Statement Presented to
The U.S. House of Representatives
Committee on Small Business
Subcommittee on Finance and Tax

Hearing on
Pension Parity: Addressing the Inequalities between Retirement Plan Options for Small and Large Businesses

October 24, 2007

Transamerica Retirement Services appreciates the opportunity to provide this written testimony in connection with the hearing of the U.S. House of Representatives Committee on Small Business, Subcommittee on Finance and Tax on the issues related to the offering of retirement benefits by small business. TRS commends Subcommittee Chairwoman Bean and Ranking Member Heller for focusing on the particular concerns of small business in providing retirement benefits.

Transamerica Retirement Services ("TRS"), a marketing unit of Transamerica Life Insurance Company and its affiliates, designs customized retirement plan solutions to meet the unique needs of small to midsized businesses. TRS serves more than 14,500 small business clients who collectively represent over $14 billion in plan assets under management as of December 31, 2006. Transamerica Retirement Services is part of the AEGON companies. Headquartered in the Netherlands, AEGON is one of the leading insurance and pension groups, and a strong provider of investment products. AEGON's businesses focus on life insurance, pension, supplemental health, savings and investment products.

Pertinent Facts about Small Business

According to the U.S. Census Bureau, small businesses (less than 500 employees) represent 99.7% of the total firms and 50.9% of the workforce in the United States.[1] Further, according to the U.S. Small Business Administration, small businesses have generated 60 to 80% of net new jobs annually over the past decade in the United States and supply more than half of U.S. non-farm private gross domestic product.[2] Given the prominent role that small businesses play in the U.S. economy, it is vital to encourage small business owners to sponsor retirement plans and help the small business workforce adequately prepare for retirement.

The small business sector is highly dynamic with high start up rates, closure rates, and merger and acquisition activity. Small businesses are represented in all industries and generate a wide range of revenue, earnings, and payroll. As such, at any given time, a small business may have unique needs and objectives for sponsoring a retirement plan.

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[1] U.S. Census Bureau, 2004 County Business Patterns. For information on confidentiality protection, sampling error, non-sampling error, and definitions, see http://www.census.gov/epcd/susb/introusb.htm
[2] *See* U.S. Small Business Administration, Frequently Asked Questions, at www.sba.gov.

While some small business owners feel that they need to sponsor a plan to attract and retain employees, others may be somewhat more focused on how a retirement plan will meet their own personal retirement savings needs. Regardless of the specific rationales at play, and there are usually several, all small employers interested in sponsorship of a plan seek to do so at a cost that they can afford.

Small Businesses' Role in Providing Workplace Retirement Benefits

It is well documented that Americans do not save adequately for their retirement. Yet employer-sponsored retirement savings plans play a critical role in facilitating such savings and making the savings process easy and attractive for American workers. With the benefits of saving in an employer-sponsored plan (investment education, the potential for employer contributions, fiduciary oversight), combined with the convenience of automatic payroll deduction, Americans are far more likely to save for retirement through participating in a company-sponsored retirement plan versus contributing to an individual IRA. The Eighth Annual Transamerica Retirement Survey[3] (the "Transamerica Survey") found that 73% of employees with qualified plans (at companies with greater than 10 employees) participate in their company's defined contribution retirement plan. By comparison, the Investment Company Institute found that only 17% of U.S. households contributed to an IRA in 2004.[4]

The role of employers in providing retirement savings plans to their employees has long been supported by public policy and the work of this and prior congresses in enacting tax incentives both for employers to sponsor retirement plans for their employees and for employees to accumulate long-term savings through those plans. The current tax system

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[3] The 8th Annual Transamerica Retirement Survey can be found at http://www.transamericacenter.org. Harris Interactive was commissioned to conduct the Eighth Annual Transamerica Retirement Survey. There are two components to the survey: Employer and Worker. Where appropriate, questions were tracked and some new questions were added to investigate new topics of interest. The *worker survey* component was conducted via telephone by Harris Interactive within the U.S. between July 27 and October 7, 2006 among 1,402 workers. Respondents met the following criteria: work full-time for pay at a company with at least 10 employees, are age 18 or older, and do not work for the government nor a non-profit organization. Results for age, sex, race/ethnicity, education, region and household income were weighted where necessary. Data were weighted to ensure that each quota group had a representative sample based on the number of employees at companies in each employee size range.
The *employer survey* component was conducted by Harris Interactive on behalf of Transamerica Retirement Services via telephone within the U.S. among 659 owners/heads of small businesses and benefits decision-makers in larger companies, using a nationally representative random sample. Respondents met the following criteria: business executives who make decisions about employee benefits at their company, must be at a company that employs 10 employees or more, and not work for a government, education or not-for-profit organization. Interviews averaged 18 minutes in length and were conducted between July 25 and October 10, 2006. Data were weighted to ensure that each quota group had a representative sample based on the number of companies in each employee size range.
All sample surveys and polls, whether or not they use probability sampling, are subject to multiple sources of error which are most often not possible to quantify or estimate, including sampling error, coverage error, error associated with nonresponse, error associated with question wording and response options, and post-survey weighting and adjustments. Therefore, Harris Interactive avoids the words "margin of error" as they are misleading. All that can be calculated are different possible sampling errors with different probabilities for pure, unweighted, random samples with 100% response rates. These are only theoretical because no published polls come close to this ideal.

[4] Investment Company Institute, The Role of IRAs in Americans' Retirement Preparedness, January 2006

also helps to ensure that these savings will be there for retirement by placing restrictions on pre-retirement distributions and imposing tax penalties for early withdrawals.

However, it is striking that while small business accounts for 50.9% of jobs in the economy, according to the Transamerica Survey only 71% of small business employers with 10-499 employees reported that they provide 401(k) or other employee retirement savings plans for their employees. This is in contrast to the fact that 95% of large employers with over 500 employees reported that they provide 401(k) or other employee-funded retirement plans for their employees.

According to the Transamerica Survey, while 71% of small businesses reported providing 401(k) or similar retirement savings plans for their employees only 24% indicated that they provided a company funded defined benefit pension plan. Therefore, this testimony will focus on those retirement savings/defined contribution plans.

There are many reasons for the disparity between small and large businesses in providing retirement savings benefits for their employees. Many small businesses do not have the financial or administrative resources to provide or maintain such plans. The Transamerica Survey found that of small business employers that do not sponsor a defined contribution plan, and are not likely to offer 401(k) in the next two years, 73% do not plan to do so in the future with their reasons cited as: their company is not big enough (43%); company management is not interested (41%); concerned about cost (34%); employees are not interested (34%); company encountering difficult business conditions (21%); concerned about administrative complexity (11%); and concerned about fiduciary liability (8%); some other reason (7%); and not sure (3%).

Further, despite finding that nearly all small business employees (93%) consider an employee-funded retirement plan an important benefit, the Transamerica Survey found that only 40% of small business employers who offer 401(k) or other self funded plans believe that a company's retirement savings plan is "very important" to attracting and retaining employees .

There is also a disparity in employee participation in retirement plans provided by small versus large businesses. According to the Transamerica Survey, 76% of employees in large businesses indicated that they participate in their employer-sponsored retirement plans while a somewhat lower 70% of small business employees do so. Furthermore, employees of small businesses only contribute 7% of their salary (median) to employer plans as compared to employees of large companies who contribute 8% of their salary (median).

There are several reasons for this disparity. First, the household income of employees in small businesses is typically much lower than that of employees in large businesses, and therefore these employees generally have less disposable income to contribute to a retirement plan. Second, due to the dynamic nature of the small business landscape, employee turnover also tends to be higher than that of large companies. Such turnover can be involuntary, often as the result of the business going under or merger and acquisition activity, or voluntary on the part of employees as they decide to seek jobs with higher pay and better benefits. For plan sponsors, employee turnover may increase administrative costs. For plan participants, the benefits of participating may be reduced if they leave their employer prior to vesting in any employer contributions. Further, plan sponsors often have the ability to cash out terminated plan participants with small balances.

Recent Accomplishments: Pension Reform in the 2000s

With the increasing number of Americans employed by small businesses and the particular challenges faced by small businesses in providing retirement plans for their employees, regulatory relief and incentives have been needed to ease the burdens of small businesses in providing retirement savings plans for their employees and creating incentives for employees to participate in these plans.

Many important steps were taken by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and the Pension Protection Act of 2006 ("PPA") (which both made the positive EGTRRA changes permanent and instituted a number of additional positive reforms). Legislators are commended for passing these laws that promote plan sponsorship and participation through provisions including: (1) higher retirement plan and IRA contribution limits, (2) catch-up contributions for individuals who are age 50 or older, (3) establishment of the Saver's Credit tax credit to encourage plan or IRA savings for those who meet the income and eligibility requirements, (4) a small business employer tax credit for plan formation, (5) creation of the Roth 401(k), (6) simplification of a number of complex administrative requirements, (7) incentives and safe harbors needed to increase participation in employment-based plans through automatic enrollment, and (8) removal of certain impediments to employers providing participants with investment advice and annuity distribution options to provide lifetime income.

These laws continue to be extremely valuable in increasing both the number of retirement plans offered by employers and the participation of employees in these plans; however, given the persistence of the significant disparity between the sponsorship and participation rates of small business and their employees relative to large companies, much work still needs to be done to help bridge the gap.

Recommendations

Increasing Plan Coverage in the Small Business Sector

The Transamerica Survey's findings suggest that opportunities for increasing plan coverage in the small business sector involve providing greater incentives, offering regulatory relief to help address concerns about cost and administrative complexity, and promoting greater awareness.

Congress is urged to consider additional tax incentives and guidance for small employers to establish new retirement savings plans. Tax incentives provide a valuable financial tool to small businesses that are considering establishing a retirement plan for their employees. These incentives will help to reduce the cost of establishing and administering a retirement savings plan and the relative burden this cost places on a small employer vs. a large employer. Under a provision of EGTRRA that was made permanent by 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. Consideration should be given to increasing the available amount of the credit and increasing the number of years that it may be claimed. This would provide greater incentive for small businesses to establish a plan as well as help alleviate concerns about the cost of sponsoring a plan.

Not only are the absolute costs of implementing and administering a retirement plan great, but they are relatively greater than those for larger businesses on a per employee basis due to the difficulty of achieving economies of scale. Nondiscrimination rules, compliance testing, and the cost associated with correcting failures increase the employer's overall cost of sponsoring the retirement plan. While TRS supports the spirit of the nondiscrimination rules, TRS believes that further simplification of the regulations and administrative requirements can be achieved while preserving this basic spirit of fairness.

Legal certainty and protection from fiduciary liability provide another powerful incentive to small businesses considering establishing a retirement plan. Additional guidance on safe harbors from fiduciary liability should be provided for employers whose plans meet certain requirements with respect to investments, asset class coverage, administration and processing, disclosures, etc. Further, consideration should be given to further streamlining reporting and notice requirements to make it administratively easier for small businesses to sponsor a plan.

For small businesses in which a stand-alone plan is not feasible, TRS recommends that consideration should be given to enabling and providing incentives for them to join a multiple employer or group plan to be provided by a financial institution. To be effective, this plan should be simple to administer and should provide safe harbors from fiduciary liability for each employer. In addition, care should be taken to (1) protect employers from any fiduciary liability for the acts or failure to act of other employers participating in the plan, (2) provide tax incentives for employers and employees to encourage participation and (3) provide the means to ensure reasonable compensation for financial institutions for taking on investment and administrative functions. Multiple employer plans would provide very standard plan terms, and therefore, employers that want plan design flexibility, such as by offering a more robust investment menu, would continue to offer their own plans.

Lastly, any new legislation and regulatory relief directed towards increasing plan sponsorship rates in the small business sector should be broadly promoted to help ensure that employers are aware of new advantages and the feasibility of sponsoring a plan.

Encouraging Increased Plan Participation and Savings

Congress should also consider reforms directed at helping small business employees increase their participation in those plans. The Saver's Credit, a tax credit which was created by EGTRRA and made permanent by the PPA, offers a meaningful incentive for encouraging low- to middle-income Americans to save for retirement. However, very few Americans are aware of it.

According to a recent survey commissioned by Transamerica,[5] very few American adults are aware of this tax credit designed to help low- to middle-income Americans build their retirement nest eggs. The survey found that only 11 percent of American adults who fall within the Credit's income eligibility requirements are familiar with it. The survey results could raise concerns that many Americans who are already saving for retirement through a company-sponsored retirement plan such as a 401(k), or through an individual retirement account, may miss out on taking the Credit simply because they don't know about it. Particularly vulnerable are the 29 percent of individuals and households who meet the Credit income limits and have either filed, or plan to file, their taxes using the 1040EZ form. The 1040EZ has no provision for claiming the credit, which can only be claimed using the 1040, 1040A or 1040NR (along with the accompanying Form 8880). Adding to the confusion, the Credit is most commonly known as the "Savers Credit," but the IRS refers to it as the 'Retirement Savings Contributions Credit' and the 'Credit for Qualified Retirement Savings Contributions' in its forms and publications.

While many qualifiers may be missing out on a significant tax credit, there are also many non-savers who might start saving for retirement with the help of an incentive like this if they were aware of the opportunity.

The Saver's Credit, in its current form, should be more effectively utilized to encourage increased retirement savings plan participation and help more low- to middle-income Americans save for retirement. It is recommended that the IRS broadly promote the Saver's Credit through outreach efforts, updating the tax forms and instructions to consistently refer to it as the "Saver's Credit," and adding it to the 1040 EZ form.

Senate Finance Committee Chairman Max Baucus and Ranking Republican Member Chuck Grassley are commended for their July 12, 2007 letter to the Internal Revenue Service (and accompanying press release) that requests the IRS to better publicize the Saver's Credit.

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[5] This survey was conducted online within the United States by Harris Interactive® on behalf of Transamerica from February 7 to 9, 2007 among 2,482 adults (aged 18 and over)) including 316 who meet the Saver's Credit income eligibility requirements. Figures for age, sex, race/ethnicity, education, region and household income were weighted where necessary to bring them into line with their actual proportions in the general population. Propensity score weighting was also used to adjust for respondents' propensity to be online. With a pure probability sample of 2,482, one could say with a ninety-five percent probability that the overall results have a sampling error of +/- three percentage points. Sampling error for subsamples would be higher and would vary. However, that does not take other sources of error into account. This online survey is not based on a probability sample and, therefore, no theoretical sampling error can be calculated.

Additionally, Congress should consider expanding the Saver's Credit by making it refundable so that those many low- to middle-income workers without federal income tax liability would receive a direct and meaningful financial incentive to save.

Incentives to Help Employees Manage their Savings upon Distribution.

While EGTRRA and PPA have provided many valuable reforms to help employees increase their retirement savings while participating in employer-sponsored plans, it is also important for employees to have the necessary tools to manage their employer plan savings upon distribution. Given the choice, a majority of employees elect a lump sum payout and few employer plans provide an annuity as a distribution option. TRS urges Congress to enact tax and other incentives to encourage all individuals to convert a portion of their savings into guaranteed lifetime income. Representatives Pomeroy, Tubbs-Jones and English have all taken important leadership roles in introducing bills encouraging individuals to annuitize their savings by providing a tax incentive for the purchase of a lifetime annuity.

Conclusion

TRS commends Subcommittee Chairwoman Melissa and Ranking Member Heller on their consideration of the particular challenges and needs of small businesses in providing retirement savings plans to their employees. TRS appreciates the opportunity to present its views on the particular challenges faced by small businesses and its suggestions for reforms that can help to alleviate those burdens.