Statement of the U.S. Chamber of Commerce

ON: TESTIMONY ON THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

TO: THE COMMITTEE ON SMALL BUSINESS OF THE UNITED STATES HOUSE OF REPRESENTATIVES

BY: JASON SPEER

DATE: FEBRUARY 25, 2009

TESTIMONY BEFORE

THE COMMITTEE ON SMALL BUSINESS

OF THE UNITED STATES HOUSE OF REPRESENTATIVES,

ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

ON

THE DROP IN RETIREMENT SAVINGS: THE CHALLENGES SMALL BUSINESSES FACE FUNDING AND MAINTAINING RETIREMENT PLANS IN A STRUGGLING ECONOMY

BY

JASON SPEER

WEDNESDAY, FEBRUARY 25, 2009

Thank you, Chairwoman Velázquez, Ranking Member Graves, and members of the Committee for the opportunity to appear before you today to discuss challenges facing small business in a struggling economy. My name is Jason Speer, Vice President and General Manager of Quality Float Works, Inc., based in Schaumburg, Illinois. I am pleased to be able to testify today on behalf of the U.S. Chamber of Commerce where I am a member of its Small Business Council. The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. Over ninety-six percent of the Chamber members are small businesses with fewer than 100 employees.

Quality Float Works, Inc (QFW) is a family owned and operated company that manufactures premier metal float balls. We are globally engaged and have grown our sales in the international marketplace. QFW has 24 employees and did approximately $2.7 million in revenue in 2008. We offer employees a 401(k) plan and provide up to a 4% match. The QFW plan enables employees to choose funds, change contribution rates at any time, and work with an advisor to seek guidance. We encourage all employees to participate, as they are like family and we want them to be prepared for retirement. I am the administrator of the plan and in that capacity, it is my responsibility to assist with enrollment, ensure that contributions are transferred to the facilitator, and direct questions to the appropriate person.

Introduction

According to the U.S. Small Business Administration, small businesses (less than 500 employees) represent 99.9% of the total firms and over half of the workforce in the United States.[1] Clearly, ensuring adequate retirement security for all Americans means encouraging small businesses to participate in the private retirement system. Small businesses, in general, face significant hurdles and may view retirement plans as yet another potential obstacle and therefore, choose not to establish them.[2] Thus, there have been tremendous efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.[3] Despite the obstacles, and due to certain incentives, small businesses are having success in the retirement plan arena. Small businesses with less than 100 employees cover more than 19 million American workers.[4] Most of these small business employees enjoy generous annual retirement plan contributions from their employers, often in the range of 3 to 10 percent of compensation. Nonetheless, the current economic environment raises entirely new challenges and obstacles for small business owners.

As you are aware, due to the unprecedented downturn in virtually all investment markets, pension funding ratios have fallen significantly over the past year and it is unlikely that the markets will recover sufficiently in the short term. In addition, corporate bond interest rates fell dramatically during December of 2008, triggering a significant increase in pension liabilities. According to Watson Wyatt, the global pensions balance sheet deteriorated by nearly 29% in 2008, reflecting the combined effects of poor performing assets and lower government bond yields.[5] While there is no specific data for small business plans, these plans are obviously facing similar declines. For QFW specifically we are facing slowing sales due to the economic climate even though our company is diversified. QFW has weathered many ups and downs in the past 94 years and recent additions to our product line led to record sales in 2008. However, due to the current global economic crisis, we predict that 2009 will be a difficult year and are looking at ways to cut costs as sales decline.

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[1] U.S. Small Business Administration Office of Advocacy estimates based on data from the U.S. Dept. of Commerce, Bureau of the Census, and U.S. Dept. of Labor, Employment and Training Administration.

[2] Part of the reason why small business lags behind in retirement coverage is that the first 4 years of a small businesses' existence, they are generally fighting for their lives. Across all sectors, nearly 40 percent of new establishments fail after two years and over 50 percent fail after 4 years. Survival and longevity in the Business Employment Dynamics Data, Amy E. Knaup, http://www.bls.gov/opub/mlr/2005/05/ressum.pdf.

[3] Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that was made permanent by the Pension Protection Act of 2006 ("PPA") small businesses may claim a tax credit for establishing a retirement plan equal to 50% of qualifying costs up to $500 per year for the first three years. In addition, the PPA instituted a number of additional positive reforms including the creation of the Roth 401(k), simplification of a number of complex administrative requirements, and the creation of the DB(k) for small businesses.

[4] Patrick J. Purcell, Congressional Research Service (CRS) Report for Congress, Social Security Individual Accounts and Employer-Sponsored Pensions, February 3, 2005, Table 2. Employee Characteristics by Employer Retirement Plan Sponsorship, 2003 at CRS-5.

[5] Watson Wyatt *Global Pension Assets Study 2009*, http://www.watsonwyatt.com/europe/research/resrender.asp?id=200901-GPAS&page=1.

Defined Contribution Plans

Forty percent of small employers offering an employee retirement plan offer a 401(k) plan.[6] Therefore, declining balances and administrative costs associated with these plans are a big issue for small business plan sponsors. During 2008, the S&P 500 Index lost 37.0 percent for the year, which translated into corresponding losses in 401(k) retirement plan assets.[7] Due to the transparency of these plans, participants are acutely aware of these declines and as the economic situation remains uncertain, more and more participants are concerned about retirement assets. Plan sponsors must deal with the concerns of their participants. In the small business context, this can become particularly challenging due to an environment with fewer employees. For example, QFW had 12 employees enroll when we introduced this a few years ago. In 2008, 5 stopped participation due to concerns about the market, and several others have expressed similar concern in recent months. If too many participants drop out of the plan, we risk not meeting our minimum contribution requirements that are required in the contract with our facilitator. Thus, even though we would like to continue to maintain our 401(k) plan, we may not be able to do so if our employees do not stay in the plan.

In addition, due to the financial crisis, small business plan sponsors are acutely aware of administrative costs. One result of participant concern is that there is an increase in demand for distributions – both hardship withdrawals and loans. Moreover, participants may increase their requests for changes to their investments. These events increase administrative costs unexpectedly and can take a significant toll on a small business already experiencing financial strain.

Another area undergoing financial review is the employer match. In a Mercer survey, 83 percent of plan sponsor respondents did not expect their company to reduce the level of employer contributions. However, this means that 17 percent are considering this drastic action.[8] While it is not an action that an employer wants to take, it is sometimes a necessary consideration in these challenging times.

Required Minimum Distribution Rules

There are several concerns with the required minimum distribution (RMD) rules. The changes made in the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) did not impact 2008 distributions; therefore, beneficiaries who turned 70 and ½ in 2008 still have to take a delayed distribution by April 1, 2009. Moreover, it was not a complete suspension of all RMD rules. There are still some exceptions to the suspension of the RMD rules that participants and plans sponsors may not be fully aware of. For small business owners, communicating these issues and ensuring that plan participants understand these issues can be challenging. Many employees do not understand the changes to the rules and look to me, as the plan administrator,

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[6] NFIB, 411 Small Business Facts. http://www.411sbfacts.com/sbpoll-tables-res.php?POLLID=0044&QID=00000001273&KT_back=1.

[7] EBRI Issue Brief, "The Impact of the Recent Financial Crisis on 401(k) Account Balances" February 2009 • No. 326 by Jack VanDerhei. http://www.ebri.org/pdf/briefspdf/EBRI_IB_2-2009_Crisis-Impct.pdf.

[8] Mercer Global Survey "*Leading Through Unprecedented Times*" November 2008, www.mercer.com/unprecedentedtimes.

for advice. Thus, additional clarification of the changes to the rules would help plan sponsors administer these rules effectively.

Furthermore, WRERA did not address one issue under the RMD rules that particularly penalizes small businesses owners. Under the RMD rules, a five percent owner must take a distribution at age 70 and ½ even if she continues to work, although there is an exception for non-owners who continue to work.[9] Thus, small business owners are forced to receive retirement distributions even if they do not need them. Consequently, Congress should consider a permanent change to this rule that would provide small business owners the same treatment under the RMD rules as non-owners.

Defined Benefit Plans

The Worker, Retiree, and Employer Recovery Act of 2008 provided much-needed technical corrections and certain relief provisions particularly for small business plans.[10] Nonetheless, plan sponsors are currently facing even greater economic hurdles than they were last year. Various reports show that pension funding ratios have fallen significantly over the past three months, and it is unlikely that the markets will recover in the immediate future. Without further legislative action, these unexpected funding requirements will continue to require that companies choose between funding their pension plans (which are long-term obligations) and laying off workers, closing plants, and postponing capital investments. This could result in increased unemployment and a slower economic recovery.

Because of the importance of this issue to workers' retirement security and the overall U.S. economy, the Chamber urges Congress to adopt follow-up, temporary provisions that will ease cash flow constraints and make contributions more predictable and manageable in 2009 and 2010. Specifically, the Chamber encourages Congress to enact the following provisions:

Contribution Assistance – While the general impact of the current economic situation is widespread, the particular situations of individual companies are varied and, therefore, a fix that works for one company may not work for another. Consequently, we request that Congress enact the following three alternate proposals. Individual plan sponsors would then elect to use the provision that is best suited to its situation.

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[9] IRC section 401(a)(9)(C)(ii).

[10] WRERA included the following changes for small business defined benefit plans: Flexibility in Code Section 415 Interest Rate Assumption - Small defined benefit plans would be required to determine the value of lump sum distributions not in excess of the Code section 415 limit using a fixed 5.5% interest rate, instead of the greater of the 5.5% rate or 105% of the corporate bond yield curve rate; and Clarification of the Valuation Date for Small Plans - The Secretary of Treasury is given authority to prescribe special rules for small defined benefit plans that have a valuation date other than the first day of the plan year for purposes of, among others, quarterly contributions and determining the application of the benefit restriction rules.

Option 1 - Provide a "look back." The look-back would allow companies for 2009 and 2010 to make contributions to their pension funds based on 105% and 110% of their 2008 required contribution.

Option 2 - Widen the funding corridor. Under current law, companies can "smooth" market losses over a period of time. However, the amount of losses that can be smoothed is restricted to 10 percent (this is referred to as the funding or smoothing corridor). However, the 2008 market losses were far beyond 10 percent, leaving many plans with losses that exceeded 30 percent. Temporarily widening the funding corridor to 30 percent would help companies manage the extreme unexpected losses experienced during the market downturn.

Option 3 - Amortization of 2008 losses. We propose that for 2009 and 2010, employers shall pay interest on their plans' 2008 losses to prevent the plans' shortfall from growing, but seven-year amortization of those losses would not commence until 2011. Moreover, companies electing to use this special amortization rule must, for 2009, contribute at least 105% of the amount required to be contributed for 2008. For 2010, this would be increased to 110% of the amount required to be contributed for 2008.

<u>Protection of Employees and Employers</u> – We propose that for 2009 and 2010, all benefit restrictions would apply based on a plan's funded status for 2008. Similarly, a plan's funded status for 2008 shall be deemed to remain in effect for 2009 and 2010 for purposes of determining whether the plan sponsor may use its prefunding balance or funding standard carryover balance in the next year.

<u>Critical Guidance Items</u> – In addition to the above proposals, there are items that need modification or clarification. These items impact plan funding and are critical in addressing the current funding crisis.

Ensuring Transition Relief Applies to All Plans. WRERA generally amended the Pension Protection Act of 2006 (PPA) transition rule to provide that for purposes of determining a plan sponsor's funding shortfall, the plan's funding target is 94% of liabilities for 2009, 96% for 2010, and 100% thereafter. However, certain plans were left out of this provision—new plans and plans that were subject to the deficit reduction contribution ("DRC") regime in 2007. The law should be amended to measure the funding targets for all plans by reference to the phased-in targets of 94% for 2009 and 96% for 2010.

Clarification of Target Normal Cost. In the technical corrections portion of WRERA, the definition of target normal cost was amended to include "plan-related expenses." The law has never required plan investment expenses to be included in normal cost, so the interpretation of a technical correction to make a major policy change would not be appropriate. The law should be clarified by changing the term used to "plan-related administrative expenses."

Use of the Spot Yield Curve. Consistent with the statutory language, it should be clarified that the spot yield curve for any plan year may be the spot yield curve for any "applicable month" with respect to such year, which generally can be the first month of the plan year or any of the four preceding months.

Application of the Contribution Assistance Proposals to Certain Fiscal Year Plans. For purposes of the above proposals, in the case of plans with plan years beginning after October 31, but before January 1, and for plans with end-of-year valuation dates, the relief would apply to plan years beginning in 2008 and 2009 rather than in 2009 and 2010.

Chamber Recommendations

There are no easy or complete solutions to the challenges facing small business plan sponsors. Moreover, the current challenges only highlight how small business issues often need additional consideration. To this end, the Chamber believes that it is important to increase small business representation in as many areas as possible. Specifically, it would be important to have a small business representative included on the ERISA Advisory Council. The ERISA Advisory Council advises the Secretary of Labor on ERISA issues pertaining to pension and health care issues. Having a voice dedicated to small business ERISA issues would add a critical component to that group.

In addition to the short-term provisions for defined benefit plans described above, we have several long-term recommendations that we believe would encourage small businesses to establish and maintain retirement plans. It is important to note that the Chamber opposes the mandate of benefits or benefit plans. Rather than mandating participation by either employers or employees, the Chamber recommends provisions that would incentivize participation in the qualified plan system. Thus, we recommend the following provisions:

<u>Encourage greater pre-funding of defined benefit plans</u> – Given today's financial climate – the substantial drop in equity values and rock bottom interest rates – had we allowed plans to save as much as they could during the "good" years, there would be less of a strain during the "bad" years and our defined benefit pension funding rules would be less of a problem for small businesses and might have a very positive effect on all sizes of defined benefit plans. Currently, ERISA limits the amount of pre-funding.[11] The Chamber recommends that Congress allow for unlimited pre-funding up to the amount of projected future benefits in the plan. In addition, we recommend the elimination of the tax penalty for the reversion of assets in a pension plan after all promised benefits have been paid out to participants. These changes would encourage small business plan sponsors to make larger contributions when they could afford them without fear of being penalized at a later date.

<u>Eliminate administrative complexities and burdens</u> – In general, greater regulation often leads to greater administrative complexities and burdens. Such regulatory burdens can often discourage small business plan sponsors from establishing and maintaining retirement plans. The top-heavy rules under ERISA are an example of extremely complex and burdensome regulations that do not

[11] IRC section 404(a).

offer a corresponding benefit.[12] Thus, we recommend that they be eliminated. There are also burdens in the compliance area that should be eliminated. For example, we recommend an immediate moratorium on the assessment and collection of the IRC Section 6707A penalty until the statute can be thoroughly reviewed and recommendations can be made to carry out the intention of Congress without the disproportionate and probable unconstitutional impact of current law on small businesses and their owners.[13]

Tax distributions at capital gains rate – Much of the success of the private retirement system has been attributed to the tax savings incentive. Thus, taxing distributions from qualified retirement plans at the capital gains rate instead of the income tax rate would create an even larger incentive for small plan sponsors to establish and maintain retirement plans.

Conclusion

The challenges facing small business plan sponsors in the current economic downturn are substantial. In the current economic environment, it is more important than ever that Congress focus on encouraging the implementation and maintenance of retirement plans by small businesses. The Chamber appreciates the opportunity to express our thoughts and looks forward to working with you and other interested parties to help shore up the retirement security of American workers through the provision of retirement plans established and maintained by small businesses.

[12] IRC section 416.

[13] Section 6707A of the Internal Revenue Code imposes a penalty of $100,000 per individual and $200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a "listed transaction" or "substantially similar" to a listed transaction. The Treasury Department announces on an ad hoc basis what is a listed transaction. There is no regulatory process or public comment period involved in determining what should be a listed transaction. The penalty applies even if the small business and/or the small business owners derived no tax benefit from the transaction. The penalty also applies even if on audit the IRS accepts the derived tax benefit. The penalty is final and must be imposed by the IRS and cannot be rescinded under any circumstances. There is no judicial review allowed. In the case of a small business, the penalties can easily exceed the total earnings of the business and cause bankruptcy – totally out of proportion to any tax advantage that may or may not have been realized. If a transaction is not "listed" at the time the taxpayer files a return but it becomes listed years later, the taxpayer becomes responsible for filing a disclosure statement and will be liable for this penalty for failing to do so. This is true even if the taxpayer has no knowledge that the transaction has been listed.