IRAs, that ease employers into the voluntary system without overburdening them with excessive requirements. We believe improvements can be made to these programs to facilitate their use among small employers.

In addition, we believe there is reason to support inclusion in our overall retirement system of an additional savings mechanism that would ensure continuous coverage for individuals, but we recognize it raises numerous administrative questions and problems including the management of very small accounts and the identification and location of missing participants.

Listed below are initial policy recommendations drawn from Safe and Sound for achieving the goal of increasing the number of workers in employer-sponsored retirement plans.

Policy Recommendations:

- Provide a “clearinghouse” plan. Authorize the creation of a “clearinghouse” model plan through federal legislation so workers who change jobs frequently can contribute to one retirement plan. This plan would be modeled on a multi-employer plan model that could provide individuals with one account that would stay with them when they change jobs. Employer contributions to the plan would be voluntary and no financial or administrative requirements would be imposed on employers (other than transferring worker contributions to the plan). This model plan would accept differing levels of employee contributions and employer contributions, and would be able to accommodate different investment vehicles. Any financial services firm meeting certain qualification criteria would be able to offer the “clearinghouse” model plan.

- Facilitate new models for retirement. The Pension Protection Act reduced the age at which employees can begin receiving retirement benefits and remain employed. More should be done, however, to encourage flexible working relationships and benefits arrangements through phased retirement programs.

Conclusion

The current voluntary employer-sponsored retirement system has been an enormous success. While individuals can save on their own without an employer-sponsored plan, savings rates are much higher when employees have the opportunity to save through an employer-provided plan. A broad array of demographic, workplace and economic changes in the decade ahead will provide challenges to personal financial security and the employment-based retirement system. These challenges include the aging of America, changes in the composition of the workforce, evolving changes in social structure and families, and continuously rising health care costs.

Our nation’s employer-based retirement system will continue to be an engine for increased retirement coverage and retirement security if policymakers remain committed to partnering with business to ensure a legal and regulatory framework that both promotes establishment and maintenance of retirement plans by employers and fosters education of Americans on the importance of personal financial security.