

**OPPORTUNITIES FOR SAVINGS: REMOVING
OBSTACLES FOR SMALL BUSINESS**

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OPPORTUNITIES FOR SAVINGS: REMOVING OBSTACLES FOR SMALL BUSINESS

WEDNESDAY, MARCH 7, 2012

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 2:05 p.m. in Room SD-562, Dirksen Senate Office Building, Hon. Herb Kohl, chairman of the committee, presiding.

Present: Senators Kohl [presiding], Manchin, and Corker.

OPENING STATEMENT OF SENATOR HERB KOHL, CHAIRMAN

The CHAIRMAN. Good afternoon to everybody. We'd like to welcome you to this hearing today.

American workers face a retirement gap, a gap between what they will need to retire and what they will have actually saved of \$6.6 trillion, according to the non-partisan Center for Retirement Research at Boston College. To bridge that gap, we need to make it easier for employees to save at work, because that is where it is easiest for most people to save.

However, for 42 million American workers, fully a third of the private sector workforce employed by small businesses, it's an opportunity that doesn't really exist. In fact, according to the Census estimates, as few as 29 percent of workers at small businesses have access to retirement plans at work. By comparison, 81 percent of workers at companies with more than 100 employees have access to employer-sponsored plans.

On the employer side, many small businesses want to offer retirement plans because without them they are at a competitive disadvantage when it comes to attracting and retaining good employees. With this in mind, this committee asked the Government Accountability Office to explore why so few small businesses offer retirement plans to their employees.

As you will hear today, what the GAO heard from small business owners were general concerns about a lack of time and money to select and finance plans, as well as worries about being overwhelmed by administrative requirements and the risks of being held liable for high fees or for poor plan performance.

We've been working with Senator Enzi and other senators, and we plan to introduce bipartisan legislation that will make it much easier for small business owners to set up retirement plans. Under our approach, which is supported by the U.S. Chamber of Commerce, small businesses would be able to pool together to create plans that use experienced financial experts to assume many of the

administrative and fiduciary duties that small business owners have neither the time nor the expertise to monitor. This would lower costs and encourage more companies to offer retirement plans to small businesses, and ultimately this would result in more people saving for their retirement.

Today we'll be hearing from the GAO about its findings and the Department of Labor about its efforts to reach out to the small business community. Then we'll turn to financial experts, including Mr. Bryan Fiene from my own State of Wisconsin, who will discuss the difficulties that small businesses face with savings plans, as well as the benefits of allowing small businesses to pool together.

While everyone has an individual responsibility to save, it is also essential that all workers have the opportunity to save for their retirement. More small businesses in Wisconsin offer retirement plans to their workers than almost any other state in the nation. Nevertheless, just one in five small businesses in Wisconsin do offer retirement plans to their employees.

By creating more and better opportunities for small businesses to provide retirement plans, we will come closer to building a universal, secure, and adequate pension system that can provide retirement security for all Americans.

We thank everyone for being here today. We'll be turning to our Ranking Member, Senator Corker, in a moment.

First, I'd like to recognize my staff director for this committee, Deb Whitman, who will be leaving us for a new challenge. Over the past five years, Deb Whitman has been a strong, effective, and highly skilled leader on the issues that have come before this committee. Her service and deep commitment are truly appreciated, and she will be greatly missed.

So we now turn to Senator Corker, Ranking Member.

STATEMENT OF SENATOR BOB CORKER

Senator CORKER. Thank you, Mr. Chairman, and thank you for this focus on small businesses and their ability, if you will, to offer retirement plans. This is something near and dear to my heart. I have been in business most of my life and have offered these types of plans and have seen some of the difficulties that can exist, and certainly in a country that has so many citizens that are over-leveraged and not saving for the future the way that we'd like to see citizens do, just because it's best for them to be able to do that, and with tremendous pressures that we're going to have longer term just over entitlement programs that exist, it's very important that people are setting aside monies.

And so I very much appreciate your focus on this and am looking forward to the witnesses and what they have to say and the many questions that will follow.

So thank you, and thank the witnesses.

The CHAIRMAN. Okay, Senator Corker, thank you very much.

We'll turn to our first panel right now. Our first witness will be Phyllis Borzi. She's the Assistant Secretary of Labor of the Employment Benefits Security Administration. Ms. Borzi has published numerous articles on ERISA, health care law, and policy and retirement security issues. She's been a frequent speaker to legal pro-

fessionals, business, consumer, and state and local government organizations. Welcome.

Then we'll be hearing from Charles Jeszeck, Director of Education, Workforce, and Income Security issues at the Government Accountability Office. He has spent over 26 years at the GAO working on issues concerning defined benefit and defined contribution pensions, the PBGC, Social Security, unemployment insurance, and older worker employment issues. We welcome you.

Ms. Borzi.

STATEMENT OF PHYLLIS BORZI, ASSISTANT SECRETARY, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR, WASHINGTON, DC

Ms. BORZI. Thank you, Chairman Kohl, Ranking Member Corker. I am Phyllis Borzi, the Assistant Secretary of Labor for the Employee Benefits Security Administration, and I appreciate this opportunity to discuss this afternoon EBSA's work with small business.

We agree with you, Chairman Kohl, that employment-based plans are the best way to have employees save for retirement. But today, less than half of small businesses offer these kinds of plans to their workers. So what we do is EBSA assists small employers through comprehensive education, outreach, and regulatory programs. What we do is we leverage our education and outreach efforts by partnering with the IRS, with the SBA, with the AICPA, with the Society for Human Resource Management, with the Consumer Federation of America and others.

In 2000, the Department partnered with the SBA and the U.S. Chamber of Commerce to launch our program called "Choosing A Retirement Solution For Your Small Business", and this campaign helped small businesses understand the many retirement plan options available to them. In 2004, the Department worked with the SBA, with SHRM, with the AICPA, with the Chamber and the NFIB to develop a "Fiduciary Education" campaign. These ongoing campaigns create an awareness of the responsibilities involved in maintaining a retirement plan.

After hearing from small businesses that they often look to their accountants for advice about establishing a retirement plan, the Department began to work with the AICPA, and recently the AICPA joined us as a presenter and publicized a webcast on February 23rd as part of America Saves Week. We also are working with the AICPA on a fiduciary education webcast series that's scheduled in March.

Small businesses can access a full range of government resources through Business USA, which is a website that was formed, hosted by the SBA, formed as a result of a memorandum that President Obama issued a few months ago. This site serves as a central portal for Federal agency information of interest to small businesses, and it includes a link to the EBSA resources that promote retirement plan sponsorship.

The Department also has a number of ongoing regulatory and guidance initiatives that help small business. Chairman Kohl, I know you've been very interested and a leader in the target date fund set of issues around them. The Department expects to soon

release tips for plan fiduciaries on how to select these funds. As you know, in choosing a TDF, it's very important to understand the differences in investment strategies, in asset allocation, and investment-related fees. Even among target date funds with the very same target date, there are wide variations. Our guidance will help plan fiduciaries assess these differences.

The Department has also provided tips for participants who are considering choosing a TDF. This we did in conjunction with the SEC and proposed disclosure changes to our qualified default investment alternative regulation that focuses on the need for greater disclosure around target date funds.

I want to briefly mention two of our regulatory initiatives that benefit small businesses sponsoring retirement plans. First, on February 2nd, the Department issued a final regulation that improves the transparency of 401(k) fees and will help small businesses obtain investment, recordkeeping, and other services at a fair price. This will put small businesses on the same footing as larger employers and allow them to obtain information about retirement plan services, their costs, and service providers.

Second, we're working to update our rule on when a person providing investment advice for a fee becomes a fiduciary under ERISA. Our revised fiduciary definition would protect small employers by making it more difficult for advisers to steer them into investment options that pay the adviser higher fees. Under the current law, advisers can avoid responsibility for these types of recommendations and for losses that result from imprudent advice. Our new rule will hold advisers responsible so that small employers can have confidence in the investment advice they receive and won't be left holding the responsibility for losses that occur when what they've done is dutifully followed the investment advice they've been given which turned out to be imprudent.

Of course, the Department supports efforts to expand small business coverage and provide compliance assistance. However, in so doing, it's essential that ERISA's protection for workers' pensions be maintained. The Department is aware of promoters marketing so-called "open" multiple employer plans to small businesses. According to some promoters, these arrangements allow unrelated businesses to avoid ERISA reporting and fiduciary obligations. However, the lack of employer involvement may make these plans more susceptible to abuse by unscrupulous actors.

EBSA has had difficult experiences over these decades with similar open employee benefit structures in the group health plan area, where multiple employer welfare arrangements, or MEWAs, have been the subject of civil and criminal enforcement actions for many years. Among other problems, MEWAs have generated large, often hidden, fees for the promoters. By bringing this type of product to the pension marketplace, we are concerned that it presents a number of complicated legal and policy issues. We have pending requests for guidance and are actively working on trying to answer these questions.

So thank you again for the opportunity to testify at this important hearing. The Department recognizes the critical role that small businesses play in the economy, and we'll continue to expand

our efforts to help them offer high-quality retirement plan options for their workers. Thank you so much.

[The prepared statement of Phyllis Borzi appears in the Appendix on page 24.]

The CHAIRMAN. Thank you very much, Ms. Borzi.
Mr. Jeszeck.

**STATEMENT OF CHARLES JESZECK, DIRECTOR, EDUCATION,
WORKFORCE AND INCOME SECURITY, U.S. GOVERNMENT
ACCOUNTABILITY OFFICE, WASHINGTON, DC**

Mr. JESZECK. Thank you. Chairman Kohl and Ranking Member Corker, thank you for inviting me here today to discuss the state of pension coverage among our nation's small businesses and the challenges these businesses face in helping their employees achieve retirement security. My comments are based on the findings of our report that this committee is releasing today.

Small employers are a critical sector of our economy, providing employment for many millions of Americans. Businesses with fewer than 100 employees, those firms which are the focus of our report, employ over 42 million workers, about one-third of the private sector workforce. Our report focuses on the extent of small business pension plan sponsorship, the challenges facing small businesses in providing such coverage, and the options that have been suggested to address these challenges.

In summary, while longstanding observers of retirement security will not be surprised, the rest of us may find the results disturbing. Pension sponsorship among small employers is low, the challenges they face in sponsoring plans are many, and the numerous proposed solutions each have their advantages and disadvantages.

In our study, where we were able to link IRS and Labor Department data on small employers and pension plans, we found an overall sponsorship rate of about 14 percent. To give context, most studies have found at any one time about 50 percent of private sector workers participate in a pension plan.

We also found that the larger the firm, the more likely it was to offer a plan. Among the smallest firms, those with one to four employees and who account for the majority of funds in our study, the rate was 5 percent. Sponsorship rates for firms with 26 to 100 employees were higher, at 31 percent. Similarly, small firms with low-paid workforces are generally less likely to offer a pension plan. About 3 percent of small employers who paid an average wage of \$10,000 per year or less sponsored a plan.

Of those small firms with plans, about 86 percent sponsored either a 401(k) plan or a SIMPLE IRA. Typically, the larger the firm, the more likely it was to offer a K plan and the less likely to offer a SIMPLE IRA.

This low sponsorship rate is likely a consequence of the multiple challenges small employers report in considering whether to sponsor a plan. In our focus groups with small employers around the country, we heard about many of the barriers that either deterred them from forming a plan or made maintaining a plan difficult. These businesspeople took time out of their busy lives to tell us that they were overwhelmed by the number of plan design options from which to choose, and by the administrative requirements to

be met, and that they were afraid that they were not fully knowledgeable about the legal responsibilities associated with sponsoring a plan. Others felt that the existing financial incentives to sponsor a plan were insufficient.

Further, while Labor collaborates with other agencies to provide information and guidance to small employers on pension plans, most of the business people we spoke to were unaware that such information was available.

Small employers, experts and other stakeholders suggested a variety of solutions to address these challenges. These ranged from enhancing available guidance from the government and relaxing certain reporting and disclosure requirements, to expanding current financial incentives to start a plan, to introducing broader, more universal solutions like the auto-IRA. Each of these options poses tradeoffs. For example, some options may reduce Federal revenues, while others may represent significant departures from our existing voluntary employer-based pension system.

Thus, in light of this serious issue, we have recommended that Labor, building on its collaborative efforts with other agencies, take the lead in exploring this critical issue of small business plan sponsorship in assessing and developing proposals to address these challenges and in consolidating current sources of information and guidance to make it more accessible.

That concludes my statement, Mr. Chairman. I'll be happy to answer any questions you or other members may have.

[The prepared statement of Charles Jeszeck appears in the Appendix on page 39.]

The CHAIRMAN. Thanks very much to both of you.

The idea that we're talking about is setting up some kind of a central mechanism overseen by very professional, qualified organizations to which small businesses can turn to, look to, and collectively go to, to set up pension programs for their employees.

Is it a good idea? Do you think it's worth pursuing? Is there any reason why we shouldn't pursue it? What are the chances of being successful in the marketplace so that we can increase the number of small firms that offer plans to their employees?

Ms. Borzi.

Ms. BORZI. Well, you know, the administration hasn't taken a position on this, so I'm certainly not going to get out ahead of the administration. But let me just explain to you some of the problems and challenges we see, because we've been looking at these since these arrangements have been brought to our attention.

You know, for as long as ERISA existed, there have been provisions in ERISA that recognize multiple employer plans. The difference between these new arrangements that people are trying to organize and the longstanding arrangements that have been authorized under ERISA is that in the new arrangement there is not a requirement, as the statute and as our longstanding regulations require, that there be a connection among the employers, and we do that because the definition of employee benefit plan—the threshold issue is, is this an employee benefit plan, a legal issue, and the definition of employee benefit plan requires an employment connection.

The plan, the arrangement has to be sponsored by an employer, by an employee organization, or by an association or an organization acting on behalf of employers. That employment connection is very, very important, and the new arrangements that people are talking about would not require that connection. It would allow an entity—and I know you're talking about experienced financial institutions, but there is no distinction in the rule, I mean in the current statute, as to who can sponsor these, except that you have to be an association and represent employees.

The difficulty is that the employer, even in the current multiple employer plan, multiple employer trust arrangements under ERISA, the employer has to actually take a role in it. Now, that doesn't mean that they can't pool administrative expenses, that they aren't exempt from many of the fiduciary and reporting and disclosure rules. They are under the current rule. But to us, the difficulty is looking at the experience that we've had in the health area, where we've got these multiple employer welfare arrangements which for decades have been problematic, both civil and criminal problems.

In the Affordable Care Act, Congress gave the Department of Labor new specific tools, like cease and desist authority, and search and seizure authority, because we have so many problems with health care fraud in these arrangements. The statutory language is exactly the same, and the arrangements on the health side where we have the problems are where they've been marketed to a group of unrelated employers, where there's not an association bond.

Now, sometimes we've seen problems even in the association context. But generally, what the law says is that these employers have to come together for a purpose unrelated to just sponsoring a benefit plan. So a trade association under current ERISA law can get the same economies that you're talking about.

And so the proposal that has been put before us which would allow a sponsor, if you will—I shouldn't use the word "sponsor," it confuses the legal context—would allow an entity to put together a group consisting of completely unrelated employers is problematic because of the statutory rule, and it poses challenges without the employer involvement.

But certainly we're looking at it, and certainly we're willing to talk with you about it and work with you on it.

The CHAIRMAN. Good.

Mr. Jeszeck.

Mr. JESZECK. Yes, Senator. I should say I can't comment too much on this issue given that we are currently conducting work on multiple employer plans for Senator Harkin. I think as Assistant Secretary Borzi said, it's a very complex, very legalistic issue, and I think somehow you want to balance the potential for additional coverage and opportunity for retirement saving by workers with minimizing or ensuring that there is not a potential for abuse and that people lose their money. So I think somehow you want to thread the needle there. Our report is expected to be completed in June and hopefully will shed some light on this discussion.

The CHAIRMAN. Thank you very much.
Senator Corker.

Senator CORKER. Thank you, Mr. Chairman.

Ms. Borzi, what is it about an association that causes the standards to be higher than just a group of businesses that are unrelated but want to make sure that their employees have benefits? It's hard for me to understand why the standards would be any higher, let's say, for the Association of General Contractors pooling together versus just an association of folks in a community in Chattanooga, Tennessee that might want to provide benefits to their employees.

Ms. BORZI. Well, it goes initially to the statutory definition, which requires that an employee benefit plan be sponsored by employers, so that there be an employment relationship. But then it also says you can have this association of employers.

You know, if you establish a plan, or if you purport to establish a plan with all unrelated employers, people can do that under the current law. It's just that the question is, is one plan established, or does each employer establish its own plan but with a common administrative structure? Under ERISA, since 1974, we've allowed this common administrative structure. But the issue is each employer, then, in that context establishes its own plan.

I mean, one of the things that I want to call to your attention, and I think the GAO report included it, but certainly in one of the early publications we did that I mentioned in my testimony, this "Choosing A Retirement Solution For Your Small Business," which we did jointly with the IRS, one of the most important features in this is the chart. This shows the various options that are already available to small businesses, and you can get to the same result that you're talking about using several of these options.

So the question really is, and given what the GAO found, that employers were confused by the array of choices, it seems to me from a policy point of view the question is, would it be better to add yet another coverage option, which adds to the confusion and concern, or is maybe what Congress should be doing, in conjunction with all the rest of us, is looking at this array of choices and saying is there a way that we can consolidate? Are there ways that we can get economies of scale by combining some of these options so that we don't have—let's see, this has seven, eight options for small businesses. If I were a small business, and I have people in my family who run small businesses, and they have asked me what to do in terms of sponsoring a plan, there are several—all of these are relatively easy options to use.

I guess the policy question is do we need another option that is structured like an approach that, at least in the health care marketplace, has been rife with fraud and abuse? And so I think that's the fundamental question. We're not opposed to expanding coverage. The question really is what's the best way to do it.

Senator CORKER. I appreciate the explanation. And just as an editorial comment, I think that what our nation does not need to do is get the Federal Government to limit choices that people have as it relates to retirement options. It needs to allow competition to work and expansion to take place. So I hope it won't get into a Big Brother mode in that regard, and I know you're not necessarily suggesting—

Ms. BORZI. No, that's not what I'm suggesting.

Senator CORKER [continuing]. Or proposing. You're just laying out some questions.

Which brings me to another point- I had two larger operations over time that were mine. One, we had a profit-sharing plan, and it was a pain. I mean, it was troublesome to administer, and you were constantly concerned about whether you were getting the kinds of yields for your employees that were best and yet safe at the same time.

And then the second, larger operation we had a 401(k), and it was like falling off a ladder. I mean, it's the simplest thing I've ever been involved in, and there were all kinds of people in the community that were well respected that were more than willing to educate the employees and carry out the plan.

I guess I kind of wonder what the problem is. It wasn't expensive. These were people in a community that were respected. It worked very well. I'm really having difficulty understanding what the problems are as it relates to small employers, no matter how small, being involved in 401(k) plans. I mean, they're all over the place. It's like a Christmas tree, and all you've got to do is select one, and they work pretty well.

So I'm having difficulty understanding what the impediments to people doing that are, and why anybody would need a financial incentive, if you will, to want to set aside resources for their employees.

Mr. JESZECK. Well, we heard a lot of different things from small employers. In general—well, one thing was they wanted honest, and what they felt to be unbiased information. A lot of 401(k) service providers would approach these firms, these smaller firms, and sell them things, and there was a concern of these small firms that—not that these providers were going to rip them off or anything, but the fact that they were trying to sell them something. So they really didn't have confidence in the information that they got, and whether it was really in their best interest.

Senator CORKER. Were they hoping that we would tell them what was in their best interest?

Mr. JESZECK. Well, I think they were interested in getting good information. In fact, some of the quotes that we got from some of these focus groups illustrate this. There was one that said—this was a small consulting company. It had 10 employees. It had been around for seven years. And they said that if you want to start a 401(k) plan, it would be great if you could go to one source that tells you the information you need to know, what you need to do, and the forms that you need to fill out, a checklist of sorts.

Senator CORKER. Well, we have that available now, right?

Mr. JESZECK. So I think there is the potential here to help some of these employers. The other quotes we had—you know, these small businesses, they may be great at sales, they may be great at manufacturing, but they may not be financial service people. So some of these issues completely baffle them, and we would hear that a lot. We had one person who said—

Senator CORKER. Just let me focus on each of these.

Mr. JESZECK. Sure.

Senator CORKER. I agree that there are people who are more financially astute than others, and of course people out-source and

get help from all kinds of professional folks most of the time if they're successful. So what is it that would be a rational approach to somebody who isn't particularly good at that? What is it that we might suggest that government do to help them be more sound in their judgment?

Mr. JESZECK. Well, I think in our report we do identify a lot of the collaborative efforts that Labor has done with other agencies in pulling together a lot of useful information. I think in our report what we tried to get at is that there could be some improvement here. I think if we could get some of this information, match it up better with some of these small employers, as a first step, that would really help them in feeling more comfortable with some of these issues.

It was really—there was one other quote that I really need to share with you. This was a company that had been around for two years. It was an HR consulting firm. The quote was about choosing their investment options, and the woman said, "It's very scary. Last night I was having nightmares about picking plan investment choices." Now, this person, a small business person, was not a financial person, and this seemed very daunting to them.

And so I think to the extent that we can say that this is doable, it's not as complicated, there is information that can help them, walk them through these issues I think that would be, as a first step would be incredibly helpful.

Senator CORKER. I know my time is up. So what you're really advocating is just making information available to people so that they might be more open to creating these plans. And like Ms. Borzi, it looks like she's doing a lot of that already.

Ms. BORZI. Yes, and one of the reasons—we know that one of the recommendations in the GAO report was that the Department of Labor be the central portal, and I know I should be a cheerleader for my agency, and I am, because they've done a fabulous job, but if I were a small businessperson, I wouldn't think to go to the EBSA website for information on retirement. I would think to go to the SBA website, which is I believe the reason that the President in this memorandum, in this order he gave all of the agencies that deal with this, was to use the SBA's Business USA as the central portal, because as a small business person, that would be most likely where the person would go.

The SBA put together a working group, and we're part of it, the IRS is part of it, the other agencies that provide financial information and other kinds of resources for small businesses are part of it, and on that website there are links to our publications, to our website. We have a specially dedicated small business page on our website, and our folks put a lot of effort into it, and it is underutilized. I'm willing to certainly say that.

So I think we need to think about how better to get the information out that's already there, which doesn't mean that there isn't room for improvement in terms of getting additional information out.

Senator CORKER. I appreciate both of you coming here. And I, along with Chairman Kohl, would certainly love to see more people having plans. They are so simple, so simple today to create, and I think if people did need information, having a place to go, one

central place would be helpful. And I think you're right to be sensitive that most employers are pretty reticent about going to the Department of Labor for anything.

Ms. BORZI. I just don't think they think about it.

Senator CORKER. Yes, I agree. Thank you.

The CHAIRMAN. Just one question Ms. Borzi before we turn to Senator Manchin. We're well aware of the dismal statistic of how few small companies offer retirement plans. On the one hand, I think I have been listening to you say that there are many options that they can go to, but we still have that statistic to deal with. So we're trying to come up with ways and means to get to a desired goal, which is to have more and more small companies engaged in offering retirement plans. Is that right?

Ms. BORZI. Yes. I—

The CHAIRMAN. I mean, do you agree with that?

Ms. BORZI. I do.

The CHAIRMAN. Or are you saying we have a system, it just doesn't seem to be clicking?

Ms. BORZI. I'm not for closing the fact that we should maybe look at ways to simplify the system, maybe take some other steps.

The CHAIRMAN. Okay.

Ms. BORZI. I'm not saying that our system is perfect right now, that it's just a matter of people not having the information.

I mean, I've been in this business for 40 years. I haven't been at the Department of Labor for 40 years, but I've been in this business for 40 years, and it's my observation, taking off my Department of Labor hat, as Phyllis Borzi, citizen taxpayer, it's my observation that what we've been able to do, what Congress has done over particularly the past two decades, in focusing on trying to simplify options and give more options to small business, I think what we've done, unfortunately, is we've been able to pluck all the low-hanging fruit. And now what we're left with is the really intractable problem of how to encourage small employers who, given all these other options, haven't taken those options.

It's a hard, hard thing to do, and I'm the last person in America that's ever going to say we should give up, because my whole career has been devoted to try to expand opportunities for small businesses and for participants to have retirement plans. So I think we do need to work on this.

The CHAIRMAN. Senator Manchin, do you have a comment, or two or three? Go ahead.

Senator MANCHIN. I'm very sorry. If I ask a question that has already been asked, just stop me. But, Ms. Borzi, if I may, small business owners are concerned about plan administration fees, as you know, and all the different paperwork that goes with that. Not just a bottom line, but I'd like to have your perspective to ensure that the fiduciary duties to their employees they're going to be able to meet. They're concerned about can they do what they're going to have to do with the regulations, or are there going to be undue regulations put on them.

Ms. BORZI. Well, we are working on some regulations that will ease the burden on small employers, but also will give them more tools to be able to make better choices. For instance, I did talk in my testimony about our 401(k) fee rules that will require the serv-

ice providers to give plan small employers—it's primarily a problem of small and medium size employers—all the information about what they're actually paying for those investment options that they're offering to their employees, what they're paying in administrative fees, in recordkeeping fees, in investment fees.

The problem of fiduciary responsibility for small employers is a difficult one, and we are looking at, in several different marketplaces, looking at ways to ease the burden.

Senator MANCHIN. What is identified as the most burdensome regulations, or what's the most burdensome thing they have as businesses responding to—

Ms. BORZI. I think just the whole notion of establishing a retirement plan is frightening to a lot of employers. I don't know that they necessarily understand what that means, but the fact that they don't understand it makes it more frightening to them than if they did understand it.

Senator MANCHIN. Are we talking about incentives or reducing regulations? What do you think would be most helpful? Are you getting any input?

Ms. BORZI. Well, we would certainly welcome input. We've gotten a lot of input as part of—

Senator MANCHIN. What do you think will work?

Ms. BORZI. Well, we're not quite sure yet. I think it has to be a combination of all of the above. So we are looking at regulations. We're looking at updating regulations. We're looking at regulations that could be consolidated or reduced. We're looking at all sorts of things.

Senator MANCHIN. Sir, if I may ask you, many employers probably receive their information regarding investment options from probably a plan adviser. What makes you think they would come to the government for this advice?

Mr. JESZECK. Well, Senator, first of all, we found in our study that people used third-party service providers in a variety of areas. Not everybody used an investment adviser. We don't suggest that they necessarily should go to the Federal Government for that. I know that there are regulations concerning fee disclosure. That should be helpful, we didn't recommend that they go to the Federal Government to obtain investment advisors.

I do want to get back to your question about fiduciary responsibility because that was something that we heard from a lot of the small businesses. People are afraid of getting sued even if, in fact, if they talked to an attorney or something, that the likelihood of that happening was really quite remote. That was something that they were afraid of. The term itself is somewhat a little fearsome for some of these companies.

The other issue is in terms of paperwork. For a lot of small businesses it's not that they differentiate between the Form 5500 and annual reports and plan amendments. To them it's just one big group of—a bunch of paperwork requirements, and it just seems overwhelming, which is one of the reasons why, and given the discussion we've had here, that we recommended that there be a task force that Labor would head to work with other agencies that, among other things, would look at those reporting and disclosure

requirements and maybe look to see the extent to which those things could be streamlined or simplified.

So that was part of the basis for our recommendation.

Senator MANCHIN. Thank you.

The CHAIRMAN. Senator Corker.

Senator CORKER. Thank you.

On the fiduciary piece, what kind of standard is there really? I mean, if you have—and maybe the second panel will speak to this. But what is the real risk? I know people are getting concerned about terms and liabilities that maybe they don't quite fully understand. But if you have a legitimate group that's handling this on your behalf, what is your real exposure as an employer in that fiduciary responsibility or relationship?

Mr. JESZECK. I would defer to—

Ms. BORZI. Well, this is one of the difficulties, is that under ERISA, the people who we can hold accountable for imprudent investments, for instance, are people who are called fiduciaries, but many of the people today who provide investment guidance, et cetera, advice to small employers, what options to offer your employees, what should the platform look like in your 401(k), many of those people take the position that under the Department of Labor's old 1975 regulation that existed before 401(k) plans even were in existence, that they are not fiduciaries, and that was what I was alluding to in my testimony.

What we're trying to do through our regulation is reduce the burden on small employers in particular, because what happens is a small employer, recognizing their inability to handle all these—make all these financial decisions themselves, will quite often reach out and hire somebody, a consultant, a broker, somebody to give them investment advice, and then they—

Senator CORKER. Hopefully they do, yes.

Ms. BORZI. Right, and we want them to do that. But then when they follow that individual's advice or that entity's advice, and it turns out ultimately to be an imprudent investment, the person giving the advice steps back and says "Don't look to me."

And so we wind up at the Department of Labor, when we conduct our investigations, if there's a substantial loss to the participants in the plan because of an imprudent investment decision, we wind up with a Hobson's Choice. Either we leave the loss unaddressed or we have to go after the employer, in many cases a small employer, who is just as much a victim as the participants are because they hired an investment adviser. The statute says if you're an investment adviser for a fee, so if you get paid, then you're a fiduciary, but our regulation is mismatched with today's marketplace.

So one of the things we are doing, and that's what I alluded to in my testimony, through regulation is to try to make it easier for small employers, relieve the burden for them.

I'll tell you one of the things that businesses are most afraid of in the fiduciary context, and I think it's really just a misunderstanding of how the fiduciary rules play out in the law and in the cases. When somebody tries to decide whether a fiduciary's decision is prudent—that's the basic standard. Your decision has to be pru-

dent, it has to be made for the exclusive benefit of the participants and beneficiaries. That's sort of the simple benchmark.

In deciding whether a decision on the part of the fiduciary is prudent, you don't use hindsight. You don't say, oh, gosh, they invested in a hedge fund and it lost all this money. What you do is you look at what are the facts that the fiduciary had in front of him or her at the time they made the decision. Did they act prudently? Did they hire somebody to advise them if they didn't know what they were doing? Did they prudently select that person? Did they monitor what was going on?

So it isn't if there a loss at the end of the road and, oh, my God, I'm going to get sued and I'm going to lose my business. That isn't the way the fiduciary standard is approached. But I think most small businesses—I can say this, again, from my own dealings with friends and family that run small businesses—I think they just don't understand that. I think that what happens, I think they think that they are the ultimate guarantors of the success of any investment they offer to their employees, and that's just not the case.

Senator CORKER. So it sounds like you can, without any legislative action, you can easily fix that through regulatory action at the Department level.

Ms. BORZI. We can reduce the burdens on small employers significantly through regulatory action.

Senator CORKER. I know it's taking a long time, but I think this is very important to the topic. So it seems like you can fix that part.

Now, on the investment part, aren't many of these 401(k)s today set up in such a way that the employee is actually making the decision? They'll have four or five or six, or maybe more options of investment modes, and the employees themselves are really directing the type of investments?

Ms. BORZI. And they need investment advice as well.

Senator CORKER. But it still eliminates the fiduciary piece to a degree when that's happening.

Ms. BORZI. That's right. But people who give them investment advice, as well as the people who give the employers investment advice, the employees need to know, the participants in the plan need to know that those people who give them investment advice are doing so in an unbiased way and that they can rely on the advice.

Senator CORKER. Okay. Thank you.

The CHAIRMAN. Thank you both very much. You've been very helpful.

Ms. BORZI. Thank you, Mr. Chairman. Thank you.

The CHAIRMAN. So we'll turn now to our second distinguished panel.

First we'll be hearing from Bryan Fiene, who is the Senior Vice President and Investment Consultant at Robert W. Baird & Company, Inc., in Milwaukee. Mr. Fiene is from Madison. He has spent 19 years in the financial industry serving dozens of small and medium-sized retirement plans that encompass thousands of people across southern and central Wisconsin.

And next we'll be hearing from John Kalamarides, who is a Senior Vice President at Prudential Retirement, where he leads the Institutional Investment Solutions business. That includes Prudential Bank and Trust, Stable Value Funds, Institutional Retirement Income Products, and Institutional Investments. He's a frequent speaker at industry, professional, academic, and public policy conferences, as well as forums on practices and trends in the retirement area and the challenges facing today's plan sponsors and participants. Currently, he oversees more than \$120 billion in assets.

So, Bryan why don't you say a few words?

STATEMENT OF BRYAN FIENE, QPFC, SENIOR VICE PRESIDENT AND SENIOR INVESTMENT CONSULTANT, PRIVATE WEALTH MANAGEMENT, ROBERT W. BAIRD & COMPANY, MADISON, WI

Mr. FIENE. Thank you, Chairman Kohl and Senator Corker and Senator Manchin. Good afternoon. I appreciate the opportunity to provide this testimony regarding small employer challenges to retirement plan sponsorship. As a financial advisor with Baird, I've served dozens of small businesses for 19 years. I am a designated qualified plan financial consultant, and I work with many small businesses on lots of issues.

My firm, as you said, Baird, was established in 1919, and we have 100 locations around the country, including one in Nashville with a couple of good retirement plan teams down there.

As a resident of Sauk Prairie, which is a very small town in southern Wisconsin, I'm very proud of our state, and Wisconsin has got dozens of world-class publicly traded companies, just as Tennessee does. I think we can all be proud of that, and I think the goal here, if I understand it correctly, is to get more participation from small businesses.

We need to encourage these small businesses to succeed so that they can grow up to be household names and employ thousands of American workers. I think that's everybody's goal. So my testimony is going to focus on the following points.

First, there are lots of reasons driving small employers away from offering retirement plans. We've heard some of those today.

Second, Federal and state agencies have an opportunity to improve how they support small businesses, understanding whether and how to offer a plan.

Third, financial advisers and plan providers play a critical role in helping small employers cope with challenges of adopting and maintaining a plan.

Fourth, many small employers seeking to establish a plan I think will be helped by expanding the multiple employer plan option, and I'll talk about that a little bit as well.

Pre-crisis, businesses needed a strong retirement plan to recruit and retain good people, as you said in your opening remarks, Senator Kohl. These days, all they need is an ad in the newspaper. It's really not that difficult to retain and find good people.

The small business owner's personal finances are very complex, and generally they have most of their net worth tied up in their businesses, and a lot of their free cash is in their retirement ac-

count. You guys are both businessmen, so you know what I'm talking about.

Faced with a lot of different choices, many small businesses have cut employer contributions for immediate survival and to fortify their balance sheets in case the economic situation worsens. Unfortunately, this is detrimental to participants, but many small businesses are left with few other options. They look at things at a very high level, asking what will this do to enhance my business and what is my risk in implementing and maintaining it. Those are probably their two biggest concerns.

In studying a plan, small business owners will look at the risk versus reward, as they would with any investment. While the Department of Labor website offers a myriad of information, rather than turn to government for guidance, they often will seek out a trusted adviser to help navigate this decision, as they would any other related to their business. They will probably start with a financial accountant, adviser, or attorney. As Phyllis stated earlier, her friend asked her what kind of retirement plan they should start. That's where it starts with small businesses.

A small business owner, like most Americans, has many competing priorities for their income. These priorities include Federal, state, and payroll taxes, living expenses, college savings for children. Often now they're caring for their own aging parents, and frankly their own retirement becomes a back-burner issue.

Of course, it would be remiss for me not to commend Congress and the Department of Labor for many recent innovations, and I think maybe the most powerful one is auto-enroll. I can't emphasize enough how powerful that tool is going to be, I think, to grow retirement plans and help people down the road.

Since I'm almost out of time, I'm going to move on, and certainly if you have questions, feel free to ask. I think, Senator Corker, you had a question about understanding why small businesses are not starting plans, and I think I might have an answer for you on that.

So thank you for inviting me out here. Washington is a beautiful city and I'm having a great time.

[The prepared statement of Bryan Fiene appears in the Appendix on page 60.]

The CHAIRMAN. Great. Thank you, Bryan.
John, go ahead.

STATEMENT OF JOHN J. KALAMARIDES, SENIOR VICE PRESIDENT, INSTITUTIONAL INVESTMENT SOLUTIONS PRUDENTIAL RETIREMENT, HARTFORD, CT

Mr. KALAMARIDES. Thank you, Chairman Kohl, Ranking Member Corker, and members of the committee, for your invitation to discuss the challenges facing small employers in providing retirement plans. The focus of my testimony is going to be on multiple employer plans, a structure that enables small business owners to pool their resources into a single plan to enjoy efficiencies typically limited to large plan sponsors and to pass those benefits along to their employees.

As a supplement to my written testimony, Prudential is releasing a white paper on this topic. Also, the U.S. Chamber of Commerce, which has reviewed and supports my testimony, will release its

own white paper on the challenges facing plan sponsors and will propose solutions, including multiple employer plans.

This afternoon I'd like to discuss the scope of the retirement coverage gap, the reasons for the gap, how multiple employer plans can help close the gap, and recommendations for expanding access to multiple employer plans.

Too many employees do not have access to workplace retirement plans, and therefore do not save adequately. The Employee Benefit Research Institute found that more than 51 percent of today's workers, or 78 million Americans, have no access to workplace retirement plans. This lack of coverage is most acute among employers with less than 100 workers. EBRI found that only 36 percent of employees with 10 to 100 workers provide plans, compared to nearly two-thirds of larger employers. EBRI also found that 58 percent of workers who do not participate in a retirement plan have saved less than \$10,000, as compared to \$59,000 saved by those who do participate. In short, the smaller the employer, the less likely their workers will have saved adequately for retirement.

Small employers don't provide retirement plans due to cost, administrative complexities, and concerns about fiduciary liability. Looking from the perspective of an employer, I have an obligation to prudently select the plan service providers and investment options, assess whether the compensation I'm paying to the plan service providers is reasonable, ensure that my employees receive comprehensive disclosures about the plan's investment options and fees; and on the plan administrative side I have a legal obligation to ensure my employees receive a compliance summary plan description and quarterly benefit statements, I have to file an annual financial report, and perhaps hire an independent qualified public accountant. And finally, as an employer, I need to understand the serious penalties and litigation risks of not complying with these requirements.

Clearly, these requirements are important to protecting plan participants, but understanding the requirements and liabilities can prevent many employers from establishing retirement plans, particularly small employers who, in my view, are less likely to be experts or have the finances to even hire an expert.

The administration recognized these challenges in framing their auto-IRA proposal. That proposal, as I understand it, is premised on the adoption of a model plan under which employer responsibilities and liabilities would be limited to making timely employee contributions. We believe these principles can and should be extended to multiple employer plans.

Multiple employer plans can offer employers the opportunity to reduce plan costs, achieve economies of scale through pooling, and pass those benefits along to their workers. A study by Deloitte and the Investment Company Institute referenced in our white paper demonstrates these potential savings. The average expense of a retirement plan for an employer with fewer than 100 employees is 132 basis points. If 100 small employers were to pool their assets in an MEP, expenses could be reduced to roughly 50 basis points, generating more than a 60 percent savings for participants.

MEPs also afford employers a practical means by which to have administrative and fiduciary responsibilities carried out by profes-

sionals. We at Prudential believe the MEP structure, with the adoption of a standardized plan design, would benefit small employers in particular. We refer to this combination of an MEP and a standardized plan as a multiple small employer plan, which is the focus of our white paper. An MSEP would include a model plan document to provide uniformity and increase portability, provisions for automatic enrollment, automatic contribution escalation, and a qualified default investment alternative. It would include a \$10,000 annual contribution limit, and it would restrict participant loans and hardship distributions.

To provide for MEP growth, we believe four legislative or administrative actions are required. First, expand the standards for MEP sponsorship. Second, limit the responsibilities of employers to making timely employee contributions. Third, limit the liability to the non-compliant employers, not all. And fourth, eliminate non-discrimination testing.

We welcome the opportunity to work with the committee and the agencies on these important issues. This concludes my testimony. I'd be happy to answer any questions.

[The prepared statement of John J. Kalamarides appears in the Appendix on page 66.]

The CHAIRMAN. If we had a goal of getting up to 50 or 60 percent of all small businesses providing pension plans, savings plans, is that a goal that we should have as a public policy in this country, or something of that sort in terms of a goal? And number 2, and I think you began to touch on it, John, how do we get there? I mean, is it worth pursuing? Is it a good public policy? I happen to think it is. So what do we need to do, John?

Mr. KALAMARIDES. I think increasing retirement security for American workers is an incredibly important public policy.

The CHAIRMAN. Yes.

Mr. KALAMARIDES. To do that, a very efficient way for people to save for retirement is through the workplace.

The CHAIRMAN. Yes.

Mr. KALAMARIDES. We see the benefit of that through behavioral finance, paying yourself out of your paycheck first, and benefitting from the economies of scale and the ERISA fiduciary oversight that we get at the workplace.

The 401(k) system works for larger employers. How can we bring that 401(k) system that's working so well to smaller employers? By doing the steps I outlined in my oral testimony, expanding access and promoting multiple small employer plans, allowing small employers to overcome the hurdles. Allow them to pool their purchasing power. Allow them to have the responsibilities that are appropriate for them, and to be able to rely on financial professionals for that critical guidance and fiduciary oversight.

The CHAIRMAN. Yes. Bryan, do you agree with much of what John said?

Mr. FIENE. Yes, I agree with what he said. I think, to add to that, I think the goal is terrific. I think it could be even higher. But the blockades to these small businesses are many.

Senator Corker, you talked about your business and it was like falling off a ladder to have a 401(k). When you get down to the very small employers, the costs are very high versus a larger employer.

Just to give you an example, I went on your website in Tennessee, and 49 percent of the employers in Tennessee are five people or less. Two-thirds are 20 people or less. I don't know any financial adviser or plan provider that would target that group to help them start retirement plans because it's not economically feasible. It takes approximately the same amount of time to set up a small plan as it does a large plan, but there's not any revenues there unless the business owner fronts, pays that bill up front. If it's spread across plan participants like it is in a larger plan, it's not a big deal.

But when it's in a small plan, if you've got \$1,000 for start-up, and maybe it's another \$2,000, \$3,000 a year to administer the plan, you're talking about 4 percent on a \$100,000 plan. You've got five people, it takes \$20,000 for the first year to get to \$100,000.

The financial adviser is also not compensated very much on that. We may net \$100 on 30 or 40 hours of work with the small businesses. We do most of those businesses as a favor to our other clients, and in some cases we do it because the businesses will grow.

But I think what the MEP—the ability to bolt on a small employer onto a plan that's got all of the qualities of a large plan, and I personally think if you allowed the expansion of MEPs, you'd see start-up costs go away. Competition would take care of that problem. I think features and benefits would go up, and as these multiple employer plans get larger, costs go down. It's happening all the time.

So I think that's a great solution.

The CHAIRMAN. Senator Corker.

Senator CORKER. Yes, regarding multiple employer plans for me, I like association health plans, I like anything that allows people to band together and lower cost.

I do think there are people who service small companies who do other things for those small companies, like health insurance and those kinds of things—20 and smaller companies do those things and are glad to do them. But that doesn't mean I don't want to expand that, and I can't imagine why we would want to keep that from happening.

As a matter of fact, you have to wonder why even an employee wouldn't have the ability, whether their employer was a member of this or not, if the employer wasn't making contributions on their behalf—certainly we did, and I think employers should - you would wonder why an employee, even if their employer wasn't a member, couldn't do it, right? I mean, we want to encourage that as much as we can, and as long as the standards are there, it seems like we'd want to do everything we possibly could to allow people to have the critical mass but also the opportunity to get in.

The \$10,000 limit issue you mentioned, what are you referring to when you say that?

Mr. KALAMARIDES. I'm referring to the amount of a deferral limit of pre-tax contributions to this particular plan. 401(k) plans have a higher limit. Currently, they're well over \$16,000, plus there's a catch-up contribution. When we thought about the multiple small employer plan concept, our whole goal was to increase coverage and keep cost and efficiency as clear as possible. To be able to do that,

we structured a proposal that was simple and got to the essence of contributions.

We also want to make sure that——

Senator CORKER. The maximum you can put in on a tax-deferred basis would be \$10,000?

Mr. KALAMARIDES. That is what is in the multiple small employer plan proposal.

Senator CORKER. Why would you do that?

Mr. KALAMARIDES. You would do that in a number of ways.

Senator CORKER. No. Why would you do that?

Mr. KALAMARIDES. You could make it larger. The reason why we thought it was appropriate to have \$10,000 is it gave the incentive that if a company or a group of individuals or a small business owner wanted to have the maximum contribution in a 401(k) plan, that they would then adopt all the standards of a 401(k) plan, not just what this multiple small employer plan concept is.

Senator CORKER. But why?

Mr. KALAMARIDES. If we look—you could easily make it larger if you thought that that was an appropriate public policy, the tax deferrals associated with it.

Senator CORKER. What is in a 401(k), just for our education?

Mr. KALAMARIDES. A 401(k) deferral is well over \$16,000, and there's a catch-up contribution of \$6,500 as a maximum deferral. An IRA——

Senator CORKER. And how far can you go back to catch up?

Mr. KALAMARIDES. You can only provide contributions this year. If you are over a certain age, you're allowed to make catch-up contributions so that you can catch up towards the savings that you missed in previous years.

Senator CORKER. So \$16,000 is the maximum tax-deferred contribution that can be made, including the employer contribution component?

Mr. KALAMARIDES. No, not including that. The employee's contribution.

Senator CORKER. So then the employer, how much can the employer put in on behalf of an employee that is tax deferred?

Mr. KALAMARIDES. I think the maximum amount is \$36,000 in total contributions that an employer and an employee can put into a current 401(k) plan.

Senator CORKER. And so why wouldn't that be the limit on a multiple employer plan?

Mr. KALAMARIDES. When we were making this proposal, we were trying to balance both the tax consequences and the incentives between and match up the capabilities between the deferral limits and the benefits and the responsibilities of an employer. An IRA has a much lower deferral limit. A 401(k) plan with increased responsibilities would have a higher limit, trying to create a continuum of options as we talked about, and the previous panel talked about as well. The increased deferral limits would become increased responsibilities.

Senator CORKER. So it's maybe a camel nose into the tent approach, too, that over time we could build upon.

Mr. KALAMARIDES. Indeed.

Senator CORKER. Any comments, Bryan?

Mr. FIENE. Yes. In my written testimony, I put an example in there of someone that makes a \$17,000 contribution every year for 25 years, and if they make \$100,000 a year, they end up at a 5 percent return worth about \$900,000. And with a 5 percent return on that, that's \$45,000 a year pre-tax. Department of Labor's website said they need between 70 and 90 percent of their income replaced at retirement. So they come up about 50 percent short, even with a \$17,000 contribution.

I guess we differ on this one. I think that they should be allowed to put in enough to get to where they need to be.

Senator CORKER. John, you're just basically trying to get something passed. Is that correct?

Mr. KALAMARIDES. I'm not opposed to more. I recognize that that is probably the minimum necessary to make that attractive to a small business employer versus having an IRA just for themselves and not offering any solution to their employees.

Senator CORKER. I applaud both of your efforts to try to make these kinds of things happen. I know for years, in our own business activities, we did everything to try to create association health plans. I know that was very difficult. But this, with all the issues that we all face relating to people and their standard of living after retirement, seems like a no-brainer, and I look forward to working with Senator Kohl and others to hopefully cause something like this to happen.

So I thank you very much for your testimony. And I would agree with Bryan on the limits, for what it's worth.

The CHAIRMAN. Some people have expressed concern about third-party plan administrators not looking out for the plan participants in the same way as an employer himself might. Is that legitimate, or do you think that's not a big issue for us to be concerned about?

Mr. KALAMARIDES. I think that financial service providers that are experienced do take their role very seriously, and there is precedent for financial service providers acting in that capacity. When a plan exists and it is abandoned by that particular employer due to bankruptcy or death of the small business owner and the like, there are provisions already within the IRS code and the ERISA regulations that allow an independent trustee and financial service provider to act in a wide capacity, and we've included in our written testimony a proposal that new legislation or new regulatory guidance could build off of to specifically protect the employees by allowing financial service providers to act in that very similar capacity to abandoned plans.

The CHAIRMAN. Good.

Bryan, would you be worried about that?

Mr. FIENE. No, I wouldn't be worried about it. I've seen, in my 19 years, I've seen an evolution by service providers from something that was very, very basic to something that is very, very sophisticated now. They can reach out, all the way down to single participants in plans now with education programs. They've got safeguards in place to prevent fraud and misuse. A few years ago when the lawsuits came down on mutual funds about the active trading in the mutual funds, they've got systems now where they can track your trades, whether it's 30 days or 60 days or there's a penalty or you can't get back in.

I think it would be fairly easy to work with a service provider and DOL or whoever is worried about it and work out a solution that everybody thinks is safe for participants.

The CHAIRMAN. Thank you.

Senator Corker.

Senator CORKER. Yes. I assume that anybody taking on the responsibility of administering a plan would be very open to very stringent penalties in every way if there were any kind of failures? I would think the fiduciary standard for any kind of sponsor would be far beyond what any employer would have of a personal plan. I mean, that's the kind of responsibility you're looking at, right?

Mr. FIENE. Yes. It's been my experience that whenever a provider makes a mistake, and mistakes are made, in every instance they calculate whatever damages may have been done and they fix it immediately.

Senator CORKER. Are there insurance requirements or bond requirements or anything that are typically—is that the kind of thing that would be envisioned with multiple employer plans?

Mr. FIENE. That's really not my area of expertise, but I would think you could work that out with them.

Senator CORKER. So you would envision exceptionally strong fiduciary standards and liabilities if people were to enter the business of being plan sponsors, and you would envision insurance and those types of things to cover activities that ended up because of fiduciary issues—not necessarily investments that went sideways but fiduciary responsibilities, you would envision tremendous liabilities being held by these folks?

Mr. FIENE. Yes. I think it's critical that some of these fiduciary liabilities are transferred from plan sponsors that know nothing about fiduciary responsibility to sophisticated financial institutions that know everything about fiduciary liability.

Senator CORKER. But do you see those duties even being stepped up beyond what would be at an employer level?

Mr. FIENE. I don't think that they would worry about tightening up procedures and policies at all. They've been doing it for 30 years.

The CHAIRMAN. John, any other comments you want to make?

Mr. KALAMARIDES. Thank you for the committee's attention to this important issue, and for increasing retirement security and coverage amongst small businesses.

The CHAIRMAN. Thank you.

Mr. FIENE. Thanks for having me out.

The CHAIRMAN. Thank you, Bryan.

Thanks, folks.

[Whereupon, at 3:20 p.m., the hearing was adjourned.]

APPENDIX

**TESTIMONY OF PHYLLIS C. BORZI
ASSISTANT SECRETARY OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION
BEFORE THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE
March 7, 2012**

Introductory Remarks

Good afternoon Chairman Kohl, Ranking Member Corker, and Members of the Committee. Thank you for inviting me to discuss small business retirement plan issues. I am Phyllis C. Borzi, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to represent the Department of Labor (Department), EBSA, and its employees, who work to safeguard retirement and other employee benefits for America's workers, retirees and their families and to support the growth of our private benefits system. Secretary Solis' overarching vision for the Department is to advance good jobs for everyone, and a good job, among other things, is one that provides a secure retirement. We are committed to promoting opportunities and helping America's workers to achieve a secure retirement.

Helping workers to achieve a dignified and secure retirement means encouraging employers to establish and maintain retirement plans and protecting workers' benefits. We know we must work particularly hard to assist small businesses because of the challenges small businesses face in providing retirement plans. There are six million businesses with fewer than 100 employees employing 42 million workers.¹ Less than half of these businesses offer a retirement plan.²

¹ U.S. Small Business Administration, Office of Advocacy, based on data for 2008 provided by the U.S. Census Bureau, Statistics of U.S. Businesses.

² U.S. Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in the United States, March 2011, Bulletin 2771. Private Industry Tables. Table 1, Establishments offering retirement and health care benefits.

To expand access for workers to employer-based retirement plans, the Department has long recognized that we need to reach out to the small business community. Employer-sponsored plans are the best way for most workers to accumulate savings for a financially secure retirement. It is not easy for workers to save and invest so that they will be able to maintain their current standard of living in retirement. According to experts, workers will need to replace 70 to 90 percent of preretirement income.³ Therefore, we need to do all we can to assist small employers in establishing and operating retirement plans.

Background

EBSA is responsible for the administration, regulation, and enforcement of the fiduciary, reporting, and disclosure provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). EBSA assists small employers in evaluating their options for establishing a retirement plan and provides compliance assistance to help employers understand their fiduciary and reporting responsibilities for employer-sponsored plans. We accomplish this through comprehensive education, outreach,⁴ and regulatory programs.

EBSA's Office of Participant Assistance (OPA) reaches out to small businesses through comprehensive campaigns designed to help them make knowledgeable choices and assist them in complying with the law. The goal of the campaigns is to provide comprehensive information and tools to assist small business owners. EBSA's Office of Regulations and Interpretations

³ Alicia H. Munnell, Francesca Golub-Sass, and Anthony Webb. "How Much to Save for a Secure Retirement." Center for Retirement Research at Boston College, Issue Brief #11-13, November 2011. Bruce A. Palmer. "2008 GWU/Aon RETIRE Project Report," Research Report Series Number 08-1, June 2008.

⁴ Section 516 of ERISA requires the Department to maintain a program designed to effectively promote retirement income savings by the public, including information on the forms of retirement income savings.

(ORI), Office of Chief Accountant (OCA), and OPA also provide compliance assistance to employers and employee benefit plan officials.

In order to leverage our education and outreach efforts, the Department continues to build on our relationships with strategic partners from within the federal government and among external stakeholders. In particular, we partner with the Internal Revenue Service (IRS), the Small Business Administration (SBA), the American Institute of Certified Public Accountants (AICPA), and the Consumer Federation of America, and others to reach small businesses. In addition to these partnerships, we work to maximize the impact of our announcements of new materials, tools and events by coordinating the timing with high profile events such as America Saves Week, Financial Literacy Month and National Save for Retirement Week.

Education, Outreach and Compliance Assistance to Small Businesses

The Department understands that small employers need assistance in choosing a retirement plan appropriate for them and their workers. As the research has demonstrated over the years, there are many factors that impact a small business owner's decision to sponsor a retirement plan, including the focus on growing a new business, employees' preference for higher wages or health benefits before a retirement plan, as well as the economy. We work hard to address the challenges that we can through our education and outreach to assist small businesses in establishing and maintaining a plan.

Expanding Coverage by Assisting Small Employers in Choosing a Retirement Plan

In 2000, the Department launched a formal dedicated small business campaign partnering with the Small Business Administration and the U.S. Chamber of Commerce. The *Choosing a*

Retirement Solution for Your Small Business campaign helps small businesses that do not have a retirement plan understand the many options available and determine which options might be appropriate for them. The campaign highlights the tax incentives available for the various options and provides more detailed information on how to establish and operate the various plan options.

To provide a comprehensive one-stop resource for small business owners, the Department has worked with the IRS to develop a series of publications and materials geared to small businesses that describe all of the plan options available and the highlights of each. The options range from the basic to those with more design flexibility and include individual retirement arrangements (IRAs), defined contribution plans, and defined benefit plans. Many small businesses will be able to find and establish more than one of these options through financial service providers and retirement plan practitioners. The publication, *Choosing a Retirement Solution for Your Small Business*, provides a comparison chart of all of the options and the key features and is available on our website at www.dol.gov/ebsa/publications/choosing.html.

The other EBSA publications developed with the IRS provide more detailed information on the individual options, providing overviews of the law for establishing and operating the respective plan option. These publications are all posted on the EBSA, IRS and SBA websites and include links to the resources noted in the publications so that a small business owner who is interested in finding more information has easy access to it. In addition, we work with the IRS to keep the publications current and to include new options as they become law. For example, in 2008 we released a publication on automatic enrollment 401(k) plans that incorporates the safe harbors for both ERISA and the Internal Revenue Code as added by the Pension Protection Act.

We also provide outreach to small business owners and their accountants through workshops and webcasts. The IRS and AICPA have participated with us in the workshops and webcasts and we have worked closely with the SBA, the Department's Small Business Programs Office and local Chambers of Commerce along with State CPA societies, local Society for Human Resource Management (SHRM) chapters and other organizations to promote these workshops and webcasts. Webcasts enable us to reach a wider audience that we can't reach in person. For example, recently we held a webcast on February 23 with the AICPA, the Consumer Federation of America and NACHA, the Electronic Payments Association, as part of America Saves Week. The archive is available at <http://www.dol.gov/ebsa>.

After receiving feedback from small businesses that they tend to look to their accountants for help in determining if they should offer a plan, the Department began working with the AICPA. Members of the AICPA frequently join the local workshops we conduct and help to promote the events and our materials. Our work with the AICPA includes a video with accountants, their small business clients and some of the employees of those businesses talking about their experience in selecting a plan option. We also developed the interactive website, www.choosingaretirementsolution.org, that helps accountants and small business owners evaluate those options most suitable for their situation after they answer a few questions about their businesses and a few key plan features (such as whether they want to make contributions). This website links to the publications the Department developed with the IRS for additional information on the options.

Helping Small Businesses Comply When Sponsoring a Plan

In order to assist service providers and employers, including small businesses with compliance issues once they have set up a retirement plan, the Department developed with others the *Fiduciary Education* campaign in 2004 partnering with the SBA, SHRM, AICPA, Chamber and the National Federation of Independent Business (NFIB). This campaign creates an awareness and understanding of the law and responsibilities involved in operating a retirement plan. This includes highlighting some of the most common problems that EBSA encounters in our enforcement program and steps on how to avoid them. The campaign helps plan sponsors and other fiduciaries to:

- Understand the terms of their plans;
- Select and monitor service providers carefully;
- Make timely contributions to fund benefits;
- Avoid prohibited transactions; and
- Make timely disclosures to workers and their beneficiaries and reports to the government.

As part of the campaign, the Department developed a number of publications, as well as tips and other tools, providing an overview of the fiduciary responsibilities and other provisions under Title I of ERISA. We developed additional publications and full day seminars, which are joined by the IRS, on areas of the law such as the tax qualification requirements, reporting and disclosure and voluntary correction programs. The cornerstone publication, *Meeting Your Fiduciary Responsibilities*, is also available in Spanish. We keep the publications and seminars updated for new law and guidance. To reach a wider audience, we provide assistance by

contributing a column for the IRS' quarterly newsletter for small businesses where we provide information on new guidance, tools and outreach that is available on the EBSA website (with links). We also hold annually a two-part webcast series and have developed an interactive website for the campaign. This year, the two-part webcast will be held on March 27-28. Registration is available on the EBSA website homepage.

The Department also provides assistance to small business employers through our Benefits Advisors, located in EBSA's field offices, who answer inquiries and complaints received by phone, mail, electronically or in person. In FY 2010, EBSA's Benefits Advisors responded to more than 233,700 telephone, written and electronic communications from plan participants, employers and plan sponsors, assisting them in understanding their rights and obligations under the law and in obtaining benefits.

EBSA's Office of Regulations and Interpretations also helps employers, plan sponsors and plan service providers in understanding the ERISA fiduciary duties and regulatory requirements through its telephone and web inquiry technical assistance program. In this regard, ORI's employee benefits law specialists are available to answer technical questions on regulations, advisory opinions and other non-regulatory guidance provided by the Department.

Similarly, EBSA's Office of Chief Accountant provides compliance assistance activities with respect to ERISA's reporting and disclosure requirements. Since FY 2000, our EFAST Help Desk has handled over 800,000 filer inquiries with the scope of the inquiries ranging from routine, general information requests to working with plan filers to resolve the most complex filing scenarios. EBSA's recent Gallup survey also rated the EFAST Help Desk highly with respect to customer satisfaction. We saw a significant increase in filer inquiries during FY 2010

in conjunction with the transition year of EFAST2 – the new electronic filing system. We are now down to normal levels of filer inquiries which indicate we have successfully helped many small businesses through the transition year.

Partnership with SBA

The Department has partnered with the SBA to help expand our reach to the small business community in both the *Choosing a Retirement Solution for Your Small Business* and the *Fiduciary Education* campaigns. We actively work with the SBA on an ongoing basis and provide information on Department events and resources to SBA.

Information on our events as well as our resources for employers with and without retirement plans is provided on BusinessUSA (business.usa.gov), a website formed as a result of a Memorandum issued by President Obama on October 28, 2011. The Presidential Memorandum calls for this website to be the central portal for small businesses, providing information from all of the Federal executive departments on the issues of interest to small businesses. The goal is to make it easier for small businesses to access the full range of government programs and information. We continue to work with the SBA and the Department of Commerce staff to keep our information both updated and expanded on the website. The BusinessUSA site also attracts service providers to small businesses looking to assist their clients.

Regulatory Initiatives to Help Small Employers

Millions of workers rely on their employer-sponsored retirement plans to finance their retirements, making it critical that the retirement system be safe, transparent, and well-regulated. The Department has a number of ongoing initiatives designed to improve the transparency and

adequacy of retirement savings plans, in particular focusing on 401(k) plans where a number of investment and other risks have been shifted onto the shoulders of workers. Our goal is to make sure that employers and workers have good retirement savings options and the information to make the best choices about retirement savings.

Guidance to Fiduciaries on Target Date Funds

Chairman Kohl, I know that you have devoted significant time and energy to looking into target date funds, or TDFs, which have become an increasingly popular investment option in 401(k) plans and similar employee-directed retirement plans. That is why I want to be sure to highlight the guidance that the Department expects to soon release providing tips for ERISA plan fiduciaries on these funds. A TDF can be an attractive investment option for employees who do not want to actively manage their retirement savings, as it offers a long term asset-allocation strategy that automatically adjusts as the individual ages. Many plan sponsors, including small business plan sponsors, have also opted to use TDFs as their plan's qualified default investment alternative (QDIA) under Department regulations. This means that plan fiduciaries can obtain some legal protections under ERISA by choosing such a default investment option for participants who fail to make an election regarding investment of their account balances.

In many cases, especially for small businesses sponsoring a 401(k) plan, a broker or record keeper/administrator may offer an investment platform with a group of investment options which include a TDF option. In selecting a TDF as an investment option for a plan, it is important that plan fiduciaries understand the differences in investment strategies, asset allocations, and investment-related fees among TDFs offered by different providers, even with the same target date. We anticipate that this guidance will help plan fiduciaries to meet their responsibilities in

the review and selection of a TDF by setting forth a number of fiduciary considerations in choosing a TDF as an investment option.

408(b)(2) Regulation

On February 2, the Department issued a final rule that will provide employers sponsoring pension and 401(k) plans with information about the administrative and investment costs associated with providing such plans to their workers.⁵ The rule requires service providers to furnish information that will enable pension plan fiduciaries to determine both the reasonableness of compensation paid to the service providers and any conflicts of interest that may impact a service provider's performance under a service contract or arrangement. This final regulation improves the transparency of 401(k) fees to help workers and plan sponsors make sure they are getting investment, recordkeeping, and other services at a fair price. This is important in an environment where the plan administration and investment-related expenses are often borne by the plans' participants and beneficiaries. In particular, we believe that small business plan sponsors will greatly benefit from the final regulation, as they typically have not had the leverage of larger employers to obtain comparable information on fees and expenses. This regulation will put small businesses on the same playing field as larger employers by allowing them to obtain information sufficient to enable them to make informed decisions about an employee benefit plan's services, the costs of such services, and the service providers.

⁵ 29 CFR 2550.408b-2(c).

Fiduciary Regulation

On September 19, the Department announced it will repropose the definition of a fiduciary. The agency is seeking to update a 1975 regulation, which defines when a person providing investment advice for a fee becomes a fiduciary under ERISA, in order to adapt the rule to the current financial services marketplace. The proposal's goal is to ensure that potential conflicts of interest among advisers are not allowed to compromise the quality of investment advice on which millions of America's workers rely.

This initiative will especially help small business employers in the design and implementation of a retirement plan. Selecting investment options for such plans is a fiduciary function under ERISA, and many small employers rely on advice from financial professionals to prudently select investment options. A revised fiduciary definition would protect these small employers (and of course other employers) by making it more difficult for these advisers to steer small employers to investment options that pay the adviser higher fees. It also would hold the advisers responsible for losses that result when they recommend imprudent investments. Under the current rule, such advisers can avoid responsibility for these losses and leave the small employers as the sole fiduciary and therefore the sole responsible party under ERISA. The proposed regulation will hold the advisers accountable for imprudent and conflicted advice, and the harm this advice causes to plans and participants.

Proposals to Expand Small Business Coverage*Administration Proposal*

There are a number of existing proposals to expand small business retirement plan coverage. In the Administration's FY 2013 budget proposal released on February 13, the Department's budget request contains a proposal to establish Automatic Workplace Pensions, commonly known as "Auto-IRAs." Under the budget proposal, the Administration projects that the new system of automatic workplace pensions will expand access to tens of millions of workers who currently lack pensions. Coverage will be expanded by requiring employers who do not currently offer a retirement plan to enroll their employees in a direct-deposit IRA account compatible with existing direct-deposit payroll systems. Employees would be permitted to opt-out if they choose. Employers with ten or fewer employees and employers in existence for less than two years would be exempt. Employers with fewer than 100 employees who set up these arrangements would be eligible for temporary business tax credits.

Legislation introduced in both the House and Senate contained Auto-IRA provisions similar to the proposal included in President Obama's FY 2013 budget. On February 16, Rep. Richard Neal (D-MA) introduced a bill entitled the "Automatic IRA Act of 2012," and in September 2011, Senators Jeff Bingaman (D-NM) and John Kerry (D-MA) also introduced an Auto-IRA bill, also entitled the "Automatic IRA Act of 2011."

Multiple Employer Plans

While it is clear from my testimony that the Department supports efforts to expand small business coverage, it is just as important that ERISA's protections for workers' pensions be

maintained. In that regard, the Department has more recently become aware of promoters marketing multiple employer plans, or “MEPs,” that do not involve collective bargaining with an employee representative. These arrangements, often called “open MEPs,” purport to allow totally unrelated businesses to join together to offer a collective pension plan. Promoters claim that these arrangements relieve businesses of their ERISA reporting and fiduciary obligations in connection with administering the plan or monitoring the plan investments and service providers. Proponents say such arrangements can provide the participating employers with a way to pool resources and reduce administrative costs. There are several bills pending in Congress which call for the Department, in coordination with the Treasury Department, to provide fiduciary relief and simplified administrative, reporting and disclosure obligations for multiple employer plans. We are currently analyzing these proposals.

Under ERISA, employee benefit plans must be sponsored by an employer, by an employee organization, or by both. ERISA expressly recognizes the idea of a “multiple employer plan” by including in the definition of “employer” any “person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity.”

For example, a MEP operated by a *bona fide* employer association or group of related employers is a well-established concept in ERISA. Such plans in fact can provide the participating employers with a way to pool resources and reduce administrative costs. The idea of “open MEPs,” however, is not an established concept in ERISA. Indeed, EBSA has had difficult experiences with similar “open” employee benefit structures in the group health area. These arrangements, called “MEWAs,” or multiple employer welfare arrangements, can be provided

through legitimate organizations, but they sometimes are marketed using attractive, but unsound, organizational structures and generate large, often hidden, administrative fees for the promoters. In addition, certain promoters try to use ERISA's general preemption of state laws as a way to avoid state insurance or other regulation. That fact, together with the claimed separation of the employer from accountability for the plan's administration, too often put workers at risk of not getting the benefits they were promised. Bringing this type of product to the pension marketplace presents a number of complicated and significant legal and policy issues. We understand that the Government Accountability Office is actively studying this development in the pension marketplace.

We have also heard about this "open MEP" development from regulated financial institutions, including insurance companies and other financial service providers, who currently are allowed under Internal Revenue Code rules to offer "prototype" plan products to employers. These prototype plans are another way to reduce legal and administrative costs of offering employees a tax qualified pension plan. Some financial institutions have expressed reservations about developing competing "open MEP" products. Their lawyers, based on a review of the many Department of Labor opinions and other guidance on "open MEWAs," have expressed concerns about whether these "open" benefit arrangements can fairly be classified as a "single" plan as opposed to a collection of separate plans being collectively administered much like the prototype plans they already offer. We have been informally asked to provide guidance in this area by some of those groups, and we have two formal requests for guidance, one directly presenting the open MEP issue and the other indirectly. We are actively working on answering these requests.

Conclusion

Thank you for the opportunity to testify at this important hearing. We recognize the challenges small businesses face in providing retirement plans. As I noted, our partnerships from within the federal government and among external stakeholders are a key component to these efforts to develop and disseminate the information. We will continue to expand our efforts, paying particular attention to feedback we receive from small businesses and their service providers, to provide responsive, timely and comprehensive information and compliance assistance. The Department recognizes the critical role that small businesses play in the economy as employers. The Department remains committed to initiatives which protect both the security and growth of retirement benefits for workers, retirees, and their families.

United States Government Accountability Office

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Testimony
Before the Special Committee on Aging,
U.S. Senate

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PRIVATE PENSIONS

Better Agency Coordination Could Help Small Employers Address Challenges To Plan Sponsorship

Statement of Charles A. Jeszeck, Director
Education, Workforce, and Income Security



Chairman Kohl, Ranking Member Corker, and Members of the Committee:

I am pleased to be here today to discuss the challenges that small employers face when sponsoring retirement plans for their workers. About 42 million workers, or about one third of all private-sector employees, work for employers with less than 100 employees and recent federal data suggest many of these workers lack access to a work-based retirement plan to save for retirement. An estimated 51 to 71 percent of workers at employers with less than 100 workers do not have access to a work-based retirement plan, compared to an estimated 19 to 35 percent of those that work for employers with 100 or more workers. Small employers face a number of barriers to starting and maintaining a plan for their workers. Certain characteristics associated with small employers may contribute to the challenges of sponsoring a plan. For example, in 2008, we reported on challenges that can limit small employer sponsorship of Individual Retirement Arrangement¹ (IRA) plans, including administrative costs, contribution requirements, and eligibility based on employee tenure and compensation, among others.² Additionally, federal data suggest that about half of all new businesses (nearly all of which are small) do not survive for more than 5 years.

My statement is based on our report released today that examines (1) the characteristics associated with small employers that are more or less likely to sponsor a retirement plan, (2) challenges small employers face in establishing and maintaining a retirement plan, and (3) options that exist to address those challenges and increase small employer sponsorship.³

To answer these objectives, we combined and analyzed retirement plan data from the Department of Labor (Labor) and the Internal Revenue Service (IRS) employer data to produce a regression analysis and

¹An IRA is a personal savings arrangement that offers certain tax advantages. IRAs may include individual retirement accounts and individual retirement annuities.

²GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, GAO-08-590 (Washington, D.C.: June 4, 2008).

³GAO, *Private Pensions: Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship*, GAO-12-326 (Washington, D.C.: March 5, 2012).

descriptive statistics on 5.3 million small employers.⁴ We conducted literature reviews and interviewed groups of small employers in five cities⁵ as well as other stakeholders.⁶ We conducted our work in accordance with generally accepted government auditing standards from October 2010 to March 2012. More complete information on our scope and methodology is available in our issued report.

In summary, we found that the likelihood that a small employer will sponsor a retirement plan largely depends on the size of the employer's workforce and the workers' average wages. Small employers, retirement experts, and other stakeholders also identified a number of challenges—such as plan complexity and resource constraints—to starting and maintaining retirement plans. In addition, stakeholders offered options for addressing some challenges to plan sponsorship, which included simplifying federal requirements for plan administration and increasing the tax credit for plan startup costs. Although Labor, IRS, and the Small Business Administration (SBA) collaborate in conducting education and outreach on retirement plans, agencies disseminate information online through separate websites and in a largely uncoordinated fashion. In addition, IRS currently does not have the means to collect information on employers that sponsor a certain type of IRA plan. As a result of our findings, we are recommending efforts for greater collaboration among federal agencies to foster small employer plan sponsorship and more complete collection of IRA plan sponsorship data.

Background

To encourage employers to sponsor retirement plans for their employees, the federal government provides preferential tax treatment under the Internal Revenue Code (IRC) for plans that meet certain requirements. In addition, the Employee Retirement Income Security Act of 1974 (ERISA), as amended, sets forth certain protections for participants in private-sector retirement plans, including fiduciary responsibilities that may apply

⁴For the purposes of this study, GAO defined a small employer as a for-profit firm with at least 1 employee and no more than 100 employees.

⁵The five cities were Atlanta, Boston, Chicago, Los Angeles, and Washington, D.C.

⁶Other stakeholders included retirement experts, organizations representing small employers, retirement plan service providers, representatives of the accounting profession, and officials at Labor and IRS.

to plan sponsors, which establish certain standards of conduct for those that manage employee benefit plans and their assets.⁷

Small employers may choose a plan for their employees from one of three categories: employer-sponsored IRA plans; defined contribution (DC) plans; and defined benefit (DB) plans (often referred to as traditional pension plans).⁸ Employer-sponsored IRA plans, which can be either Savings Incentive Match Plans for Employees (SIMPLE) or Simplified Employee Pension (SEP) plans, generally allow employers and, in SIMPLE IRA plans, employees, to make contributions to separate IRA accounts for each participating employee. Employers generally have fewer administration and reporting requirements compared to other types of plans. The second plan category—DC plans—which includes 401(k) plans, allows employers, employees, or both to contribute to individual employee accounts within the plan. DC plans tend to have higher contribution limits for employees than employer-sponsored IRA plans; however, they also have more reporting requirements and other rules; for example, they may be subject to requirements for nondiscrimination testing or top-heavy testing.⁹ The third category is DB plans, which promise to provide a specified retirement benefit to employees; the employer is generally responsible for funding the plan.¹⁰

Over the years, Congress has responded to concerns about lack of access to employer-sponsored retirement plans for employees of small employers with legislation to lower costs, simplify requirements, and ease administrative burden. For example, the Revenue Act of 1978 and the Small Business Job Protection Act of 1996 established the SEP IRA plan

⁷Pub. L. No. 93-406, 88 Stat. 829. Plan sponsors assume fiduciary responsibilities to the extent they qualify as fiduciaries as defined by ERISA. See 29 U.S.C. §§ 1002(21), 1101-14.

⁸For more information and the sources of the requirements for these plans, see GAO-12-326.

⁹Some plans may be required to conduct annual nondiscrimination testing to ensure that the contributions or benefits do not discriminate against rank-and-file workers in favor of highly compensated employees. See 26 U.S.C. § 401(a)(4). Top-heavy testing may also be required to ensure a minimum level of benefits are provided to rank-and-file workers in plans sponsored by owner-dominated businesses, where the majority of benefits accrue to “key” employees such as owners and top executives. See 26 U.S.C. § 416.

¹⁰The retirement benefit provided by DB plans is often calculated based on factors such as the employee’s length of service and pay.

and the SIMPLE IRA plan respectively, featuring fewer administration requirements than other plan types. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) also included a number of provisions that affected small employers, which were made permanent by the Pension Protection Act of 2006 (PPA). The PPA also established additional provisions that support retirement plan participation by rank-and-file employees, such as automatic enrollment.

Federal agencies also play a role in fostering retirement plan sponsorship by small employers. To help encourage sponsorship, federal agencies conduct education and outreach activities and provide information about retirement plans for small employers. Labor, IRS, and SBA—which maintains an extensive network of field offices—have collaborated with each other and with national and local organizations to develop information on small employers retirement plans and conduct outreach with small employers.

Various private-sector service providers—from individual accountants, investment advisers, recordkeepers, and actuaries to insurance companies and banks—assist sponsors with their retirement plans. Some sponsors hire a single provider that offers a range of plan services for one fee, sometimes referred to as a “bundled” services arrangement. Other sponsors hire different providers for individual services under an “unbundled” arrangement, paying a separate fee for each service. Plan services include legal, accounting, trustee/custodial, recordkeeping, actuarial (for defined benefit plans), investment management, investment education, or advice. Service providers can also assist with plan administration functions, including any required testing and filing of government reports.

Number of Employees and Average Pay Level Greatly Influence Plan Sponsorship

More Employees and Higher Average Wages Increase the Likelihood of Plan Sponsorship

We found that the number of employees and average wages greatly influence the likelihood that a small employer will sponsor a retirement plan.¹¹ Further, our regression analysis using Labor and IRS data found that small employers with larger numbers of employees were the most likely of all small employers to sponsor a plan, as were those paying average annual wages of \$50,000-\$99,999. Conversely, employers with the fewest employees and the lowest average annual wages were very unlikely to sponsor a plan.

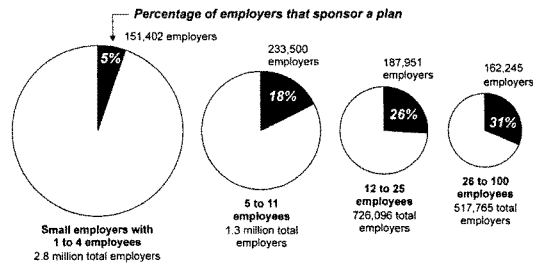
A separate analysis we conducted using Labor and IRS data found an overall small employer sponsorship rate of 14 percent in 2009.¹² It is important to note, however, that this sponsorship rate does not include small employers that sponsor SEP IRA plans because IRS currently does not have a means to collect data on employers that sponsor this plan type.

Further examination found that small employers with 26 to 100 employees had the highest sponsorship rate—31 percent—while small employers with 1 to 4 employees had the lowest rate—5 percent (See fig 1).

¹¹Several experts stated that a firm's age could also affect the likelihood of plan sponsorship, with newer employers less likely to sponsor a plan. However, our analysis was unable to address the number of years in operation due to technical challenges. For further discussion of the technical challenges, see GAO-12-326.

¹²The sponsorship rate cited in this testimony is limited to single employers that sponsor a plan. Consequently, the rate does not include small employers that participated only in multiple employer plans or multiemployer plans, which are outside the scope of this study. We are currently conducting ongoing work on these plan types and their role in the private pension system.

Figure 1: Small Employer Plan Sponsorship by Number of Employees in 2009



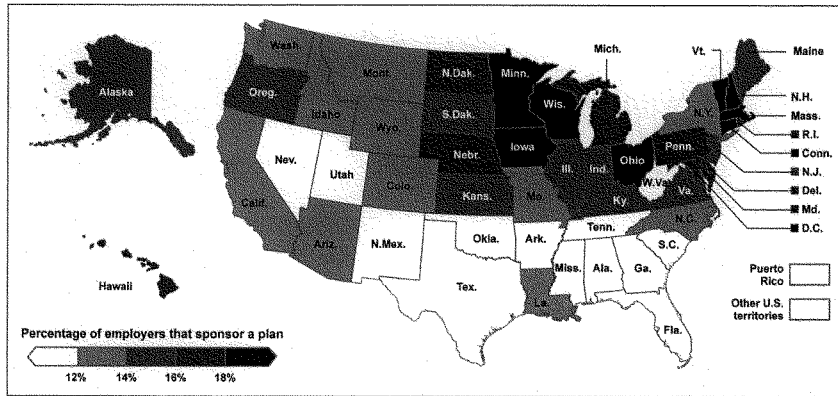
Source: GAO analysis of Labor and IRS data.

In our examination of average annual wage characteristics, small employers with average annual wages of \$50,000 to \$99,999 had the highest rate of plan sponsorship at 34 percent while small employers with average wages of under \$10,000 had the lowest sponsorship rate—3 percent. In examining the interaction between both characteristics—the number of employees and average annual wages—we found that the sponsorship rate for small employers with 26 to 100 employees exceeded 75 percent when average wages were \$50,000 or more. In contrast, small employers with one to four employees reached their highest sponsorship rate of 13 percent when average annual wages were \$50,000 or more.

We also found differences in sponsorship rates in different parts of the country, and found small employers in the Midwest and Northeast were more likely to sponsor plans while employers in the West and South were less likely.¹³ Connecticut, Wisconsin, and Washington, D.C. had the highest sponsorship rates—with Washington, D.C., showing the top rate of 23 percent. Mississippi and Florida had the lowest sponsorship rates at fewer than 10 percent (see fig 2).

¹³For purposes of this analysis, we used Census Bureau geographic regions.

Figure 2: Small Employer Plan Sponsorship by State in 2009



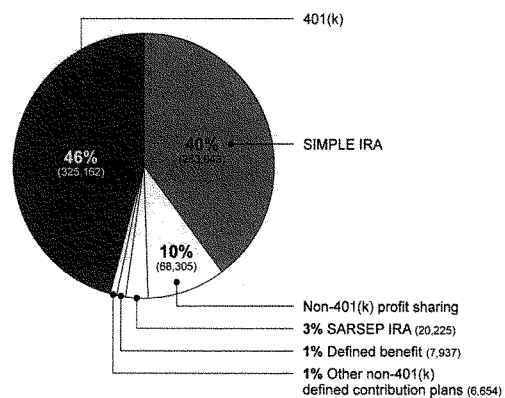
Source: GAO analysis of Labor and IRS data.

**401(k)s and SIMPLE IRAs
Were the Most Common
Plan Types**

According to our analysis of Labor and IRS data, 401(k) and SIMPLE IRA plans were overwhelmingly the most common types of plans sponsored by small employers. Out of slightly more than 712,000 small employers that sponsored a single type of plan, about 86 percent sponsored either a 401(k) or a SIMPLE IRA plan.¹⁴ Figure 3 shows the proportion of plan types sponsored by small employers.

¹⁴Three percent of the small employer population sponsored more than one plan; however, these small employers were excluded from our plan type analysis to avoid double counting plans.

Figure 3: Small Employer Plan Sponsorship by Plan Type in 2009



Source: GAO analysis of Labor and IRS data.

Notes: Percentages in figure do not add up to 100 due to rounding.

A SARSEP plan is a type of SEP IRA plan set up before 1997 that permits employee salary reduction contributions. Employee salary reductions under SEP IRA plans were eliminated beginning in 1997; however, SARSEP plans established prior to 1997 may continue to offer salary reductions, 26 U.S.C. § 408(k)(6)(H).

While SIMPLE IRA plans were the most common plan type along with 401(k) plans, they made up a smaller proportion of overall contributions. Contributions to SIMPLE IRA plans in 2009 amounted to \$4.3 billion or 11 percent of the total contributions made by small employers and their employees into the plan types we analyzed. By contrast, 401(k) contributions amounted to \$29.2 billion, or 76 percent of all contributions.

Plan Complexity and
Resource Constraints
Were Most Frequently
Cited Barriers to
Retirement Plan
Sponsorship

Many Small Employers
Find Retirement Plans
Complex and Burdensome
to Start and Administer

Small employers and other stakeholders we interviewed identified various plan options, administration requirements, fiduciary responsibilities, and top-heavy testing requirements as complex and burdensome—often citing these factors as barriers to sponsoring retirement plans or as reasons for terminating them.

Plan options and administration requirements: Small employers and other stakeholders said that plan options and administration requirements are frequently complex and burdensome and discourage some small employers from sponsoring a plan. For example, some small employers and retirement experts said that the broad range of plan types and features makes it difficult for small employers to compare and choose a plan that best meets their needs. Some stakeholders also described the administrative burden on small employers of plan paperwork, such as reviewing complicated quarterly investment reports or complying with federal reporting requirements—like those associated with required annual statements—as particularly burdensome.¹⁵

Fiduciary responsibilities: A number of stakeholders indicated that understanding and carrying out a sponsor's fiduciary responsibilities with respect to managing or controlling plan assets presents significant

¹⁵Most tax-qualified plans are required to annually file Form 5500, developed jointly by Labor, IRS, and the Pension Benefit Guaranty Corporation to satisfy the annual reporting requirements under ERISA and the IRC. ERISA established a reporting and disclosure framework, in part, to protect the interests of participants and beneficiaries by requiring that certain financial and other information be provided to participants and beneficiaries, as well as to the federal government. Modifications or exceptions to the general reporting requirements may be available to some small plans.

challenges to some small employers.¹⁶ Some small employer sponsors found the selection of investment fund choices for their plans particularly challenging. Further, a number of stakeholders said some small employers may not have an adequate understanding of their fiduciary duties and are not always aware of all their responsibilities under the law.

Top-heavy requirements: Top-heavy requirements are more likely to affect smaller plans (those with fewer than 100 participants) than larger ones, according to IRS. A number of stakeholders said compliance with requirements is often burdensome and poses a major barrier to small employer plan sponsorship.¹⁷ According to some experts, some small employers with high employee turnover may face an even greater likelihood of becoming top-heavy as they replace departing employees while key employees—such as business owners or executives—continue to contribute to the plan. A number of stakeholders stated that compliance with top-heavy rules is confusing and can pose significant burdens on some small employers. For example, some retirement experts said that small employers whose plans are found to be top-heavy may encounter a number of additional costs in the effort to make their plans compliant. These plans can incur additional costs associated with hiring a plan professional to make corrections to plan documents and instituting a minimum top-heavy employer contribution for all participating rank-and-file employees. While sponsors can avoid top-heavy testing by adopting a safe harbor 401(k) plan that is not subject to top-heavy requirements, experts pointed out that the employer contributions required for such plans may offset the advantages of sponsoring such a plan.

¹⁶To the extent they qualify as fiduciaries under ERISA, plan sponsors may assume fiduciary responsibilities, such as the duty to act prudently, solely in the interest of plan participants and their beneficiaries, and to diversify the investments of the plan. 29 U.S.C. § 1104(a).

¹⁷Top-heavy testing is required annually for certain plans and the requirements ensure a minimum level of benefits are provided to rank-and-file workers in plans that are sponsored by owner-dominated businesses, where the majority of benefits accrue to “key” employees, such as owners and top executives. Certain plans, such as SIMPLE IRAs, are not subject to the top-heavy requirements. 26 U.S.C. § 416.

Federal Guidance Is Available to Address the Complexities Associated with Plan Sponsorship But May Lack Visibility among Small Employers

Federal agencies provide guidance that can assist small employers in addressing some of the challenges they face in starting and maintaining retirement plans. Labor and IRS, often in collaboration with SBA, have produced publications, conducted workshops, and developed online resources, among other efforts, to assist small employers. However, a number of stakeholders, including the IRS Advisory Committee on Tax Exempt and Government Entities, indicated that many small employers are unaware of federal resources on retirement plans, which may, in part, be due to difficulties in finding useful, relevant information across a number of different federal websites. For example, IRS's Retirement Plans Navigator, a web-based tool designed to help small employers better understand retirement plan options, is located on a separate website from the rest of the agency's online plan resources for small employers. Furthermore, Labor and IRS each present retirement plan information separately on their respective websites. Neither agency maintains a central web portal for all information relevant to small employer plan sponsorship, though such portals exist for federal information resources in other areas such as healthcare.¹⁸

Small Employers Identified Lack of Financial Resources, Time, and Personnel as Deterrents to Sponsoring Retirement Plans

Small employers that lack sufficient financial resources, time, and personnel, such as smaller or newer firms, may be unwilling or unable to sponsor plans.

Financial resources: Small employers, especially those with lower profit margins or an unstable cash flow, could be less willing or less able to sponsor a retirement plan. One-time costs associated with starting a plan and the ongoing costs involved with maintaining the plan—as well as any requirement to match employee contributions or make mandatory contributions to an employee's account—were cited as barriers to plan sponsorship. Further, small employers we interviewed stated that general economic uncertainty makes them reluctant to commit to such long-term expenses and explained that they needed to reach a certain level of profitability before they would consider sponsoring a plan.

Time and personnel: Some small employers stated they may not have sufficient time to administer a plan themselves or lacked the personnel to take on those responsibilities. Further, small employers may not have

¹⁸For example, see: <http://www.healthcare.gov/>.

time to develop the expertise needed to investigate and choose financial products, select the best investment options, or track their performance. For example, one small employer described how business owners without the financial expertise to compare and select from among different plan options would likely find the experience intimidating.

Small Employers Report That Insufficient Incentives and Lack of Employee Demand Discourage Plan Sponsorship

Some small employers we interviewed stated that they may be less likely to sponsor a retirement plan if they do not perceive sufficient benefits to the business or themselves. For example, several small employers stated that their firms sponsored plans in order to provide owners with a tax-deferred retirement savings vehicle and one employer described how the firm annually assesses the plan to determine if it continues to benefit the owners. Additionally, a number of small employers stated that employees prioritized healthcare benefits over retirement benefits. Some small employers, such as those who described having younger or lower paid workforces, stated that their employees were less concerned about saving for retirement or were living paycheck to paycheck and did not have funds left over to contribute to a plan. As a result, both types of workers were not demanding retirement benefits.

Plan Service Providers Help Small Employers Meet Some But Not All Retirement Plan Needs

A number of small employers indicated that they use plan service providers to address various aspects of plan administration, which enabled them to overcome some of the challenges of starting and maintaining a plan. For example, one employer noted that her business would not have the time or the expertise to administer its plan without the help of a service provider. While some service providers said they offer affordable plan options and some small employers said the fees service providers charge were affordable, others said they were too high. Further, some stakeholders pointed to other limitations of using service providers, such as the difficulties of choosing providers, setting up a new plan through a provider, switching from one provider to another, as well as the significant responsibilities that may remain with the sponsor, such as managing plan enrollments and separations and carrying out their fiduciary duties, where applicable.

Proposed Options to Spur Plan Sponsorship Target Simplification, Incentives, and Education

Stakeholders proposed several options to address some of the administrative and financial challenges that inhibit plan sponsorship.¹⁹ These options included simplifying plan administration rules, revising or eliminating top-heavy testing requirements, and increasing tax credits.

Simplify plan administration requirements: Some stakeholders suggested options that could simplify plan administration requirements. Options included reducing the frequency of statements sent to plan participants and allowing some required disclosures to be made available solely online. IRS officials stated that the agency is also considering proposals to replace a requirement for some interim amendments²⁰—which stakeholders have identified as a burden for some small employers—with a requirement for notices to be sent directly to employees, which would reduce the number of times plan documents must be amended and submitted to IRS.²¹

Revise or eliminate top-heavy testing: A number of stakeholders proposed revising or eliminating top-heavy testing requirements to ease administrative and financial burdens. For example, representatives of the accounting profession told us that top-heavy testing is duplicative because other plan testing requirements help detect and prevent plan discrimination against rank-and-file employees.²² Representatives of a large service provider told us that lack of plan participation or high turnover among a business' rank-and file employees frequently cause plans sponsored by small employers to become top-heavy.

¹⁹The key proposals discussed in our full report are not exhaustive, and we did not attempt to quantify the costs and benefits of each proposal or their potential effectiveness in encouraging small employer plan sponsorship.

²⁰When statutes and regulations change, some sponsors may be required to modify plan documentation and submit it to IRS. Each year since 2004, IRS has published a cumulative list of changes in plan requirements that must be incorporated by plan sponsors. See, for example, IRS Notices 2011-97.

²¹Under these proposals, the amendments that would be subject to the less-stringent requirement would be those triggered by changes to laws and regulations but which do not affect plan benefits.

²²For example, some plans must conduct nondiscrimination testing—in addition to top-heavy testing—to ensure that the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees. See 26 U.S.C. § 401(a)(4) and 26 C.F.R. §§ 1.401(a)(4)-1 through 1.401(a)(4)-4. We did not specifically assess duplication between top-heavy and nondiscrimination testing requirements.

Increase tax credits: Some stakeholders believed that tax credits, in general, are effective in encouraging plan sponsorship, but other stakeholders said that the current tax credit for starting a plan is insufficient. A national organization representing small employers cited tax credits as a top factor in an employer's decision to sponsor a plan, adding that an employer's willingness to start a plan depends, to some degree, on the extent to which the tax credit offsets plan-related costs.²³ Similarly, some small employers stated that larger tax credits could ease the financial burden of starting a plan by offsetting plan-related costs. Additionally, one small employer said the incentive needs to be larger as sponsorship costs can amount to \$2,000 or more per year.

Stakeholders Said More Education and Outreach Are Needed to Increase Awareness of Plan Options and Requirements

Numerous stakeholders agreed that the federal government could increase education and outreach efforts to inform small employers about plan options and requirements; however, opinions varied on the appropriateness of the federal government's role in these efforts. Officials of a service provider to small employers stated that, because clients are generally not aware of the retirement plan options available to them, the federal government should offer more education and outreach to improve awareness of the types of plans that are available and the rules that apply to each. Several small employers also offered ideas. For example, a small employer said the federal government should focus education and outreach efforts on service providers instead of on small employers. Conversely, some small employers said the federal government should have a limited role or no role in providing education and outreach efforts.

²³Currently, small employers that sponsor plans may claim an annual tax credit of up to \$500 based on plan startup costs for each of the first 3 years of starting a qualified plan. See 26 U.S.C. § 45E. However, any increase in tax incentives would have to be balanced by the loss of revenue to the federal government. Increasing tax credits to subsidize plan-related costs for small employers would generally reduce the amount of federal tax revenue collected. The Administration's Fiscal Year 2013 Budget proposed doubling the tax credit limit for small employers starting a plan to \$1,000 per year for a maximum of 4 years. The Administration estimated that this proposal—along with another proposal for automatic IRA tax credits, would reduce revenue by \$15 billion over 10 years, starting in 2013.

Other Options to
Encourage Plan
Sponsorship Would
Require Broader Reforms

Domestic pension reform proposals from public policy organizations, as well as practices in other countries, include features such as asset pooling that could reduce the administrative and financial burdens of small employers. For example, one domestic proposal calls for the creation of a federally managed and federally guaranteed national savings plan.²⁴ Under this proposal, participation in the program would generally be mandatory for workers;²⁵ both employers and employees would contribute to the plan; and plan funds would be pooled and professionally managed.²⁶ By pooling funds, plan administration would be simplified and administrative costs and asset management fees would be reduced. In addition, Automatic IRAs—which are individual IRAs instead of employer-sponsored plans—are another proposal that draws from several elements of the current retirement system: payroll-deposit saving, automatic enrollment, and IRAs. Such a proposal would provide employers who do not sponsor any retirement plans with a mechanism that allows their employees to save for retirement.²⁷ However, as we reported in 2009, such proposals pose trade-offs.²⁸ For example, although a proposal that mandates participation would increase plan sponsorship and coverage for workers, employers might offset the resulting sponsorship costs by reducing workers' wages and other benefits. Retirement systems in other countries also use asset pooling and other

²⁴T. Ghilarducci, *Guaranteed Retirement Accounts Toward Retirement Income Security*, Economic Policy Institute, Briefing Paper #204 (Nov. 20, 2007).

²⁵Under this proposal, workers participating in equivalent or better employer DB plans where contributions are at least 5 percent of earnings and benefits take the form of life annuities would be exempt from participating in the guaranteed retirement accounts program.

²⁶Recent legislation introduced in Congress, the Small Businesses Add Value for Employees Act (SAVE Act), would also build on the concept of asset pooling by establishing multiple employer plans for small employers, in which separate small employers would pool their resources to offer a single plan. See H.R. 1534, 112th Cong. (introduced Apr. 14, 2011).

²⁷J. M. Iwry and D. C. John, *Pursuing Universal Retirement Security Through Automatic IRAs*, Retirement Security Project, No. 2009-03 (2009). In addition, the Administration's Fiscal Year 2013 Budget also proposed requiring employers in business for at least two years that have more than 10 employees to offer an automatic IRA option. The proposal includes new tax credits for small employers who adopt such arrangements. The Administration estimates that these proposals—including the increased pension startup tax credit—would reduce revenue by \$15 billion over 10 years, starting in 2013.

²⁸GAO, *Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs*, GAO-09-642 (Washington, D.C.: July 24, 2009).

features that help reduce administrative and financial burdens for small employers. For example, as we previously reported, the predominant pension systems in the Netherlands and Switzerland pool plan assets into pension funds for economies of scale and for lower plan fees.²⁹ The United Kingdom's National Employment Savings Trust (NEST) features low fees for participating employers and employees and default investment strategies for plan participants.

Conclusions and Report Recommendations

With a significant portion of the private-sector workforce not covered by a pension plan at any one time, retirement security remains a critical issue for our nation. Based on the limited data available, we found the rate of plan sponsorship among small employers, a segment of the economy which employs about one third of all private sector workers, was only 14 percent in 2009. Although one would expect that the high churn rate of small business formation and dissolution would impede small employer plan sponsorship, it also means that many millions of workers in this sector are without access to an employer-sponsored retirement savings plan. Thus, while remaining sensitive to the financial challenges currently facing our nation, expanding coverage among small employers should be an important consideration of national strategies seeking to strengthen the pension component of retirement income security.

Our discussions with small employers and other stakeholders identified a variety of challenges small employers face in sponsoring retirement plans. One initial problem is the inability of small employers to easily obtain useful information on how to establish and maintain plans. Although Labor and IRS already provide small employers with considerable online information about retirement plans, information is scattered across multiple federal websites and portals in a largely uncoordinated fashion, making it difficult for busy employers to navigate and locate what they need. However, even if federal information about retirement plans were more accessible to small employers, our interviews with small employers identified a number of other significant challenges to plan sponsorship, including plan administration requirements that are perceived to be unduly complicated and burdensome, not having sufficient financial and personnel resources to sponsor a plan, and insufficient incentives to create and maintain a plan.

²⁹GAO-09-642.

These challenges, while very real, are also complex and in many instances may not lend themselves to easy answers. Because the expertise to address these issues is spread across multiple agencies and departments that may not always communicate or work together effectively on these issues, there is the potential that inertia and other competing priorities will push these issues onto the back burner.

The report we are issuing today recommends the creation of a multiagency task force, to be overseen by the Department of Labor, that would explore and analyze these challenges in greater detail, including ways to make information more accessible, to streamline reporting and disclosure requirements in a thoughtful manner, and to identify the appropriateness and effectiveness of existing and proposed tax incentives and plan designs to boost sponsorship among small employers. Such a task force could help jump-start sustained action on what we consider to be an essential element of our nation's retirement security challenge and initiate a national dialogue on the critical issues of pension coverage

Finally, federal agencies' ability to address the challenges to small employer plan sponsorship depends in part on the availability of relevant, timely, and complete data. During our work in estimating the extent of small employer plan sponsorship, we found that complete data on small employer plan sponsorship did not exist because IRS did not have the means to collect information on employers that sponsor SEP IRA plans. Although there are about 1.5 million SEP IRAs, many of these may be sponsored by larger businesses, and we simply do not know the distribution of these plans across all employers. Without a complete picture of small employer plan sponsorship rates, agencies may find it difficult to effectively target their research and outreach efforts. Thus, in our report we also recommend that the Secretary of the Treasury direct the Commissioner of the Internal Revenue Service to consider modifying existing tax forms, such as Forms W-2 or 5498, to gather complete and reliable information about these plan types. Although the challenges that small employers face in sponsoring plans are significant, they can be addressed with appropriate federal action and cooperation as well as assistance from the service provider community.

While the Department of Treasury, IRS, Labor, SBA, and the Department of Commerce generally agreed with our findings and conclusions, Labor disagreed with our recommendation to create a single web portal for federal guidance on retirement plans for small employers. Because federal resources are scattered across different sites, we believe

consolidating plan information onto one web portal can benefit small employers. A complete discussion of our recommendations, Labor's comments, and our response are provided in our full report.

Chairman Kohl and Ranking Member Corker, and Members of the Committee, this concludes my prepared remarks. I am happy to answer any questions that you or other members of the committee may have.

For further questions on this testimony, please contact me at (202) 512-7215. Individuals making key contributions to this testimony include Edward Bodine, Kun-Fang Lee, David Lehrer, and David Reed.

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**Statement Presented to
The U.S. Senate Special Committee on Aging**

Hearing on

Opportunities for Savings: Removing Obstacles for Small Business

March 7, 2012

Good afternoon, Chairman Kohl, Senator Corker and Members of the Committee. I am Bryan Fiene, Senior Vice President, Robert W. Baird & Co. Incorporated ("Baird").

I appreciate the opportunity to provide this written testimony in connection with the hearing of the U.S. Senate Special Committee on Aging regarding small-employer challenges to retirement plan sponsorship. As a financial advisor with Baird, I have served dozens of small and medium sized retirement plans with thousands of participants around central and southern Wisconsin for 19 years. I am a designated Qualified Plan Financial Consultant with the Association of Pension Professionals & Actuaries. I work with many small businesses, owners and executives. My firm, Robert W. Baird & Co., was established in 1919 and is headquartered in Milwaukee Wisconsin. We have more than 100 office locations in the United States, Europe and Asia, including an office with two retirement plan teams in Nashville, Tennessee. Baird has a culture where clients come first, integrity is irreplaceable and how we succeed is as important as if we succeed. Those quotes were delivered to the desks of every associate in the firm years ago and they still sit on my desk. I am personally proud to be an associate at this great Wisconsin-based company which serves small-business clients all over the United States. My testimony, however, will focus on my personal observations and experiences as a financial advisor to small businesses while building a retirement advisory plan business within Baird. My testimony will represent my own opinions and not those of Baird.

As a Wisconsin resident and a professional, I'm proud of my state. We are home to several dozen world-class companies like Harley Davidson, Briggs & Stratton, Johnson Controls, Rayovac, Regal Beloit, Rockwell Automation, Snap On, Mercury Marine and Kohler. In Senator Corker's home state of Tennessee, they have Autozone, Dixie, FedEx, Forward Air, Fred's, Harrah's, HCA, King Pharma, UnumProvident and many more. All these wonderful companies have one thing in common: each started as a small business. We need to encourage all small businesses to succeed so they too can grow up to be household names and employ thousands of American workers. We welcome this committee's concern with trying to encourage small-businesses to sponsor retirement plans for the benefit of their present and future employees.

My testimony is intended to focus on the following points:

First, there are many reasons driving small employers away from offering retirement plans.

Second, Federal and state government agencies do not effectively help small businesses understand whether and how to offer a plan.

Third, financial advisors can play a critical role in helping small employers cope with the challenges of adopting and maintaining a plan.

Fourth, for many small employers seeking to establish a plan, Multiple Employer Plans (MEPs) can be a very attractive option, particularly as a “starter plan.”

Fifth, Congress and the regulatory agencies should further facilitate the adoption of MEPs.

Before persistently high unemployment set in, businesses needed strong retirement plans to recruit and retain good people. Now, all they have to do is put an ad in the paper. This dynamic directly relates to the perceived costs and benefits of starting up and keeping a retirement plan in place and intact. In short, many small employers do not offer retirement savings plans simply because it is too expensive or too time consuming. Small-business owners need a strong incentive to start a plan and the tax savings for the owners themselves usually provide that incentive. However, when the small-business owner is losing money or cannot contribute as much as he wants, that incentive tends to go away. The regulations related to starting and operating a plan are also a huge disincentive for a small-business owner. I had a plan ready to start a number of years ago but the owner decided not to start the plan when he learned that he had to sign as trustee and was personally responsible for carrying out his fiduciary duties. He had no interest in learning about the potential liability either. These folks are so busy with their business, they simply can't take the time to learn how to operate a plan.

The recent economic downturn, with its associated tightening of credit, put a major strain on small-business owners. When they cannot access credit and need cash, small business owners often look to their largest existing cash pools, which are typically their retirement plans. However, if that small-business owner is under retirement age and cannot take out a loan against the assets in a retirement plan, he or she cannot directly access funds without terminating the plan and ending the benefit for all of the company's employees.

Faced with difficult choices, many small-business owners have cut employer contributions either for immediate survival or to fortify their balance sheets in case the economic situation worsens. Unfortunately, this is also detrimental to participants, but many small businesses are left with few other options, save cutting hours or pay, laying people off or raiding their own assets. It often comes as a surprise to employers that they cannot access “their” money without dismantling their business' retirement plan. In fact, many things come as a surprise to small plan sponsors. You see, they are already working long hours just to keep their companies going or trying to grow them. They look at things at a very high level, asking: “What will this do to enhance my business?” and “What is my risk in implementing it?”

As for starting a new plan, small-business owners will look at the risk versus the reward just as one would with any investment. Often they will seek out a trusted advisor to help navigate this decision as they would any other related to their businesses. They will probably start with a financial advisor, accountant or lawyer. They may also ask friends and peers if they are happy and how much of a hassle their plans are.

I personally don't know of anyone that has ever gone on their state website or the Department of Labor website for advice on starting a new plan. Even a sophisticated small-business owner will simply not have the expertise or time to understand all of the information on these websites. On the U.S. Department of Labor (DOL) website there are 92 links to information on small business plans alone.

I looked at the Wisconsin Department of Workforce Development website and, after 10 pages, found no information on how to start a new small business plan. I also looked at Tennessee's Department of Economic & Community Development website, and I found some very interesting stats about Tennessee and the fact that Tennessee is doing a great job getting small companies started. But again, nothing to help a small business owner in Tennessee understand how to start a plan.

Moreover, the information is often presented in a manner that suggests establishing a plan would likely be futile. The Department of Labor web site states that: "Experts estimate that Americans will need 70 to 90 percent of their preretirement income to maintain their current standard of living when they stop working." But many small-business owners do not expect themselves or their employees ever to be able to save a sufficient amount of funds for retirement, so the prospect of starting a plan for an uncertain goal is not a priority. As an example, if a person making \$100,000 contributes \$17,000/year (which is the current maximum deductible amount) for 25 years, at a 5% rate of return, the person would have just over \$900,000 saved, which again at 5% would yield them about \$45,000 per year in income, right around half of what the DOL website says they need. You might suggest that they take advantage of an IRA to supplement that contribution but the deductibility starts to phase out at \$92,000. They could do a Roth but they would have to have the cash to do it. If I take a \$100,000 annual compensation and subtract \$17,000 for plan contributions, \$18,600 for federal tax not counting payroll tax, \$6,645 for Wisconsin State tax, \$5000 for property tax, \$12,000 for health insurance for the family, \$24,000 for mortgage payments, \$5000 for life, home and car insurance, \$3,600 for a car payment, \$6,000 for food, \$3600 for clothes, \$2,400 for phone, \$1,200 for cable and Internet, \$3600 for utilities and \$5000 for gas, then the individual has a net *deficit* of \$3,445 per year – and that is not sustainable. The numbers I used are not exact, but you get the picture. And with our college kids graduating with mountains of debt, they have a very hard time contributing anything to their plan for years. Participants simply can't do it on their own; they must have the help of their employer and that employer needs to see the plan as a huge benefit and not a huge headache or risk to him. If we add in an annual \$3,000 contribution by the employer, the end balance nets an income of 53% of salary, still far short of 70-90% but if he can save outside the plan, get a higher rate of return or lower his cost of living, he can make it.

Of course, I would be remiss if I did not commend Congress and the Department of Labor for many recent innovations that help plan sponsors. We now have portability for participants, automatic enrollment, Roth, Safe harbor, some fiduciary relief and clarification on education policies. These improvements have made a huge difference in getting to the ultimate goal of retirement success for workers.

Given the tremendous challenges employers face, alongside the absence of clear, accurate, and encouraging information from government agencies, it has been my experience that the vast majority of small business owners who decide to offer a retirement plan rely on an outside advisor. The role of a financial advisor to small-employers is critical. I help the small-employer understand the advantages of saving on a tax deferred basis through a qualified retirement plan. This understanding at a personal level is critical. I also help small-business owners to: understand plan provisions, evaluate fees and other considerations, and determine the scope of fiduciary liabilities and the duties for which they are responsible. I also work to find an appropriate plan vendor and administrator with a proven track record structuring and offering small plans and providing other services small-employers need. Plan vendors and administrators are essential to removing the overwhelming burden on the small-employer in maintaining a plan, including providing plan statements and delivery to participants, conducting discrimination testing, preparing Form 5500, plan notices and other compliance matters.

Even with the support of a financial advisor, a stand-alone plan may not be a feasible option for a small-employer due to the cost and administrative burdens outlined above. Unfortunately, even if the small-business owner is willing and interested in establishing a plan, oftentimes advisors and vendors are not willing to work with them.

The field of vendors willing to sell stand-alone plans to small employers has shrunk in recent years due to the lack of profitability in offering these plans. Most financial advisors have also backed away from this business for the same reasons and the increased fiduciary responsibility involved. Advisors and record keepers typically need a base of assets in a plan large enough to make it profitable. Start ups or small plans simply don't have that. For example, when a plan is started, an advisor typically incurs some marketing costs and may put in as many as 20-30 hours of work helping the sponsor identify the right vendor, compare costs, decide on plan provisions, fund lineups, create investment policy statements and conduct enrollment meetings. Then there are travel costs. Unless the sponsor is prepared to pay the administrative costs of the plan, the employees must bear those costs, which can range between \$500-\$1,000 for start-up costs and \$1,500-\$3,000 per year for ongoing record keeping and tax filings. If the business needs the advice of an attorney, mailing costs for notices, wages for the person that administrates the plan at the business or fiduciary insurance, those costs can be higher.

I had a client that called me a number of years ago because, he said, even with the market up, nobody was making any money on their plan. When I reviewed it, I could see that the participants were being asked to incur all the plan fees as is standard procedure for the larger plans. However, given the size of the plan and the average account, participant

accounts were being charged about 4% in addition to the fund costs of about 1.4%. Such a structure makes it pretty hard to make money and as a general matter, advisors would not suggest a plan in which the benefit to participants is minimal relative to the plan costs. So the choice of the advisor is to either lose money for several years on the plan or simply choose not to work with those plans.

Defined contribution multiple employer plans (MEPs) could go a long way to address this serious issue. I think that giving small businesses the ability to hand over the vast majority of those administrative responsibilities to a vendor that can handle them through an MEP would be a great relief. Benefits would include the economies of scale you get from bundling plans, as well as the reduced costs and additional features enjoyed by larger plans.

MEPs provide an excellent cost-effective alternative to stand-alone plans for small employers. An MEP is a single plan maintained by an MEP sponsor and one or more unrelated employers ("adopting employers"). Under an MEP, many small-employers can join together to achieve economies of scale and advantages with respect to plan administration, making retirement plans much more affordable and easier to manage. A typical MEP arrangement allows for the same essential features and benefits of a 401(k) plan, such as higher deferral limits and employer contributions, and offers both the small employer and the plan vendor the ability to achieve economies of scale by spreading the costs of administering the plan among all of the employers participating. The MEP structure also offers flexibility for small employers to easily graduate to a stand-alone plan when they are ready.

I have had extensive experience dealing with such plans for Wisconsin employers. I worked with Wisconsin farm co-ops in the 1990's to set up some of the first MEPs in Wisconsin. And my experience bears out that MEPs are useful "starter plans." Once these co-ops grew large enough, we decoupled their plans from the MEP and transitioned them to successful stand-alone plans.

However, more can be done to facilitate the adoption of MEPs by other small employers.

I submit the following for consideration:

First, I recommend enactment of the following reforms to the current MEPs covered in S. 1557, introduced by Senators Bingaman and Kerry:

1. Implementing safe harbors from liability for the MEP sponsors and adopting employers;
2. Restricting the responsibility of an adopting employer for the delinquent obligations of another MEP employer; and
3. Further simplifying the reporting and disclosure obligations of MEP sponsors and adopting employers. These reforms have also been included in some form in H.R. 1534, sponsored by Representative Ron Kind, and H.R. 4050, sponsored by Representative Richie Neal.

Second, I recommend that the definition of an MEP plan sponsor be clarified to permit an MEP to consist of unaffiliated employers with no other relationship to each other. Employers not bound by the traditional commonality factor found in farm co-ops or professional employer organizations would benefit from the economies of scale and expertise in joining a MEP. Existing ERISA protections would apply to such plans, just as they apply to plans maintained by large affiliated employers, to ensure that benefits are paid to participants and beneficiaries and that plan sponsors have the same responsibilities and liabilities.

The quality and capabilities of plan vendors have grown dramatically in recent years and costs have actually come down due to competition. With large and well-capitalized providers in this space, I would expect to see things like start-up costs go away. I would also expect clearly defined duties for plan sponsors, the highest quality and most competitive investment options and consistent reductions in prices as plans grow.

In conclusion, I'd like to commend Chairman Kohl, Ranking Member Corker and other members of the committee for their attention to and consideration of this important issue, and I appreciate the opportunity to share my professional experience and opinions on the matter. I strongly believe that removing the obstacles that currently prevent many small employers from adopting savings plans will be beneficial to those businesses and their employees.



Written Testimony of

**John J. Kalamarides
Senior Vice President
Institutional Investment Solutions
Prudential Retirement**

**Before the
Senate Special Committee on Aging**

**"Opportunities for Savings:
Removing Obstacles for Small Business"**

March 7, 2012

Introduction

Chairman Kohl, Ranking Member Corker, and members of the Committee, thank you for your invitation to discuss with you the challenges facing small employers in extending retirement plan coverage to their workers.

I am John J. (“Jamie”) Kalamarides, a senior vice president at Prudential Retirement, where I lead the Institutional Investment Solutions business, which includes Prudential Bank & Trust, stable value funds, institutional retirement income products and institutional investments. Prudential’s experience in the retirement industry dates back to 1924. Today, Prudential Retirement supports over 6,000 defined benefit and defined contribution retirement plans, and covers nearly 3.6 million defined benefit and defined contribution plan participants and annuitants. As of December 31, 2011, Prudential Retirement’s account values totaled \$229.5 billion.

I would like to begin my testimony by commending the Committee for its interest in what I will refer to as the “retirement coverage gap” – a gap that is in large part due to the concerns of many employers, particularly small businesses, about the costs and liabilities associated with maintaining stand-alone retirement programs for their employees. I would also like to commend and thank the Chairman for his many years of dedication to addressing issues critical to millions of today’s workers as they strive to save and prepare for retirement.

My testimony today will focus on Multiple Employer Plans – or MEPs– a structure that enables small business owners to pool their resources in a single plan and enjoy the efficiencies and benefits typically limited to large employers and collectively bargained multiemployer plans.

To supplement to my testimony, Prudential is releasing a white paper entitled *Leveraging Multiple Small Employer Plans to close the Retirement Coverage Gap*, advance copies of which have been provided to the Committee. The U.S. Chamber of Commerce, of which Prudential is a member and which has reviewed and is supportive of my testimony, will be releasing its own white paper addressing the challenges facing retirement plan sponsors in the 21st Century and will include proposed solutions, like MEPs, to encourage retirement plan sponsorship and expand employee coverage.

In my remarks today, I would like to address the following topics:

- The scope of the retirement coverage gap;
- The reasons for the gap - challenges facing small employers in offering retirement plans;
- Multiple employer plans – what they are and how they can help close the gap; and
- Recommendations for expanding access to MEPs.

The “Retirement Coverage Gap”

More than 51 percent of today’s workers, or 78 million individuals, have no access to a workplace-based retirement plan¹ – this is the “retirement coverage gap.”

This “coverage gap” is preventing nearly half of the American workforce from beginning to systematically save and invest for retirement at the workplace. According to a recent EBRI survey, 58 percent of workers who do not participate in a retirement savings plan at work have saved less than \$10,000,² significantly lower than the average defined contribution plan account balance of \$59,000,³ which itself is an inadequate retirement saving for most Americans. Left unaddressed, the coverage gap for workers without retirement plans will result in far too many individuals entering retirement without sufficient savings to sustain their pre-retirement standard of living.

The lack of access to a workplace retirement plan is most acute among smaller employers – this is best exemplified by a table prepared by EBRI⁴ and included as an exhibit in the white paper accompanying my testimony. Nearly two-thirds of workers employed by private employers with 100 or more employees have access to workplace retirement plans, while only 36 percent of those who work for employers with ten to 100 employees have access. Availability is reduced further as employee numbers decrease, with only 18 percent of those who work for employers with ten or fewer employees having access.

Why the gap? Challenges for small businesses

Many small employers are reluctant to offer retirement savings plans because of concerns about costs, administrative complexities and fiduciary liability.

Over the years, a variety of legislative and administrative efforts have been directed toward closing the coverage gap with simplified retirement savings vehicles, such as SEPs, SIMPLEs and voluntary payroll deduction IRAs. Moreover, despite the commendable efforts by the Employee Benefits Security Administration to educate small employers and their service providers about their retirement plan options, the coverage gap remains significant.

¹ Employee Benefit Research Institute, “Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010, Issue Brief No. 363, October 2011, p. 9.

² Employee Benefit Research Institute, “2011 Retirement Confidence Survey Fact Sheet #2,” March 2011, p. 4.

³ As of December 31, 2009. Employee Benefit Research Institute, “401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009,” Issue Brief No. 350, November 2010, p. 11.

⁴ Employee Benefit Research Institute, Issue Brief No. 363, October 2011.

Clearly, attempting to understand one's obligations under ERISA and liabilities as a plan administrator and plan fiduciary can be daunting, even for the most sophisticated among us.

Small business owners are challenged with understanding a plan sponsor's obligations and costs associated, among other things, with:

- Summary plan descriptions and quarterly individual benefit statements for plan participants;
- Annual financial report filings with the Federal government, and perhaps engagement of a qualified independent public accountant to review the plan's books and records;
- Prudent selection of plan service providers - including analysis of costs and potential conflicts of interest, as required by the Department of Labor's new regulations under section 408(b)(2); and
- Potential liabilities for failing to make timely disclosures, file timely reports and prudently carrying out responsibilities with respect to the plan.

While important and useful information, gaining such understanding - or having to hire an ERISA expert to assist with these responsibilities and obligations - will be a challenge, financially and otherwise, for most small employers and serve as a disincentive for far too many to offer any form of retirement savings plan to their employees.

We do not propose eliminating these important responsibilities; rather, we propose consideration of a Multiple Employer Plan and a standardized plan framework under which these responsibilities would not be the sole obligation of the small employer.

This framework would, in principle, be similar to the approach the Administration appears to be supporting in connection with automatic IRA options. That framework appears premised on adoption of a simple "model" plan structure with pre-defined investment options, with respect to which employers would have little or no administrative or fiduciary responsibilities beyond the timely remitting of employees' contributions. We believe these principles can - and should - be extended to MEPs.

Multiple employer plans –how they can help close the gap

In general, an MEP is a plan structure that enables two or more employers – unrelated by ownership or control – to join a single plan. Typically, MEPs are sponsored by employer associations and other affinity groups for their members.⁵

MEPs can offer employers, particularly small employers, the opportunity to reduce costs and responsibilities otherwise required by stand-alone retirement plans. MEPs afford employers the ability to achieve economies of scale not otherwise possible with a stand-alone retirement plan, including the ability to hire the expertise necessary to both protect participating employees and reduce the personal financial risks of participating employers. According to a Deloitte Consulting study, which is illustrated in our white paper, the average expense of a retirement plan for a small employer with fewer than 100 employees is 132 basis points. If 100 of such small employers were to pool their assets together in an MEP, the expenses could be reduced to an average of 50 basis points.

We, at Prudential, further believe that, while the MEP structure is an attractive starting point for closing the retirement coverage gap, the structure and the benefits for small employers can be further enhanced with the development of a “model” plan; a plan designed to simplify administration, reduce costs, increase participation and enhance portability. Along with others, we have referred to this simplified MEP design as a Multiple Small Employer Plan – or MSEP.

Our **Multiple Small Employer Plan** framework, as noted in the accompanying white paper, would, among other things, include:

- A model plan document, approved by the Internal Revenue Service (IRS), which would provide uniformity and increase portability among recordkeepers and other service providers;
- Automatic enrollment of participants and automatic escalation of contributions to increase employee participation and retirement savings;
- A Qualified Default Investment Alternative (QDIA) for defaulted participant contributions;
- Adoption of a \$10,000 annual contribution limit, with adjustments by the IRS to reflect cost-of-living changes. Catch-up contributions would not be permitted;

⁵ “Multiple employer plans” should not be confused with “multiemployer plans.” “Multiemployer plans” are plan maintained pursuant to one or more collective bargaining agreements negotiated between the union and employer plan sponsors. See ERISA section 3(37), 29 CFR § 2510.3-37. Unlike multiemployer plans, multiple employer plans” are not required to be maintained pursuant to a collective bargaining agreement and typically are not.

- Prohibiting participant loans and restricting hardship distributions to those falling under existing IRS safe harbor hardship standards in an effort to reduce leakage and administrative costs; and
- Permitting contributions to be rolled into an IRA or other qualified retirement plan upon separation from employer to better ensure the availability of the funds at retirement.

Whether the discussion is about MEPs or MSEPs, we believe the benefits of a multiple employer plan type retirement structure are clear, but the rules in place today unnecessarily restrict and inhibit the availability and use of MEPs for many employers.

Recommendations for expanding access to multiple employer plans

If MEPs are to serve as a decisive tool for closing the retirement savings gap, we believe a combination of legislative and administrative (regulatory or interpretive) actions may be required to promote and foster MEP offerings and growth.

Specifically, we recommend consideration of the following:

- **Expand standards for sponsorship of MEPs.**

Without further clarifications from the Department of Labor, it appears that sponsorship of MEPs may be limited to employer associations in which member employers have a commonality of interest and some form of participation in the association, as determined by the Department on a case-by-case basis. Such organizations have not been successful in closing the retirement coverage gap, because of the limited number of associations and their limited scope. We believe that, if MEPs are to play a role in closing the retirement coverage gap, the organizations or entities permitted to sponsor MEPs must be broadened.

We believe there may be various approaches to expanding permissible MEP sponsorship without increasing risk to small employers and their employees or increasing the need for oversight by the Department of Labor. In this regard, we have included, in an attachment to my testimony, one such approach which follows a framework already reviewed and adopted by the Department.

- **Eliminate or limit fiduciary and plan administrator responsibilities attendant to participating in an MEP.**

We believe a safe harbor or similar provision is needed to clarify and limit the responsibilities and liabilities of employers participating in MEPs. In this regard, we believe the use of an approved "model" plan document may serve as the appropriate vehicle for setting forth responsibilities and liabilities of the parties responsible for the MEP. Among other things, such a "model" would have an

identified plan fiduciary who would carry out the day-to-day administration of the plan, as well as oversee the continued prudence of the MEP's designated investment options, the engagement of an independent qualified public accountant, and the filing of an annual report and accountant's opinion with the Department of Labor and Internal Revenue Service. Employer liability would be limited to making timely employee contributions to the plan.

- **Eliminate employer and plan liability (e.g., disqualification) for non-compliance with tax laws as a result of a non-compliant participating employer.**

We believe the current ambiguity should be removed regarding one participating employer's liability for the acts of another. In other words, the liability of participating employers should be several, not joint and several. Today, the possibility of becoming liable for the acts of another participating employer in connection with an MEP is a major concern to employers considering MEP participation.

- **Eliminate non-discrimination testing.**

Application of these tax rules, particularly for small employers, adds complexity, costs and risks that may discourage employer participation, as well as reduce retirement savings, from which such costs are assessed. Again, we believe that the adoption of a "model" plan - one that includes automatic enrollment, automatic escalation of contributions, contribution limits and limits on withdrawals - would eliminate the need for plan qualification testing.

Conclusion

The retirement savings, and thus the retirement readiness, gap between American workers who have access to workplace plans and those who do not, especially those who work for smaller employers, is significant.

We believe the response to this challenge should be a Federal solution, not a State reaction that competes in or replaces the competitive marketplace of retirement plan products and services.

We believe expanding the availability and attractiveness of Multiple Employer Plans with a Federal solution would significantly increase the likelihood that millions more Americans will have access to workplace retirement savings plans and, in turn, an increased opportunity to enjoy a secure retirement.

Complementing the work of this Committee, I should note the work of Congressmen Ron Kind and David Reichert in introducing their Small Business Add Value for Employees Act (SAVE Act), which would foster the growth of Multiple Small Employer Plans, and the work of Congressman Richard Neal, who recently introduced the Retirement Plan Simplification and Enhancement Act of 2012, which, among other things, would also strengthen MEPs.

We welcome the opportunity to work with the Committee on these important issues.

This concludes my testimony, I would be happy to answer questions.

Attachments:

1. Proposal for Expanding MEP Sponsorship
2. *Leveraging Multiple Small Employer Plans to close the Retirement Coverage Gap, Prudential Retirement*

Proposal for Expanding MEP Sponsorship

Problem:

When multiple employers are involved with a non-collectively bargained plan, the current rules applicable to determining whether that plan will be treated as a single employer plan or a separate plan with respect to each participating employer generally turns on whether the sponsor is a bona fide group or association, with respect to which member employers have a commonality of interest (such as being in the same trade or business), participate in the organization, and directly or indirectly exercise control over the plan (in form and substance); all of which, according to the Department of Labor opinions, must be determined on the basis of all the facts and circumstances.

Proposed Solution:

We believe the Department has the authority to recognize entities, in addition to employer associations, as "acting directly or indirectly in the interest of an employer" for purposes of sponsoring a pension plan. In the case of MEPs, we believe one approach to expanding the availability of MEPs would be to recognize as permissible MEPs sponsor entities (primarily financial institutions) that are eligible to serve as a trustee or issuer of an individual retirement plan within the meaning section 7701(a)(37) of the Internal Revenue Code.

We believe, consistent with the Department's own findings, that such entities would, as plan sponsors and fiduciaries, offer plan-maintenance safeguards that would enhance the protections available to small employers and their employees, as well as minimize the need for administrative and enforcement oversight by the Department. In this regard, note that, in framing its abandoned plan regulation (29 CFR § 2578.1), the Department of Labor was comfortable vesting considerable authority and control over retirement plan assets in such entities when terminating an abandoned pension plan. In explaining its decision to limit such authority to those trustees and issuers, the Department indicated that, given the authority and control over plans vested in such entities under the regulation, entities must be "subject to standards and oversight that reduce the risk of losses to the plans' participants and beneficiaries," and the Department concluded that "the standards applicable to such trustees and issuers are well understood by the regulated community and the Department is unaware of any problems attributable to weaknesses in the existing Code and regulatory standards for such persons." (77 Fed Reg 20821, April 21, 2006).

For the same reasons, we believe consideration should be given to expanding MEP sponsorship to include such trustees and issuers. Moreover, if it was determined to be helpful to monitoring and enforcement, an MEP sponsorship registration could be developed and required to be filed with the Department of Labor, to be supplemented each year with the filing of the MEP's annual return/report (Form 5500).

March 2012

PRIVATE PENSIONS

Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship

This Report Is Temporarily Restricted Pending
Official Public Release.





Highlights of GAO-12-326, a report to congressional requesters

Why GAO Did This Study

Because about one-third of private-sector employees in the United States work for small employers, Congress and federal agencies have made efforts to encourage small employers to sponsor retirement plans for workers. However, federal data show workers' access to plans remains limited, leaving many without a work-based plan to save for retirement. For this report, GAO examined (1) characteristics of small employers that are more or less likely to sponsor a plan for their employees, (2) challenges small employers face in establishing and maintaining a plan for their employees, and (3) options to address these challenges and attract more small employer plan sponsors.

GAO defined small employers as for-profit firms that employ 100 or fewer employees. GAO analyzed Internal Revenue Service (IRS) and Department of Labor (Labor) data, interviewed agency officials and experts, held discussion groups with small employers, and reviewed relevant federal rules, literature, and retirement plan proposals.

What GAO Recommends

GAO recommends that Labor convene an interagency task force with Treasury, IRS, and SBA to coordinate existing research, education, and outreach efforts to foster small employer plan sponsorship. GAO also recommends that IRS consider modifying tax forms to gather complete, reliable information about SEP IRAs. Agencies generally agreed with GAO's recommendations; however, Labor disagreed with our recommendation to create a single webportal for federal guidance. However, because federal resources are scattered across different sites, GAO believes consolidating plan information onto one webportal could benefit small employers.

View GAO-12-326. For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeck@gao.gov.

March 2012

PRIVATE PENSIONS

Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship

What GAO Found

Based on available data, about 14 percent of small employers sponsor some type of retirement plan. Overall, GAO found that the likelihood that a small employer will sponsor a retirement plan largely depends on the size of the employer's workforce and the workers' average wages more than on the industry in which the employer operates and the geographic region in which the employer is located. GAO found the greatest likelihood of plan sponsorship was among small employers with larger numbers of employees and those paying an average annual wage of \$50,000 to \$99,999. GAO also found that the most common plans sponsored by small employers are 401(k)s and Savings Incentive Match Plans for Employees (SIMPLE) Individual Retirement Arrangements (IRA)—an employer-sponsored IRA designed for small employers—at 46 percent and 40 percent, respectively, of total plans. However, IRS currently does not have the means to collect information on employers that sponsor another type of IRA plan designed for small employers, the Simplified Employee Pension (SEP) IRA plan, which limits what is known about employers that sponsor these plans.

Small employers and retirement experts identified several challenges to starting and maintaining retirement plans. Many small employers said they feel overwhelmed by the number of retirement plan options, administration requirements, and fiduciary responsibilities. For example, many are concerned about the potential risks associated with sponsoring a plan. Although federal agencies conduct education and outreach on retirement plans, a number of small employers and other stakeholders said small employers were unaware of these initiatives. For example, Labor, IRS, and the Small Business Administration (SBA) collaborate to develop and disseminate information and guidance online but do so through separate websites and in a largely uncoordinated fashion. Small employers and other stakeholders also cited other challenges to plan sponsorship, including a lack of financial resources, time, and personnel. However, some small employers said their employees prioritized health benefits over retirement benefits. To address some of the challenges to plan sponsorship, some small employers said they use contracted service providers that perform plan administration tasks.

Small employers and other stakeholders offered options for addressing some challenges and reducing the complexity of plan sponsorship for small employers. Options included simplification of federal requirements for plan administration, such as easing or eliminating certain plan testing requirements. Some stakeholders said increasing the tax credit for plan startup costs could further defray costs and help boost plan sponsorship. Some stakeholders also said that the federal government could conduct more education and outreach efforts to inform small employers about plans. Pension reform proposals in the United States, along with certain features of pension systems in other countries, may provide additional options that could increase plan sponsorship and increase workers' access to retirement plans. For example, asset pooling is a feature that allows small employers to pool resources for economies of scale, which can lower plan costs. In light of the variety of options, Labor, the Department of the Treasury, IRS, and SBA should jointly evaluate existing options and develop new proposals with the goal of mitigating barriers to small employer plan sponsorship.

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Abbreviations

ACT	Advisory Committee on Tax Exempt and Government Entities
AICPA	American Institute of Certified Public Accountants
ASPPA	American Society of Pension Professionals & Actuaries
BLS	Bureau of Labor Statistics
CDW	Compliance Data Warehouse
CPS	Current Population Survey
CRS	Congressional Research Service
DB	defined benefit
DC	defined contribution
EGTRRA	Economic Growth and Tax Relief Reconciliation Act of 2001
EIN	employee identification number
ERISA	Employee Retirement Income Security Act of 1974
IRA	Individual Retirement Arrangement
IRC	Internal Revenue Code
IRP	Information Returns Processing
IRS	Internal Revenue Service
Labor	Department of Labor
NAICS	North American Industry Classification System
NCS	National Compensation Survey
NEST	National Employment Savings Trust
PBGC	Pension Benefit Guaranty Corporation
SARSEP	Salary Reduction Simplified Employee Pension
SBA	Small Business Administration
SEP	Simplified Employee Pension
SIMPLE	Savings Incentive Match Plans for Employees

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United States Government Accountability Office
Washington, DC 20548

March 7, 2012

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

The Honorable Michael B. Enzi
Ranking Member
Committee on Health, Education, Labor,
and Pensions
United States Senate

The Honorable Jeff Bingaman
United States Senate

About 42 million workers, or about one-third of all private-sector employees, work for small employers, and recent federal data suggest many of these workers lack access to a work-based retirement plan to save for retirement. An estimated 51 percent to 71 percent of workers at employers with fewer than 100 workers do not have access to a work-based retirement plan compared to an estimated 19 percent to 35 percent of those who work for employers with 100 or more workers.¹

Over the years, the federal government has taken steps to encourage small employers to sponsor retirement plans, and Congress has enacted legislation that has established incentives such as plan types with fewer federal reporting requirements, higher plan contribution limits, and a tax credit for plan startup costs. The Department of Labor (Labor) and the Department of the Treasury's (Treasury) Internal Revenue Service (IRS) have also increased education and outreach to these employers. However, small employers continue to face a number of barriers to starting and maintaining plans for their workers. In 2008, GAO reported on challenges that can limit small employer sponsorship of Individual

¹The lower percentages in these ranges are Labor's Bureau of Labor Statistics' (BLS) estimates based on 2011 data from the National Compensation Survey. The higher percentages are the Employee Benefit Research Institute's (EBRI) estimates based on 2011 data from the Census Bureau's Current Population Survey. For more information on these ranges, see appendix I.

Retirement Arrangement (IRA)² plans, including administrative costs, contribution requirements, and eligibility based on employee tenure and compensation, among others.³ Other research also suggests that a difficult economy and concerns about the overall cost of retirement plans may be factors for some small employers that are less likely to sponsor plans. For example, a recent survey found that difficult business conditions were a top reason employers reported for being unlikely to sponsor a retirement plan.⁴

Certain characteristics associated with small employers may also contribute to the challenges of starting and maintaining a plan. When compared with large employers, small employers are more likely to encounter higher rates of employee turnover and higher costs per employee to comply with federal regulations. Further, small employers—especially start-ups—rely heavily on owner investment and bank credit, and operating revenue can be uncertain from year to year.⁵ Federal data suggest that about half of all new businesses (nearly all of which are small) do not survive for more than 5 years. All these conditions can make it difficult for small employers to focus on providing retirement benefits for their workers.

²An IRA is a personal retirement savings arrangement that offers certain tax advantages and allows individuals to set aside money for retirement into an individual account, or purchase an annuity contract. IRAs can be employer-sponsored or maintained by an individual.

³GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, GAO-08-590 (Washington, D.C.: June 4, 2008).

⁴Transamerica Center for Retirement Studies, *12th Annual Retirement Survey* (July 2011).

⁵Previous work by GAO has discussed revenue uncertainty among small employers as a factor in low rates of plan sponsorship. For more information, see GAO, *Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage*, GAO/HEHS-00-131 (Washington, D.C.: Aug. 22, 2000).

In light of these ongoing challenges, GAO was asked to examine issues related to retirement plan sponsorship among small employers.⁶ We answered the following questions:

- What characteristics are associated with small employers that are more likely or less likely to sponsor a retirement plan for their employees?
- What challenges do small employers face in establishing and maintaining a retirement plan for their employees? and
- What options exist to address these challenges and attract more small employer plan sponsors?

To answer these research questions, we combined and analyzed retirement plan data from Labor and IRS data on 5.3 million small employers.⁷ We performed regression analyses to identify characteristics of small employers that are most likely to sponsor plans. We conducted literature reviews and interviewed retirement experts, organizations representing small employers, agency officials, and others on challenges faced by small employers in establishing and maintaining plans, and options for addressing those challenges. In addition, we conducted structured interviews with groups of small employers that did and did not sponsor plans. These interviews were conducted in five cities, which were judgmentally selected for geographic diversity.⁸ We also reviewed relevant federal laws and regulations. Additional details regarding our methodology can be found in appendix I. We conducted this performance audit from October 2010 to March 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our

⁶GAO limited the scope of this study to employer-sponsored plans and did not examine work-based retirement plans that are offered through but not sponsored by the employer or retirement plans maintained by individuals outside of the workplace. Further, since the report's focus was on the employer, GAO did not examine the participation rates of the employees at small employers as this was also considered outside the scope of this report.

⁷For the purposes of this study, GAO defined a small employer as a for-profit firm with least 1 employee and no more than 100 employees. For more information, see appendix I.

⁸The five cities were Atlanta, Boston, Chicago, Los Angeles, and Washington, D.C.

audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

To encourage employers to establish and maintain retirement plans for their employees, the federal government provides preferential tax treatment under the Internal Revenue Code (IRC) for plans that meet certain requirements.⁹ In addition, the Employee Retirement Income Security Act of 1974 (ERISA), as amended, sets forth certain protections for participants in private-sector retirement plans and establishes standards of conduct for those that manage the plans and their assets, generally called fiduciaries.¹⁰ To the extent they qualify as fiduciaries under the law,¹¹ plan sponsors assume certain responsibilities and potential liability under ERISA. For example, a fiduciary must act prudently and solely in the interest of plan participants and their beneficiaries, which may require documenting decisions relating to the plan, including hiring outside professionals or service providers that advise and help administer plans. Small employers may choose a plan for their employees from one of three categories: employer-sponsored IRA plans; defined contribution (DC) plans; and defined benefit (DB) plans (often referred to as traditional pension plans).¹² Appendix II presents

⁹The Internal Revenue Code (IRC) establishes requirements that private retirement plans must satisfy, including minimum coverage and benefits, in order to qualify for favorable tax treatment. Employers that sponsor these tax-qualified plans are entitled to a deduction (within limits) for the contributions they make, and contributions are not included in an employee's income until benefits are received. IRS enforces the IRC requirements that apply to tax-qualified plans.

¹⁰Pub. L. No. 93-406, 88 Stat. 829, 874.

¹¹ERISA requires plans to have at least one named fiduciary who manages plan operation and administration, and other individuals may qualify as fiduciaries based on their function. For example, a person who exercises any discretionary authority or control over the management of the plan or any control over the assets is considered a fiduciary under ERISA. 29 U.S.C. § 1002(21); see also 29 C.F.R. § 2510.3-21. For more information about the fiduciary requirements, see 29 U.S.C. §§ 1101-14 and 29 C.F.R. part 2550. Labor enforces the fiduciary responsibility standards and certain other ERISA requirements, such as reporting and disclosure requirements. In 2010, Labor's Employee Benefits Security Administration proposed expanding the regulatory definition of "fiduciary," 75 Fed. Reg. 65,263 (Oct. 22, 2010), but in 2011, the agency announced plans to repropose the rule after further analysis and additional public input.

¹²In this report, we use the term "pension" to refer generally to all types of private retirement plans, not just DB plans.

information provided by Labor and IRS about some of the various types of retirement savings plans available to small employers.

Employer-sponsored IRA plans: Employer-sponsored IRA plans allow employers and, in some cases, employees to make contributions for deposit in separate IRA accounts for each participating employee. These plans generally have fewer administration and reporting requirements than other types of plans. Participating employees bear the full investment risk of their account assets. There are two types of employer-sponsored IRA plans. Savings Incentive Match Plans for Employees (SIMPLE)¹³ IRA plans require employers to either match their eligible employees' voluntary salary reductions (typically up to 3 percent of compensation) or to contribute 2 percent of compensation for each eligible employee. The second type is the Simplified Employee Pension (SEP) IRA plan,¹⁴ which can be sponsored by an employer of any size, and has higher employer contribution limits than the SIMPLE IRA plan. In a SEP IRA plan, employer contributions are voluntary and employee salary reductions are not permitted.¹⁵

Defined contribution plans: DC plans allow employers, employees, or both to contribute to individual employee accounts that are grouped under a single plan. Employee salary reductions, if provided under the plan, may be pretax or after-tax, in some cases. As with employer-sponsored IRA plans, employees participating in DC plans bear the full risk of investment and will realize any returns (gains or losses) on those investments. DC plans tend to have higher limits for employee contributions but also more rules and reporting requirements than

¹³26 U.S.C. § 408(p). SIMPLE IRA plans are available to employers that do not sponsor another type of qualified plan and have 100 or fewer employees who meet certain minimum compensation requirements. All employees who have received at least \$5,000 in compensation during the preceding 2 calendar years and are reasonably expected to receive at least \$5,000 in compensation during the current year must be eligible to participate.

¹⁴26 U.S.C. § 408(k).

¹⁵Employee salary reductions under SEP IRA plans were eliminated beginning in 1997. However, SEP IRA plans established prior to 1997 whose plan terms permitted salary reductions—a plan called a Salary Reduction Simplified Employee Pension Plan (SARSEP)—may continue to offer salary reductions. 26 U.S.C. § 408(k)(6)(H).

employer-sponsored IRA plans.¹⁶ For example, some DC plans may be required to conduct annual testing in order to ensure that the contributions or benefits provided under the plan do not discriminate against rank-and-file workers in favor of highly compensated employees.¹⁷ In addition to nondiscrimination testing, some DC plans may also be subject to top-heavy requirements and be required to conduct further testing to ensure a minimum level of benefits are provided to rank-and-file workers in plans that are sponsored by owner-dominated firms, where the majority of benefits accrue to “key” employees, such as owners and top executives.¹⁸ As we have previously reported, top-heavy requirements are intended to address a greater potential for tax-shelter abuses in such plans.¹⁹ Top-heavy requirements are most likely to affect smaller plans (fewer than 100 participants), according to the IRS. The

¹⁶Most tax-qualified plans are required to annually file Form 5500, developed jointly by Labor, IRS, and the Pension Benefit Guaranty Corporation to satisfy the annual reporting requirements under ERISA and the IRC. ERISA established a reporting and disclosure framework, in part, to protect the interests of participants and beneficiaries by requiring that certain financial and other information be provided to participants and beneficiaries, as well as to the federal government. Some small plans may be eligible to use a simplified version of Form 5500. SIMPLE IRA plans and SEP IRA plans that comply with certain alternative methods of compliance are not required to file Form 5500.

¹⁷See 26 U.S.C. § 401(a)(4); 26 C.F.R. §§ 1.401(a)(4)-1 through 1.401(a)(4)-4.

¹⁸26 U.S.C. § 416. In general, a plan is top-heavy if the accumulated contributions or benefits of key employees exceed 60 percent of the accumulated contributions or benefits all employees under the plan. Key employees include certain owners and officers of the employer whose annual compensation exceeds a specified amount. If a plan is determined to be top heavy, it must make certain adjustments to maintain its tax-qualified status, such as providing higher minimum contributions to nonkey employees than would otherwise be required. Other plans subject to top-heavy requirements include DB plans and SEP IRA plans.

¹⁹The definition of a key employee for purposes of top-heavy testing—as opposed to the definition of a highly compensated employee for purposes of general nondiscrimination testing—emphasizes firm ownership because in small, owner-dominated firms, compensation may not be a reliable indicator of who controls the firm and the pension plan design. Without identifying key employees, owners of smaller family-owned firms could manipulate assignments and salaries to avoid top-heavy status and exclude nonfamily workers from top-heavy benefits. For more information, see GAO, *Private Pensions: “Top-Heavy” Rules for Owner-Dominated Plans*, GAO/HEHS-00-141 (Washington, D.C., Sept. 29, 2000).

most common type of DC plan is a 401(k) plan.²⁰ In 401(k) plans, employees can defer a portion of their salary—pretax or after tax, if permitted by the plan—for deposit into a separate retirement account. Employers may also choose to make additional contributions (such as contributing a percentage of each eligible employee’s salary), match the amount contributed by the employee, or both. One type of 401(k) plan, the safe harbor 401(k) plan, is not subject to some of the requirements associated with traditional 401(k)s that generally require annual plan testing. However, under safe harbor 401(k) plans, employers are required to make certain contributions to each participant’s account.²¹ Another type of tax-qualified DC plan, the profit sharing plan, gives the employer the discretion to determine annually whether and how much to pay into the plan, within certain maximum limits. Employer contributions, if any, are allocated to each employee according to the terms of the plan.

Defined benefit plans: Unlike employer-sponsored IRA and DC plans, sponsors of DB plans promise to provide a retirement benefit of a specified amount that is typically based on factors such as an employee’s years of service and, often, salary. The benefits in private-sector DB plans are generally protected against an employer’s inability to pay, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation (PBGC).²² The employer is generally responsible for funding the plan²³ and may be responsible for investing and managing its assets. In a DB plan, the employer bears all investment risk. DB plans are also generally subject to ERISA reporting

²⁰26 U.S.C. § 401(k). Although a 401(k) arrangement is a plan feature, for purposes of this report we classified it as a plan type. Different features of 401(k) plans are also available—such as safe harbor 401(k) plans, automatic enrollment 401(k) plans, and SIMPLE 401(k) plans, which are generally subject to the same requirements as SIMPLE IRA plans.

²¹26 U.S.C. § 401(k)(12). Safe harbor 401(k) plans require employers to either make a specified matching contribution to each participating employee’s account or contribute at least 3 percent of compensation to all nonhighly compensated eligible employees.

²²The assets held in DC plans and employer-sponsored IRA plans are not insured by the Pension Benefit Guaranty Corporation.

²³Employee contributions sometimes are required as well, but the employer is generally responsible for the balance of the funding requirements, including from the effects of plan experience differing from the actuarial assumptions. Most private sector DB plans do not require any employee contributions, while most public sector DB plans do.

requirements, nondiscrimination testing, and top-heavy requirements. Operating DB plans typically requires the expertise of an actuary.

Over the years, Congress has responded to concerns about lack of access to workplace retirement plans for employees of small businesses with legislation to lower costs, simplify requirements, and ease administrative burden. For example, The Revenue Act of 1978²⁴ and the Small Business Job Protection Act of 1996²⁵ established the SEP IRA plan and the SIMPLE IRA plan respectively, featuring fewer compliance requirements than other plan types. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)²⁶ also included a number of provisions that affected small businesses. For example, EGTRRA eliminated top-heavy testing requirements for safe harbor 401(k)s, increased contribution limits for employer-sponsored IRA plans and 401(k) plans, and created a tax credit for small employers to offset startup costs, including the cost of educating employees about a new plan.²⁷ EGTRRA also created a tax credit for individuals within certain income limits who make eligible contributions to retirement plans. The Pension Protection Act of 2006,²⁸ among other changes, made these EGTRRA provisions permanent and established additional provisions that support retirement plan participation by rank-and-file employees, such as automatic enrollment.

To help encourage plan sponsorship, federal agencies conduct education and outreach activities and provide information about retirement plans for small employers. Labor, IRS, and the Small Business Administration

²⁴Pub. L. No. 95-600, § 152, 92 Stat. 2763, 2791.

²⁵Pub. L. No. 104-188, § 1421, 110 Stat. 1755, 1792.

²⁶Pub. L. No. 107-16, 115 Stat. 38.

²⁷The credit for small employer pension plan startup costs applies to certain startup costs in connection with the establishment of a new qualified DB plan, DC plan (including 401(k) plans), SIMPLE IRA plan, or SEP IRA plan. To be eligible, an employer must have no more than 100 employees who received at least \$5,000 of compensation in the preceding year. The credit equals 50 percent of qualified startup costs, which include administration costs and employee education, up to a maximum of \$500 per year (for the first 3 years of the plan). 26 U.S.C. § 45E.

²⁸Pub. L. No. 109-280, 120 Stat. 780. EGTRRA was set to expire on December 31, 2010, but the Pension Protection Act of 2006 made permanent EGTRRA's provisions relating to pensions and IRAs.

(SBA)—which maintains an extensive network of field offices—have collaborated with each other and with national and local organizations to develop information on small employer retirement plans²⁹ and conduct outreach with small employers. For example, Labor, IRS, SBA and the U.S. Chamber of Commerce partnered to create the Choosing a Retirement Solution Campaign, which targets small employers and their employees.³⁰ The campaign's educational materials, including web-based retirement plan guidance for small employers, highlight key aspects of and differences between various plans and features, including tax benefits for employers and employees. Labor also worked with the Society for Human Resource Management and the American Institute of Certified Public Accountants (AICPA) on the Fiduciary Education Campaign to provide retirement plan fiduciaries with information about their fiduciary responsibilities under ERISA.

In addition, various private-sector service providers, from individual accountants, investment advisers, recordkeepers, and actuaries to insurance companies and banks, assist sponsors with their retirement plans. Some sponsors hire a single provider that offers a range of plan services for one fee—sometimes referred to as a “bundled” services arrangement. Other sponsors hire different providers for individual services under an “unbundled” arrangement, paying a separate fee for each service. Plan services include legal, accounting, trustee/custodial, recordkeeping, investment management, and investment education or advice. Service providers can also assist with plan administration functions, including nondiscrimination testing, top-heavy testing, and filing of government reports. Some providers also include payroll services, which further centralize an employer's administrative services through a single company. Labor provides some guidance for plan sponsors in selecting and monitoring plan service providers.³¹ Further, the American

²⁹Labor, IRS, and PBGC have a Memorandum of Understanding on enhancing coordination with respect to the funding of any pension plan in connection with certain provisions of ERISA and the IRC, which includes sharing information when coordinated administrative and enforcement action concerning a specific matter is in the government interest.

³⁰U.S. Department of Labor, *Retirement Savings Education Campaign*, accessed January 16, 2012, <http://www.dol.gov/EBSA/savingmatters.html>.

³¹U.S. Department of Labor, *Fact Sheet: Tips for Selecting and Monitoring Service Providers For Your Employee Benefit Plan* (disseminated May 2004), accessed January 13, 2012, <http://www.dol.gov/ebsa/newsroom/fs052505.html>.

Society of Pension Professionals & Actuaries (ASPPA) publishes a list of certified firms that adhere to ASPPA's standards and best practices concerning recordkeeping and administration services for retirement plans.

Number of Employees and Average Pay Level Greatly Influence Plan Sponsorship

More Employees and Higher Average Wages Increase the Likelihood of Plan Sponsorship

GAO found that the number of employees and average wages greatly influence the likelihood that a small employer will sponsor a retirement plan.³² Further, the regression analysis using Labor and IRS data found that small employers with larger numbers of employees were the most likely of all small employers to sponsor a retirement plan, as were those paying average annual wages of \$50,000 to \$99,999. Conversely, employers with the fewest employees and the lowest average annual wages were very unlikely to sponsor a retirement plan.

³² Several experts stated that a firm's age could also affect the likelihood of plan sponsorship, with newer employers less likely to sponsor a plan. However, our analysis was unable to address the number of years in operation due to technical challenges. See appendix I for further discussion of the technical challenges.

A separate GAO analysis using Labor and IRS data found an overall small employer sponsorship rate of 14 percent in 2009.³³ However, the sponsorship rate does not include small employers that sponsor SEP IRA plans because IRS currently does not have a means to collect these data, which limits what is known about small employers that sponsor SEP plans. According to IRS, its Form 5498, "IRA Contribution Information,"³⁴ includes some SEP information; however, the agency is unable to link this information to an employer's employer identification number (EIN). As a result, IRS can identify participants in SEP plans but not sponsoring employers.³⁵ While the IRS Tax Forms and Publication Committee proposed a change to the form to allow IRS to identify SEP IRA plan sponsors, officials said the proposal was not adopted.

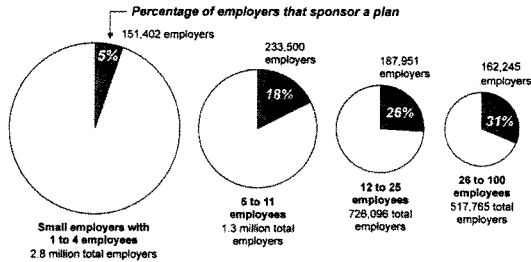
Further examination of sponsorship rates looking at small employer characteristics found that those with 26 to 100 employees had the highest sponsorship rate—31 percent—while small employers with 1 to 4 employees had the lowest rate—5 percent (see fig. 1). Additionally, even though small employers with 26 to 100 employees made up only 10 percent of the overall small employer population, they sponsored more retirement plans than employers with 1 to 4 employees.

³³The sponsorship rate cited in this report is limited to single employers that sponsor a plan. As a consequence, the sponsorship rate does not include small employers that participated only in multiple employer retirement plans or multiemployer retirement plans, which are outside the scope of this report. GAO is currently conducting ongoing work on multiple employer plans and multiemployers plans and their role in the private pension system. For further information on the scope of GAO's analysis, see Appendix I.

³⁴Plan issuers or trustees of IRA plans submit form 5498 to IRS and to IRA participants each year to report annual contribution and other information for each account. Form 5498 shows the issuer or trustee's employer identification number as well as the participant's Social Security Number. A copy of IRS Form 5498 can be found in appendix III.

³⁵Additionally, whereas IRS collects information from employers about SIMPLE employee contributions on Form W-2 filed for each employee, employers do not separately identify SEP information on an employee's W-2.

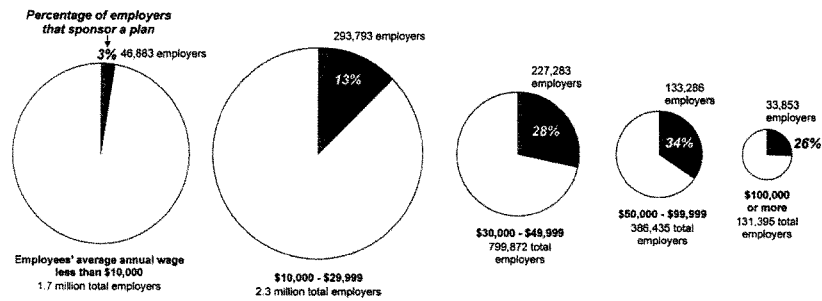
Figure 1: Small Employer Plan Sponsorship by Number of Employees in 2009



Source: GAO analysis of Labor and IRS data

Looking at the average annual wage characteristics, small employers with average annual wages of \$50,000 to \$99,999 had the highest rate of retirement plan sponsorship at 34 percent while small employers with average wages of under \$10,000 had the lowest sponsorship rate—3 percent (see fig. 2). Further, despite having a smaller overall population, small employers with average annual wages of \$50,000 to \$99,999 sponsor almost three times as many retirement plans compared to small employers paying average wages of under \$10,000. As a point of comparison, the overall annual average wages for employees working for small employers was about \$38,000.

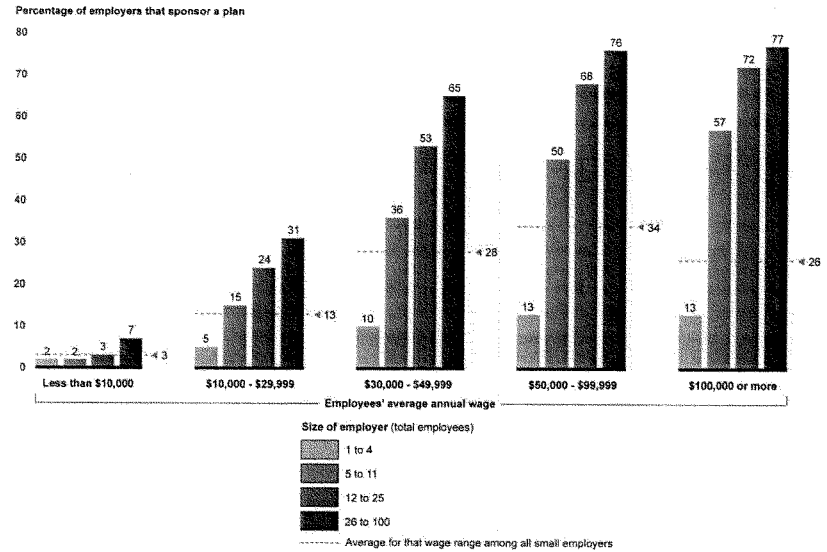
Figure 2: Small Employer Plan Sponsorship by Average Annual Employee Wage in 2009



Source: GAO analysis of Labor and IRS data.

Analysis of the Labor and IRS data examining the interaction between both characteristics—number of employees and average annual wages—illustrates how sponsorship rates increase as numbers of employees and average annual wages increase. For example, the plan sponsorship rate for employers with 26 to 100 employees and average wages of \$30,000 to \$49,999 was more than nine times higher than employers with the same number of employees and wages below \$10,000. Further, the sponsorship rate for small employers with 26 to 100 employees exceeded 75 percent when average wages were \$50,000 or higher. In contrast, small employers with 1 to 4 employees reached their highest sponsorship rate of 13 percent when average annual wages were \$50,000 or more; however, sponsorship rates were still about one-sixth the rate for small employers with 26 to 100 employees in the same wage category. Our analysis showed the sponsorship rate for employers with one to four employees lowered the overall sponsorship rate in the average annual wage categories. For example, the figure shows that small employers with average annual wages of \$100,000 or more have an overall sponsorship rate of 26 percent, but this is much lower than the sponsorship rates for small employers with five or more employees. Figure 3 shows small employer sponsorship rates by size of employer and average annual wage paid.

Figure 3: Small Employer Plan Sponsorship Rate by Employees' Average Annual Wage and Number of Employees in 2009



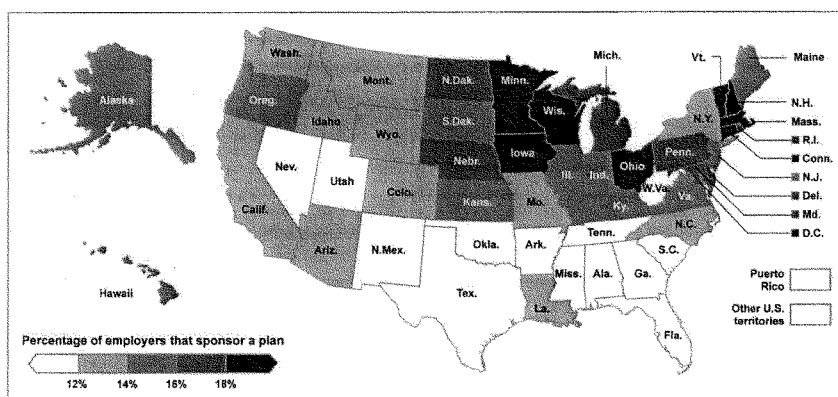
Source: GAO analysis of Labor and IRS data.

In examining the geographic distribution of sponsorship rates, small employers in the Midwest and Northeast were more likely to sponsor plans, while employers in the West and South were less likely.³⁶ Further, in examining data on individual states, Connecticut, Wisconsin, and Washington, D.C., had the highest rate—with Washington, D.C., showing the top rate of 23 percent. Florida and Mississippi had the lowest

³⁶For purposes of this analysis, we used geographic regions used by the Census Bureau. For a list of states included in each region, see appendix V.

sponsorship rates at fewer than 10 percent. Figure 4 shows the percentage of small employers that sponsor plans by state.³⁷

Figure 4: Small Employer Plan Sponsorship by State in 2009



Source: GAO analysis of Labor and IRS data.

401(k)s and SIMPLE IRAs Were the Most Common Plan Types

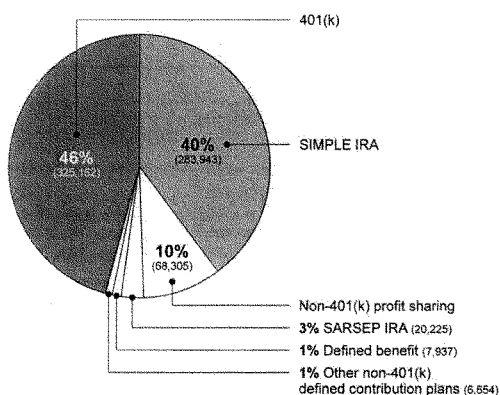
According to GAO analysis of Labor and IRS data, 401(k) and SIMPLE IRA plans were overwhelmingly the most common types of plans sponsored by small employers. Out of slightly more than 712,000 small employers that sponsored a single type of plan, about 86 percent sponsored either a 401(k) or a SIMPLE IRA plan.³⁸ Additionally, non-401(k) DC plans, which include non-401(k) profit sharing plans, make up 11 percent of the plan type population; SARSEP IRAs are 3 percent, while DB plans make up only about 1 percent of the small employer

³⁷For a complete list of sponsorship rates in each state, see appendix V.

³⁸Three percent of the small employer population sponsored multiple plans; however, these small employers were excluded from the plan type analysis. For a further discussion of this limitation, see appendix I.

sponsor population.³⁹ Figure 5 shows the proportion of plan types sponsored by small employers.

Figure 5: Small Employer Plan Sponsorship by Plan Type in 2009



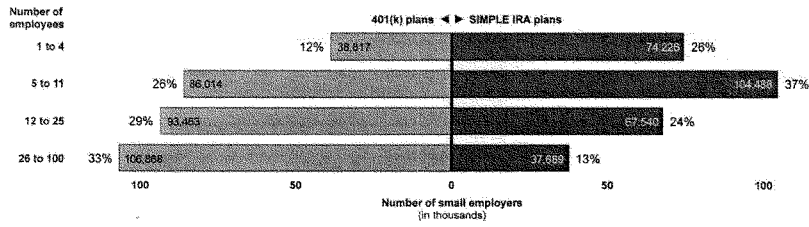
Source: GAO analysis of Labor and IRS data.

Note: Percentages do not add up to 100 due to rounding.

In examining the characteristics of small employers that sponsored the two most common plan types, SIMPLE IRA plan sponsors outnumbered 401(k) plan sponsors when small employers had fewer employees (see fig. 6). For example, looking at small employers with 1 to 11 employees that sponsored plans, there were 43 percent more SIMPLE IRA plans than there were 401(k) plans. In contrast, for small employers with 12 to 100 employees that sponsored plans, there were 90 percent more 401(k) plans than SIMPLE IRA plans.

³⁹A SARSEP plan is a type of SEP IRA plan set up before 1997 that permits employee salary reduction contributions. Employee salary reductions under SEP IRA plans were eliminated beginning in 1997; however, SARSEP plans established prior to 1997 may continue to offer salary reductions. 26 U.S.C. § 408(k)(6)(H).

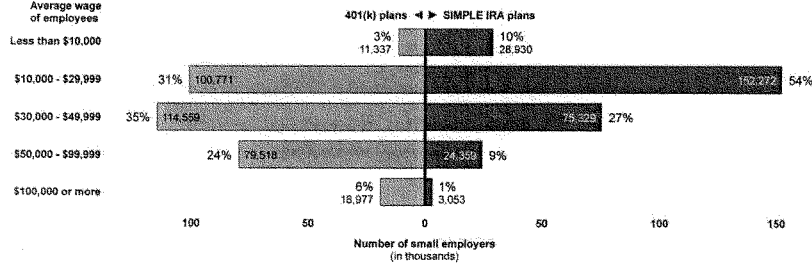
Figure 6: Percentage of Small Employer 401(k) Plan Sponsors and SIMPLE IRA Plan Sponsors by Number of Employees in 2009



Source: GAO analysis of Labor and IRS data.

Similarly, in looking at small employers by average annual wages, there were 61 percent more SIMPLE IRA plans than 401(k) plans for those with employees who had average annual wages under \$30,000. In contrast, for employers with employees who had average annual wages of \$30,000 or more, there were more than double the numbers of 401(k) plans than SIMPLE IRA plans. See figure 7 for the percentage of small employer 401(k) plan sponsors and SIMPLE IRA plan sponsors by the average annual wages of employees.

Figure 7: Percentage of Small Employer 401(k) Plan Sponsors and SIMPLE IRA Plan Sponsors by Average Annual Wages of Employees in 2009



Source: GAO analysis of Labor and IRS data.

Finally, while SIMPLE IRA plans were the most common plan type along with 401(k) plans, they made up a smaller proportion of the overall plan contributions. Contributions to SIMPLE IRA plans in 2009 amounted to \$4.3 billion, or 11 percent of the total contributions made by small employers and their employees into the plan types GAO analyzed. By contrast, 401(k) contributions amounted to \$29.2 billion, or 76 percent of all contributions.

Plan Complexity and Resource Constraints Were Most Frequently Cited Barriers to Retirement Plan Sponsorship

Many Small Employers Find Retirement Plans Complex and Burdensome to Start and Administer

Small employers and other stakeholders⁴⁰ identified various plan options, administration requirements, fiduciary responsibilities, and top-heavy testing requirements as complex and burdensome, often citing these factors as barriers to sponsoring retirement plans or as reasons for terminating them.

Plan options and administration requirements: Small employers and other stakeholders said that plan options and administration requirements are frequently complex and burdensome and discourage some small employers from sponsoring a plan. For example, some small employers and retirement experts said that the number of plan types and features make it difficult for small employers to compare and choose plans. Representatives of a plan service provider said that too many plan options overwhelmed small employers, making it more difficult for them to choose a plan and, ultimately, less likely that they will sponsor one. Some stakeholders also described the administrative burden of plan paperwork, such as reviewing complicated quarterly investment reports or complying

⁴⁰Stakeholders included small employers, retirement experts, organizations representing small employers, retirement plan service providers, representatives of the accounting profession, and officials at Labor and IRS.

with federal reporting requirements—like those associated with required annual statements—as particularly burdensome. For example, one small employer with a DB plan described a dense and highly technical quarterly investment report for his plan that ran 50 pages, making it difficult to glean summary financial information about the plan. Another small employer who previously sponsored a 401(k) with a company match said the amount of required plan paperwork, including generating annual reports, was a key reason he terminated it. Stakeholders also identified interim amendment requirements as burdensome for plan administration. Plan sponsors generally submit plan documentation to IRS periodically to ensure that plans are up to date and compliant with relevant federal statutes and regulations. However, when statutes and regulations change, some sponsors may be required to modify plan documentation and resubmit their plan documents to IRS. Some stakeholders, including small employers, a small business advocacy organization, and plan service provider, said that complying with interim amendment requirements can be costly and time consuming for small employers. IRS has recognized that interim amendment requirements pose a burden to plan sponsors.⁴¹ However, an IRS official noted that most small employer plans are likely based on plan designs that are preapproved by IRS, and interim amendment requirements are likely to entail little administrative burden for most small employer sponsors.⁴²

Fiduciary responsibilities: A number of stakeholders indicated that understanding and carrying out a sponsor's fiduciary responsibilities with respect to their qualified retirement plans presents significant challenges to some small employers. Plan sponsors may qualify as fiduciaries under ERISA, for example, if they have discretionary authority or control over the management of the plan or control the plan assets. Fiduciaries have a number of responsibilities, such as the duty to act prudently, in the sole interest of the participants and beneficiaries, and to diversify the investments of the plan.⁴³ Some small employer sponsors found the selection of investment fund options for their plans particularly challenging. A small employer with a 401(k) plan described the difficulties of selecting

⁴¹ Advisory Committee on Tax Exempt and Government Entities, *Ninth Report of the ACT*, June 9, 2010.

⁴² According to the IRS official, pre-approved plans are designed to satisfy certain IRS requirements and have fewer filing requirements.

⁴³ 29 U.S.C. § 1104(a).

appropriate investment options, with an appropriate balance of risk, for a workforce that includes younger and older workers. A number of small business advocates and retirement experts said that not all small employers have an adequate understanding of their fiduciary duties and are not always aware of all their responsibilities under the law. For example, a retirement expert said that small employers that do not consult with plan professionals often lack the time and expertise to understand complicated fiduciary rules under ERISA. One service provider explained that some small employers mistakenly believe that all fiduciary responsibilities and liabilities are transferred to a service provider when they are hired. Another expert noted that some small employers have an exaggerated sense of the liabilities that being a fiduciary carries, and may avoid sponsoring a plan out of fear of being sued by their employees.

Top-heavy requirements: Top-heavy requirements are most likely to affect smaller plans (fewer than 100 participants), according to IRS, and a number of stakeholders said compliance with the requirements is often burdensome and poses a major barrier to plan sponsorship for small employers. Small employers with high employee turnover may face an even greater likelihood of becoming top-heavy. According to some experts, employee turnover alone can force some small employers out of compliance with top-heavy requirements as they replace departing employees. Over time, rank-and-file employees separate and take their plan assets with them, while long-term employees, such as business owners or executives, continue to contribute to the plan, eventually leading to a top-heavy imbalance of plan assets. For example, one small employer with a 401(k) plan stated that, because two of the four owners had worked for the company for about 25 years and their retirement accounts made up the majority of the total plan assets in the 401(k) plan, the plan had become top-heavy.

To comply with the top-heavy requirements, sponsors of certain plans⁴⁴ are required to test their plans annually. An employer's failure to make certain adjustments to a plan deemed top-heavy can result in it losing its tax-qualified status and the associated tax advantages for the employer and employees. A number of stakeholders stated that top-heavy compliance is confusing and can pose significant burdens on some small

⁴⁴Generally, DC plans, DB plans, and SEP IRA plans are subject to the top-heavy rules. SIMPLE IRA plans and some safe harbor 401(k) plans are exempt. 26 U.S.C. § 416(g)(4)(G) and (H).

employers. For example, some retirement experts said that small employers whose plans are found to be top-heavy may encounter a number of additional costs in the effort to make their plans compliant, such as hiring a plan professional to make corrections to the plan document and instituting a minimum top-heavy employer contribution for all participating rank-and-file employees. According to one expert, in some cases, the costs of mandatory contributions to employees' accounts may prevent owners from making contributions to their own retirement accounts and may make some small employers reluctant to sponsor a plan, or may drive those that sponsor a plan to terminate it. Sponsors can avoid top-heavy testing by adopting a safe harbor 401(k) plan with no additional contributions, which is not subject to top-heavy requirements. However, safe harbor 401(k) plans require the employer to make either specified matching contributions or a minimum 3 percent contribution to each participant's account. According to representatives of the accounting profession, the additional cost to the employer of required contributions under a 401(k) safe harbor plan may offset the advantages of sponsoring such a plan.

Federal Guidance Is Available to Address the Complexities Associated with Plan Sponsorship but May Lack Visibility among Small Employers

Federal agencies provide guidance that can assist small employers in addressing some of the challenges of starting and maintaining retirement plans. Labor and IRS, often in collaboration with SBA, have produced publications, conducted workshops, and developed online resources, among other efforts, to assist small employers in understanding options, requirements, and responsibilities of running a plan. For example, Labor and IRS jointly published a guide that compares various features of different plan types, including IRA, DC, and DB plans. Both agencies have also developed websites and online tools to help small employers navigate plan information and make informed decisions about plan options. For example, IRS's Retirement Plans Navigator is a key component of its education efforts for small employers and is designed for employers that are less likely to hire a service provider. According to IRS, the navigator is intended to lead a novice through basic information on retirement plans and compliance. Similarly, Labor, in collaboration with the American Institute of Certified Public Accountants (AICPA), developed an interactive website highlighting small employer retirement options. The website introduces employers to a number of plan options from simpler IRA plans to more complex automatic enrollment 401(k) plans, and describes the advantages and features of various plan types. According to Labor, employers with as few as two employees can find options using the tool.

However, a number of stakeholders suggested that many small employers are unaware of federal resources on retirement plans. For example, the Advisory Committee on Tax Exempt and Government Entities (ACT)⁴⁵ recognized that, despite the numerous IRS retirement plan resources available, many small employers and other stakeholders in the small business community are unaware of these resources.⁴⁶ ACT indicated these resources could go a long way in addressing the needs of the small employers were it not for their lack of visibility. The lack of visibility of federal guidance on small employer plan options may be due, in part, to difficulties in finding useful, relevant information across federal websites. For example, while Labor's webpage on small employer retirement plan options contains links to relevant topics, such as compliance assistance, participants' rights and fiduciary responsibilities, it is easy to navigate away from but difficult to return to the content developed for small employers because there is no consistent page navigation menu for small employer information. Furthermore, while the Labor website includes guidance on selecting and monitoring plan service providers, there is no link to the guidance on the small employer plan options page. IRS's Retirement Plans Navigator is located on a separate website from the rest of the agency's online plan resources for small employers. When navigating from the page on small employer retirement plan resources on IRS's main portal to the agency's Retirement Plans Navigator, a message alerts users that they are leaving the IRS website and entering another government website. IRS officials noted that small employers who participated in focus groups on IRS plan resources reported challenges to understanding plan-based information when navigating these resources. Furthermore, Labor and IRS present their online content separately, which makes it necessary for an employer to navigate both agencies' websites to gather complete information about starting and maintaining a retirement plan. For example, to review information on fiduciary responsibilities, users must visit Labor's website, and to review information on nondiscrimination and top-heavy testing, users must visit IRS's site. Neither agency maintains a central web portal for all information relevant to small employer plan sponsorship, though such portals exist for federal information resources in other areas such as

⁴⁵The ACT was established in 2001 to provide an organized public forum for IRS to receive regular input on exempt organization and employee plan policy.

⁴⁶Advisory Committee on Tax Exempt and Government Entities, *Ninth Report of the ACT* (June 15, 2011).

healthcare.⁴⁷ Consolidating Internet-based services and information is also consistent with one of the purposes of the E-Government Act of 2002 to promote interagency collaboration in providing electronic government services.⁴⁸

**Small Employers Identified
Lack of Financial
Resources, Time, and
Personnel as Deterrents to
Sponsoring Retirement
Plans**

Small employers that lack sufficient financial resources, time, and personnel may be unwilling or unable to sponsor retirement plans. In particular, stakeholders stated that plan sponsorship may be impractical for smaller or newer firms that are unable to undertake the commitment to sponsor a plan. For example, one expert noted that the first priority of a small employer is remaining in business, and this focus may preclude sponsoring a retirement plan as a benefit to employees until the firm becomes more established.

Financial resources: Small employers, especially those with lower profit margins or an unstable cash flow, could be less willing or less able to sponsor a retirement plan because of the one-time costs to start a plan and the ongoing costs involved with maintaining the plan. These costs can result from start-up activities, complying with reporting and testing requirements, and fees paid to an outside party for administration tasks. Stakeholders stated that these expenses can make sponsoring a plan unappealing. For example, one small employer stated that as a new business owner, she thinks it is better for her business to proceed cautiously and avoid adding to her fixed cost structure. Additionally, any requirement for small employers to match employee contributions or to make mandatory contributions to an employee's account can also increase costs. Further, small employers stated that general economic uncertainty makes them reluctant to commit to such long-term expenses and explained that they needed to reach a certain level of profitability before they would consider sponsoring a plan. For example, one small employer stated that he wanted to be able to expect consistent profits over several years before he would consider investing in a plan. Another small employer stated that she wanted to triple her business revenue to a little less than \$1 million before she would consider sponsoring a retirement plan.

⁴⁷For example, see: <http://www.healthcare.gov/>.

⁴⁸Pub. L. No. 107-347, 116 Stat. 2899.

Time and personnel: Some small employers stated they may not have sufficient time to administer a retirement plan themselves or lacked the personnel to take on those responsibilities. For example, one small employer said that he was not prepared to assume the burden of managing a plan as he thought it would require almost daily attention and did not have the staff to devote to it. Further, a plan service provider described how the focus of the small employer would not be on absorbing the additional time that starting and maintaining a plan would require. Additionally, a plan sponsor employer stated that, since her business did not have a dedicated human resources person or accountant, she performed these duties herself, as she would ultimately be responsible for any mistakes. Further, small employers may not have time to develop the expertise to investigate or choose financial products, select the best investment options, or track their performance. For example, one small employer described how business owners without the financial expertise to compare and select from among different plan options would likely find the experience intimidating.

Small Employers Report That Insufficient Incentives and Lack of Employee Demand Discourage Plan Sponsorship

Some small employers stated that they may be less likely to sponsor a retirement plan if they do not perceive sufficient benefits to the business or themselves. For example, several small employers stated that their firms sponsored retirement plans in order to provide the business owners with a tax-deferred savings vehicle. One small employer stated that his firm evaluated the plan annually in order to determine whether it continues to benefit the owners. A service provider observed that the cost of mandatory contributions—such as those associated with safe harbor 401(k) plans—can discourage small employers, since the cost of the contributions can outweigh the benefit to the owners.

Low employee demand for an employer-sponsored retirement plan may also be a challenge for small employers. For example, a number of small employers stated that employees prioritized health care benefits over retirement benefits. One small employer thought that, given the limited funds available to contribute towards benefits, his employees would prefer those resources be applied toward lowering the employees' share of health insurance premiums. Small employers emphasized that offering health care benefits was necessary to attract quality employees. Further, one small employer stated that his employees perceived a more immediate need for health care benefits, while perceiving retirement benefits as a future concern. Additionally, some small employers, such as those who described having younger workforces, stated that their employees were less concerned about saving for retirement and, as a

result, were not demanding retirement benefits. Other small employers told us that employees, particularly those with low pay, do not have any interest in retirement benefits because they live paycheck to paycheck and are less likely to have funds left over to contribute to a plan. For example, one small employer discontinued his plan when too few of his employees—most of whom he described as low wage—participated in the plan. Another small employer noted that even senior-level managers in his business did not participate in the plan. However, a retirement expert stated that, while some employees might not be interested in participating in a retirement plan, he believed the perceived lack of demand to be exaggerated. He added that he believed some businesses may use lack of employee demand as an excuse when the small employer was not interested in sponsoring a plan.

**Plan Service Providers
Help Small Employers
Meet Some but Not All
Retirement Plan Needs**

A number of small employers indicated that they use plan service providers to address various aspects of plan administration, which enabled them to overcome some challenges of starting and maintaining a plan. For example, one small employer said his service provider addresses his plan testing requirements and educates employees about the plan. Another employer noted that her business would not have the time or the expertise to administer their plan without a service provider. A third employer stated that he would not be able to administer a plan without the assistance of a service provider to help navigate the complexity of plan administration.

Some stakeholders said that service providers offer small employers plan administration solutions by providing basic, affordable plan options. For example, one service provider said a small employer could sponsor a plan for an administrative fee as low as \$1,200 annually. They and other retirement industry representatives said they are able to provide plan options at affordable rates because they market and administer IRS pre-approved standard plans in high volume, thereby reducing the costs of administration. Even so, while some small employers said the fees service providers charge were affordable, others said they were too high. Further, some stakeholders pointed to other limitations of using service providers, such as the difficulties of choosing a provider, setting up a new plan through a provider, and switching to a new provider, as well as the significant plan responsibilities that remain with the sponsor. For example, a small employer described the process of finding a service provider and setting up a plan as particularly difficult, especially for an employer with little knowledge of retirement plans or experience in working with a service provider. Another small employer said she was not satisfied with

the services of her current service provider but would not consider switching to a new one because of the administrative hardships that would entail. Finally, as representatives of the accounting profession noted, even with the assistance of a service provider, small employer sponsors often continue to have significant plan responsibilities, such as managing plan enrollments and separations, and carrying out their fiduciary duties.

Proposed Options to Spur Plan Sponsorship Target Simplification, Incentives, and Education

Stakeholders Proposed Simplifying Requirements and Increasing Tax Credits to Encourage Plan Sponsorship

Stakeholders provided several suggestions targeted at addressing some of the administrative and financial challenges they believed inhibited plan sponsorship.⁴⁹ These proposals, which they said could reduce complexity and ease administrative and financial burdens for small employer plan sponsors, included simplifying plan administration rules, revising or eliminating top-heavy testing, and increasing tax credits.

Simplify plan administration requirements: Several stakeholders suggested proposals that could simplify plan administration requirements and ease administrative burdens for small employers. For example, representatives of a large service provider stated that there is a need for simplification of existing rules and processes for retirement plans and proposed easing nondiscrimination and top-heavy testing requirements as an example. Similarly, several small employers said that federal regulators should strive for simplicity in requirements governing plan administration. A small employer who sponsored a 401(k) plan suggested reducing the amount of paperwork as an example. Another small

⁴⁹The key proposals discussed in this report are not exhaustive, and we did not attempt to quantify the costs and benefits of each proposal or their potential effectiveness in encouraging small employer plan sponsorship.

employer who sponsored a 401(k) plan said federal regulators should “just keep it simple.” One proposal from a national small business association would simplify plan requirements by reducing the frequency of statements sent to certain plan participants, from quarterly to once per year, and allowing some required disclosures to be made available solely online. Another proposal, advocated by IRS, would simplify plan requirements by streamlining interim amendment requirements—an aspect of plan administration that stakeholders identified as particularly burdensome for some small employers.⁵⁰ Each year since 2004, IRS has published a cumulative list of changes in plan qualification requirements that must be incorporated by plan sponsors. An IRS official stated that IRS is proposing to replace a requirement for some interim amendments with a requirement for notices to be sent directly to employees. These notices would explain how a plan intends to comply with changes to relevant laws and regulations and could reduce the burden for plan sponsors by reducing the number of times plan documents must be amended. The amendments that would be subject to the less-stringent requirement would be those triggered by changes to laws and regulations but that do not affect plan benefits.

Revise or eliminate top-heavy testing: A number of stakeholders proposed revising or eliminating top-heavy testing to ease administrative and financial burdens. For example, representatives of the accounting profession told us that top-heavy testing is duplicative because there are other plan testing requirements intended to detect and prevent plan discrimination against rank-and-file employees.⁵¹ The representatives and officials of a large service provider told us lack of plan participation or high turnover among a business’s rank-and file employees frequently cause plans sponsored by small employers to become top-heavy.⁵² As a result,

⁵⁰IRS identified interim amendments as a focus for simplification in its 2011 annual work plan and is considering proposed changes. See Cumulative List of Changes in Plan Qualification Requirements reports, IRS Notices 2011-97, 2010-90 and 2009-98.

⁵¹For example, some plans must conduct nondiscrimination testing—in addition to top-heavy testing—to ensure that the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees. See 26 U.S.C. § 401(a)(4) and 26 C.F.R. §§ 1.401(a)(4)-1 through 1.401(a)(4)-4. GAO did not specifically assess duplication between top-heavy and nondiscrimination testing requirements.

⁵²However, some plans that may be sponsored by small employers, including SIMPLE IRA plans and certain safe harbor 401(k) plans, are not subject to top-heavy rules. 26 U.S.C. § 416(g)(4)(G) and (H).

the representatives said top-heavy testing should be revised or eliminated.

Increase tax credits: Some stakeholders believed that tax credits, in general, are effective in encouraging plan sponsorship and that larger tax credits could encourage more small employers to sponsor plans. However, a stakeholder cautioned that the credits must be sufficient to offset the costs of plan sponsorship, which a service provider said can amount to \$2,000 or more per year. Currently, small employers may claim an annual tax credit of up to \$500 based on plan start-up costs for each of the first 3 years of starting a qualified plan.⁵³ A national organization representing small employers cited tax credits as a top factor in an employer's decision to sponsor a plan; however, an organization official said the likelihood of an employer doing so often depends on whether the tax credit offsets a significant portion of administrative and startup costs of sponsoring plans. Some small employers stated that larger tax credits could ease the financial burden of starting a plan by offsetting plan-related costs, thus creating greater incentives for an employer to sponsor a plan. Other stakeholders said that existing plan startup tax credits are insufficient to encourage plan sponsorship. Officials at another national small business association cautioned that short term tax credits do not provide sufficient incentives for a small employer to make the long-term commitment of sponsoring a plan. Similarly, one small employer who sponsored both 401(k) and DB plans said there needs to be a larger

⁵³For information on the credit for small employer pension plan startup costs, see 26 U.S.C. § 45E.

incentive for the small employer to sponsor a plan because starting and maintaining plans can be expensive.⁵⁴

Stakeholders Said More Education and Outreach Are Needed to Increase Awareness of Plan Options and Requirements

Numerous stakeholders agreed that the federal government could conduct more education and outreach to inform small employers about plan options and requirements; however, opinions varied on the appropriate role for the federal government in this area.

A retirement expert said that the federal government can do more to educate consumers about retirement plans and improve general financial literacy. Officials of a service provider to small businesses stated that, because clients are generally not aware of the retirement plan options available to them, the federal government should provide more education and outreach to improve awareness of the plan types available and rules that apply to each. Another large service provider mentioned the federal government should provide educational materials that help small employers find quality service providers. In addition, in its 2011 report, ACT made numerous recommendations calling for better publicity of IRS resources. According to the report, the committee recommended, among other things, that IRS explore potential partnerships with community organizations and plan service providers to enhance the visibility of IRS resources for small employers.

Although several small employers agreed on the need for more education and outreach about plan options and requirements, opinions varied on the extent to which the federal government should provide these services. For example, a representative of a small employer believed the federal

⁵⁴However, any increase in tax incentives would have to be balanced by the loss of revenue to the federal government. Increasing tax credits to subsidize retirement plan sponsorship costs for small employers would generally reduce the amount of federal tax revenue collected. For example, the Administration's fiscal year 2013 budget proposed a system of automatic IRAs that would offer small employers who adopt an automatic IRA a tax credit of up to \$500 for the first year and \$250 for the second year. These employers would be entitled to an additional credit of \$25 per enrolled employee, up to \$250 for 6 years. In addition, the Administration's 2013 budget included a proposal to double the maximum tax credit for small employer plan start-up costs, from \$500 to \$1,000 per year, for 3 years, and also extend the duration of the tax credit from 3 years to 4 years if a small employer also adopts a new qualified retirement plan, SEP, or SIMPLE during the first 3 years of starting an automatic IRA arrangement. This proposal would increase the potential maximum tax credit from \$1,500 to \$4,000. According to Administration's estimates, these proposals were projected to represent about \$15 billion in reduced revenue over 10 years, starting in 2013.

government could provide more educational materials that are easy to understand. Another small employer said the federal government should focus education and outreach on service providers instead of on small employers. Conversely, some small employers said the federal government should have a limited role or no role in providing education and outreach efforts.

Other Options to Encourage Plan Sponsorship Would Require Broader Reforms

There are a number of domestic pension reform proposals from public policy organizations, as well as practices in other countries, that include features, such as asset pooling, that potentially reduce administrative and financial burdens and could boost retirement plan sponsorship among small employers. By pooling funds, small employers realize economies of scale because plan administration is simplified and administrative costs and asset management fees are reduced. Pooling also creates larger plans, which are more likely to attract service providers that previously may have found it uneconomical to service smaller individual plans. One proposal by the Economic Policy Institute, which incorporates the concept of asset pooling, would create a federally managed and federally guaranteed national savings plan.⁵⁵ Generally, participation in the program would be mandatory for workers,⁵⁶ and employers and employees would be required to make equal contributions totaling 5 percent of employees' earnings. Funds would be pooled and professionally managed, and benefits would be paid out in the form of annuities to ensure that workers do not outlive their savings.⁵⁷ In addition, Automatic IRAs—which are individual IRAs instead of employer-sponsored plans—are another proposal that draws from several elements of the current retirement system: payroll-deposit saving, automatic enrollment, and IRAs. The automatic IRA approach would provide

⁵⁵Teresa Ghilarducci, *Guaranteed Retirement Accounts Toward Retirement Income Security*, Economic Policy Institute, Briefing Paper #204 (Nov. 20, 2007).

⁵⁶Under this proposal, workers participating in equivalent or better employer DB plans where contributions are at least 5 percent of earnings and benefits take the form of life annuities would be exempt from participating in the guaranteed retirement accounts program.

⁵⁷Recent legislation introduced in Congress, the Small Businesses Add Value for Employees Act (SAVE Act), would also build on the concept of asset pooling by establishing multiple employer plans for small employers, in which separate small employers would pool their resources to offer a single plan. See H.R. 1534, 112th Cong. (Introduced Apr. 14, 2011).

employers that do not sponsor any retirement plans with a mechanism that allows their employees to save a portion of their pay in an IRA. For most employees, payroll deductions would be made by direct deposit, and enrollment would be automatic unless employees choose to opt out of participation.⁵⁸

However, as we reported in 2009, some of these proposals that call for broader systemic reforms pose other trade-offs.⁵⁹ For example, proposals that mandate participation would increase plan sponsorship and coverage for workers. However, mandatory participation may create burdens for some employers, and employers might compensate for the costs of contributing to workers' retirement plans by reducing workers' wages and other benefits. Proposals that guarantee investment returns can protect workers from market fluctuations and can ensure a minimum level of benefits; however, significant costs to the government might result if the guarantee were unsustainable. In addition, proposals that simplify and centralize 401(k) plans may require new regulatory and oversight efforts, and compliance-related costs could be passed on to employers, workers, and taxpayers in general.

Retirement systems in other countries also use asset pooling and other features that reduce administrative and financial burdens for small employers and could spur plan sponsorship. For example, the United Kingdom's National Employment Savings Trust (NEST), launched in 2011, features low fees for participating employers and employees and default investment strategies for plan participants. NEST also permits plan participants to take their retirement accounts with them throughout their working life, which eliminates ongoing administration of those accounts by former employers when a worker leaves a company. As we previously reported, the predominant pension systems in the Netherlands and Switzerland pool plan assets into pension funds for economies of scale and for lower plan fees.⁶⁰ Denmark's pension system also pools

⁵⁸J. Mark Iwry and David C. John, *Pursuing Universal Retirement Security Through Automatic IRAs*, Retirement Security Project, No. 2009-03 (2009).

⁵⁹GAO, *Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs*, GAO-09-642 (Washington, D.C.: July 24, 2009).

⁶⁰GAO-09-642.

plan assets⁶¹ and uses existing tax data to calculate plan contributions, further lowering administrative costs for small employers.

Conclusions

Despite efforts by the federal government to develop new plan designs and to increase tax incentives to spur plan formation and retirement saving generally, sponsorship remains low among small employers. To some extent, it would be expected that sponsorship rates for small employers would be somewhat lower than for larger employers partly because of the heavy “churn” of small business formation and dissolution. However, small employers’ sponsorship rates remain far below those of larger firms. If a complete picture of sponsorship by small employers were available—including information on small employers that sponsor SEP IRA plans, which is lacking because IRS currently does not have a means to collect these data—IRS and Labor would be better able to target their research and outreach efforts.

Small employers continue to face a variety of challenges to starting and maintaining retirement plans, including obtaining useful information about the large menu of available plan options, managing administrative requirements that small employers reported as burdensome and overly complex, and drawing upon small employers’ often limited resources to administer and finance a plan. While increased competition among plan service providers may result in more affordable options and plans that are easier to start and maintain, options for many small employers may remain out of reach.

Federal agencies have a key role to play in understanding and addressing the barriers to plan sponsorship and to spur sponsorship among small employers by conducting research and conducting education and outreach to small employers. Labor and IRS already provide small employers with a great deal of online information. However, much of the information is scattered among a variety of websites and portals in a largely uncoordinated fashion. A small employer with little knowledge of retirement plan options is forced to navigate multiple sources to retrieve relevant information and may be discouraged from doing so. Increased collaboration and more comprehensive strategic

⁶¹GAO *Private Pensions: Changes Needed to Better Protect Multiemployer Pension Benefits*, GAO-11-79 (Washington, D.C.: Oct. 18, 2010).

planning between these agencies could enhance outreach and education efforts to more small employers. For example, Labor and IRS could reach out to small employers by utilizing SBA's extensive network of field offices and by entering into partnerships with public and private organizations. More fundamentally, a coordinated review by the relevant agencies of existing plan designs and their effectiveness in spurring plan sponsorship and participation could help agencies evaluate and develop options that mitigate the barriers to small employer plan sponsorship.

Recommendations for Executive Action

Department of Labor

To address the need to strengthen the retirement security of employees at small businesses and to build on interagency data-sharing agreements already in place, we recommend that the Secretary of Labor convene an interagency task force with representatives from Treasury, IRS, and SBA, and other agencies deemed appropriate, to review, analyze, and address the challenges facing small business retirement security in the United States. The aim of this taskforce would be to develop strategies and arrangements for the agencies to routinely and systematically coordinate their existing research, education, and outreach efforts to foster small employer plan sponsorship. Specifically, this body should focus on, but not be limited to, the following goals:

- Conduct plan research on the characteristics associated with small businesses that are more or less likely to sponsor a retirement plan (including employer-sponsored IRA plans) to support agencies' education and outreach efforts to small employers and provide Congress and the public with information about plan coverage among them.
- Evaluate and develop proposals for mitigating barriers to small employer retirement plan sponsorship, including an assessment of the cost effectiveness of existing plan designs—with regard to the expansion of coverage, and the potential to provide an adequate retirement income, as necessary—and the appropriateness of alternative plan designs.

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- Create a single web portal to centralize federal agencies' retirement plan information to enhance the visibility and usefulness of federal guidance on plans for small employers.

Department of the
Treasury

Considering the lack of information on the number and characteristics of sponsors of SEP IRA plans, as well as their performance in improving retirement security, the Secretary of the Treasury should direct the Commissioner of the Internal Revenue Service to consider modifications to tax forms, such as Forms W-2 or 5498, that would allow IRS to gather complete and reliable information about these plans.

Agency Comments
and Our Evaluation

We provided a draft of the report to Labor, Treasury, IRS, Commerce, and SBA for review and comment. Agencies generally agreed with our recommendations. Only Labor provided a written response (see app. VII). Labor, Treasury, IRS, and SBA also provided technical comments, which we incorporated as appropriate. Commerce did not provide comments.

In its written response, Labor generally agreed with the findings and conclusions of the report. Labor also noted that, since 1995, the agency has developed various initiatives to provide education and outreach to the small business community—particularly in the context of retirement saving and financial literacy—by partnering with SBA, the U.S. Chamber of Commerce, and other entities to target small employers. Labor cited these and other efforts as progress in response to our recommendation for a taskforce that would analyze and address the challenges facing small business retirement security, stating that Labor remains committed to continuing its existing coordination efforts with respect to plan research and developing proposals for mitigating barriers to small business plan sponsorship.

However, Labor disagreed with our recommendation to create a unified web portal to centralize retirement plan information for small employers, expressing concerns about its necessity. Specifically, Labor noted that an SBA website, <http://www.business.gov>, currently serves as the central portal for information—including information about retirement plans—relevant to small employers. However, none of the stakeholders we interviewed during this report—including Labor and SBA officials—identified <http://www.business.gov> as a resource of retirement plan information for small employers. Further, in reviewing <http://www.business.gov>, we found the retirement plan information consisted primarily of links that send users to websites maintained by

Labor. We did not find links to or information regarding any IRS retirement plan guidance, including the Retirement Plans Navigator—the agency’s key online retirement plan tool for small employers—or <http://www.choosingretirementsolution.org>, Labor’s online retirement plan tool for small employers. However, even if <http://www.business.gov> contained links to all available federal guidance on retirement plans for small employers, it is not clear how it would increase the visibility of the guidance among small employers because so few small employers and other stakeholders we spoke with appeared to be aware of its existence. Thus, while we commend Labor for its existing coordination efforts, we continue to believe that there are additional benefits to be gained by consolidating information on retirement plans for small employers into a single, easy-to-use source—an initiative that would also appear to be consistent with the administration’s interest in information technology consolidation and in encouraging agencies to conduct their missions more effectively.

Finally, in its written response, Labor cited BLS’s 2010 National Compensation Survey, which found that an estimated 45 percent of establishments employing fewer than 100 workers offered a retirement plan to their workers. This is not necessarily inconsistent with our estimate of 14 percent of small employers sponsoring some form of retirement plan, given the different units of analysis used. While the National Compensation Survey used “establishment” as its unit of analysis, we chose to use “firms” for the purposes of this study. There are important differences between an establishment and a firm. For example, according to BLS’s definition, an establishment is a single economic unit at a single physical location. Thus, an establishment can be a business at a single physical location or a branch of a larger company operating multiple branches and the characteristics of each branch is measured as a separate business instead of in the aggregate. On the other hand, for this study, we defined a firm as a complete, for-profit, independent business with 1 to 100 employees. As a result, Labor’s estimate comprises a broader population of employers beyond the small employers we examined. Further discussion of our methodology can be found in appendix I.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Secretary of Labor, Secretary of the Treasury, the Secretary of Commerce, the SBA

Administrator, and other interested parties. This report will also be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions regarding this report, please contact Charles Jeszeck at (202) 512-7215 or jeszeck@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs can be found on the last page of this report. Key contributors are listed in appendix VIII.



Charles Jeszeck
Director, Education, Workforce
and Income Security

Appendix I: Objectives, Scope, and Methodology

Information Regarding the Rates of Small Business Employees Who Do Not Have Access to a Retirement Plan, Based on BLS and Census Data

In the body of this report, we present a range for the rate of employee access to retirement plans. According to the Congressional Research Service (CRS), the differences in the estimates regarding employee access to retirement plans between information obtained from Bureau of Labor Statistics (BLS) and the Census Bureau may stem from the different populations used in the surveys. BLS's National Compensation Survey (NCS) is conducted among a nationally representative sample of private-sector business establishments. The term establishment usually refers to a single place of business at a particular location. An establishment might be a branch or a small operating unit of a larger firm. The Census Bureau's Current Population Survey (CPS) is conducted among a nationally representative sample of households. Employer characteristics are reported at the level of the firm, which may include more than one establishment. CRS has reported that, in any given year, the NCS can reasonably be expected to show a higher rate of retirement plan participation than the CPS because the business owners and benefits specialists who are interviewed for the NCS might have greater knowledge about the retirement benefits they sponsor than the household members who are interviewed for the CPS. However, CRS has noted that the gap in Census and BLS estimates has grown over time, further complicating the process of estimating both the proportion of workers without employer-sponsored retirement plans and the trend in retirement plan participation rates.¹

Data Sources and Development of the Analytic Data Set

To perform this work, we combined and analyzed 2009 data from the Department of Labor's (Labor) Form 5500 database, the Internal Revenue Service's (IRS) Information Returns Processing (IRP) database, and the IRS Compliance Data Warehouse database (CDW) to obtain information on what would make a small employer more or less likely to sponsor a retirement plan, descriptive statistics on small employer retirement plan sponsors and nonsponsors, and descriptive statistics on the types of retirement plans sponsored by small employers. The Form 5500 database provided information on defined benefit (DB) and defined contribution (DC) plans, and the publicly available data was downloaded directly from Labor's website: <http://www.dol.gov/ebsa/foia/foia-5500.html>. The IRP database provided information on employer-sponsored SIMPLE

¹John J. Topoleski, *Pension Sponsorship and Participation: Summary of Recent Trends*, Congressional Research Service (Washington, D.C.: September 2009)

IRA and SARSEP IRA plans and was provided by the IRS officials in the Tax-Exempt Governmental Entity Employment Plans division. The CDW database provided the characteristics regarding the universe of small employers with 100 or fewer employees and was provided by IRS officials with the Statistics of Income (SOI) division. We assessed the reliability of the Form 5500, the IRP, and the CDW data generally and of data elements that were critical to our analyses and determined that they were sufficiently reliable for our analyses.

Our unit of analysis was the small employer, as identified by its employer identification number (EIN). For the purposes of this study, we defined a small employer as an independently owned and operated for-profit firm with at least 1 employee and no more than 100 employees. This definition excluded agricultural businesses, such as farms, as well as tax-exempt organizations, such as nonprofits and government entities. This definition also excluded subsidiary for-profit firms.

To prepare the Form 5500 data in advance of combining the data with the other datasets, we screened out any plans that were not entered in the Form 5500 or Form 5500-SF as "single employer plans," those that did not have a plan year beginning date in 2009, as well as screened out any plans that had entries in the Welfare Benefit Codes. Our analysis did not consider small employers that only participated in multiple employer plans, in which two or more employers maintain a single plan, or multiemployer plans, in which a joint plan is maintained under a collective bargaining agreement between at least one employee organization and more than one employer. As individual employers are not considered sponsors of multiple employer plans and multiemployer plans, including these plans was considered beyond the scope of this report.² We then matched the Form 5500 data and the IRP data with the CDW data using the EIN in common. Any matches between a small employer in the CDW database and a plan in either the Form 5500 or IRP database classified the small employer as one that sponsored the plan while any small employers that did not match with a plan were classified as nonsponsors.

²Under Title I of ERISA, a plan sponsor "in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations" is "the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan." 29 U.S.C. § 1002(16)(B)(iii).

Data Analysis of Small Employer Plan Sponsorship

We developed bivariate and multivariate regression models to estimate the likelihood that a small employer would sponsor a retirement plan using the following small employer characteristics: the number of employees, the annual average wage of the employees, the industry using the 2007 North American Industry Classification System (NAICS) with a depth of two digits, and the region in which the small employer resided as defined by the Census Bureau. For results of the regression model, see appendix VI. The regression model did not include the age of the business as a variable in the model. It is difficult to measure this variable because, over time, a small employer may change its EIN. For example, some small employers change their business structure,³ which may also require the business to obtain a new EIN. It would be challenging to track businesses over time with changes to the EIN.

In addition to the regression model, we produced a descriptive statistical analysis of small employer characteristics using cross-tabulations of the following characteristics: the number of employees, the annual average salary of the employees, the industry using the NAICS with a depth of two digits, and the state in which the small employer is located. The ranges used for the characteristics identifying the number of employees and average annual wages were established using the statistical spreads identified by the regression model.

Data Analysis of Plan Type

In order to categorize the plan type for plans in the Form 5500 database, we took an approach similar to a model followed by Labor.⁴ We ranked the Pension Benefit Codes using the order established by Labor and assigned a plan type according to the first ranked code found in the Pension Benefits Code variable string using the following order:

³Business structures may include a sole proprietorship, a partnership, a corporation, an S corporation, or a limited liability company (LLC).

⁴U.S. Department of Labor, *Retirement Private Pension Plan Bulletin: Abstract of 2008 Form 5500 Annual Reports* (December 2010).

Appendix I: Objectives, Scope, and Methodology

Table 1: 5500 Retirement Plan Type and Feature Assignment Order by Pension Benefit Code

Category	Plan type	Characteristic code	Variable
Defined benefit (DB)	Cash Balance Plan	1C	
	Other DB Plan	1D,1F,IG	5500: TYPE_PENSION_BNFT_CODE SF 5500 (short form): SF_TYPE_PENSION_BNFT_CODE
Defined contribution (DC)	Profit Sharing Plan	2E	
	Stock Bonus Plan	2I	
	Target Benefit Plan	2B	
	Money Purchase Plan	2C	
	Other DC plans	2F, 2D, 2O, 2P, 2R	
Feature	401(k)	2J	

Source: GAO analysis of Labor Form 5500 pension plan characteristic codes.

To categorize any remaining plans, we performed a string search of the plan names using the Plan Name variable in each form as follows:

- If "cash balance," then Cash Balance Plan.
- If "defined benefit," then "Other DB."
- If "profit sharing," then Profit Sharing Plan.
- If "stock bonus," then Stock Bonus Plan.
- If "target benefit," then Target Benefit Plan.
- If "money purchase," then Money Purchase Plan.
- If "401(k)," then Profit Sharing Plan.
- If "employee stock" or "stock ownership" or "ESOP," then "other DC plan."

Finally, with any further unassigned plans, we examined the Participant Account Balance variable for the Form 5500 and Form 5500-SF and assigned any plans with balances greater than "0" as "Other Defined Contribution."

Once all of the Form 5500 plans had been assigned a plan type, an additional search occurred to look through all of the plans to find those with a plan characteristic code 2J or variations on the string search "401(k)" in the plan name. The additional search produced a breakdown of which plan types had the 401(k) plan feature.⁵

After combining the CDW data with the IRP and Form 5500 data and after categorizing each matched plan in the Form 5500 database, matched small employers were categorized as sponsoring a type of DC plan or DB plan from the Form 5500 database or a SIMPLE IRA or a SARSEP IRA from the IRP database. We produced a frequency count of each plan type sponsored by a small employer that sponsored a single plan. Any small employers that sponsored multiple plans were excluded from the plan type frequency count due to challenges in identifying the correct plan to assign that small employer or in double counting the small employer.⁶ Additionally, we produced descriptive statistics identifying the plan types sponsored by small employers using the small employer characteristics of number of employees, average annual salary, industry type, and state of residence. Finally, we produced descriptive output information on the plan contributions categorized by the plan type, as well as cross tabulated with the small employer characteristics.

Analysis of Small Employer Challenges

To examine challenges encountered by small employers when starting and maintaining retirement plans, we interviewed 27 small employers across the country. Nineteen employers sponsored a retirement plan, and 8 employers did not sponsor a plan. We held nine small group interviews in five major cities across the country: Atlanta, Boston, Chicago, Los Angeles, and Washington, D.C. We also held individual interviews with five employers that were not able to attend group interviews in those cities. We selected these cities for the purposes of geographic dispersion, which allowed us to leverage GAO field office resources in planning and conducting interviews. To identify our interview sites, we selected urban centers instead of less-populated areas because a wider variety of businesses and industries are located in or near cities.

⁵For this study, we classified 401(k) as a plan type.

⁶About 19,000 small employers sponsored multiple plans, which represent about 3 percent of the overall sponsor population.

To select small employers, stakeholders recommended that we contact local Chambers of Commerce to identify and invite local small employers for interview participation. We discussed our study and details of our planned group interviews with officials at the Small Business Administration and the U.S. Chamber of Commerce. Chamber officials assisted us in contacting local Chambers of Commerce in the cities identified above. We discussed our study and details of the group interviews with local chamber officials, who agreed to help us with our data collection and host the interviews. We worked with the local chamber contacts to obtain lists of chamber members who were small employers, and we invited these members—through e-mail messages and phone calls—to participate in our group interviews. The local chambers hosted the interviews and allowed us to use their facilities and conference rooms.

Our interview protocols also sought to identify and interview small employers of varying sizes. The small employers that participated in our interviews represented businesses of varying sizes, up to 65 employees, from various industries and sectors of the economy, including consulting, architecture, health care, light manufacturing, law, marketing, service, and banking. Findings from our interviews with small employers are qualitative in nature and were not meant to be representative of the overall population of small employers nationwide.

In conducting our interviews, we held separate interviews with small employers that sponsored plans and that did not sponsor plans. The interview protocol for both groups was the same. However, the structured data collection instrument—our interview questions—differed between sponsors and nonsponsors. For plan sponsors, our questions focused on factors that influenced their decisions to sponsor retirement plans and challenges they encountered in maintaining retirement plans. For nonsponsors, our questions focused on factors that influenced their decisions not to sponsor retirement plans and challenges that prevented them from starting retirement plans.

To ensure that our questions were easy to understand and captured the necessary information, we conducted pretests with small employers that were members of the Washington, D.C., Chamber of Commerce. In addition, we tested our interview protocols to ensure that participation would not be burdensome for small employers. Using the pretest results, we consolidated some of our questions. However, because no substantive changes were made to our interview questions, we included results from the pretests in the results obtained from the interviews in other cities to formulate our findings.

Our examination of challenges encountered by small employers when starting and maintaining retirement plans also included interviews with retirement experts, including individuals representing public policy research organizations and attorneys specializing in retirement benefits, organizations representing small employers, retirement plan service providers, representatives of the accounting profession, as well as federal agency officials.

Analysis of Proposed Options to Address Small Employer Challenges

To compile options that could address challenges encountered by small employers when starting and maintaining retirement plans for their workers, in addition to interviews with small employers throughout the country, we interviewed a range of retirement experts, which included retirement experts, including individuals representing public policy research organizations and attorneys specializing in retirement benefits, organizations representing small employers, retirement plan service providers, and representatives of the accounting profession. Stakeholders also included officials at Labor and IRS, who provided information on the role of federal agencies in conducting oversight of federal plan requirements. In our interviews with stakeholders, we gathered information on proposed options that could address small employers' plan-related challenges. In addition, we reviewed relevant portions of federal laws and regulations and proposed legislation on new plan types. The key proposals discussed in our report are not exhaustive, and we did not attempt to quantify the costs and benefits of each proposal or their potential effectiveness in encouraging small employer plan sponsorship.

To identify domestic pension reform proposals that could address challenges encountered by small employers in sponsoring plans, we conducted a review of available literature and proposals published by public policy organizations. We selected examples that included a plan feature—asset pooling—that was common across many proposals. To identify examples of proposed legislation on new types of retirement plans, we searched electronic databases for proposed federal legislation that included provisions related to retirement plans for small employers and selected a recent proposal that builds on the concept of asset pooling. For examples of international retirement plan features that address challenges to small employer plan sponsorship, we drew from prior GAO reports on international retirement plan systems and selected examples that included features that could assist small employers.

We conducted this performance audit from October 2010 to March 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain

Appendix I: Objectives, Scope, and Methodology

sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Some Retirement Plans Available to Small Employers

Table 2 is based on guidance produced by Labor and the IRS to educate small employers about their retirement plan options. This guidance, titled "Choosing a Retirement Solution for Your Small Business," can be found at <http://www.dol.gov/ebsa/pdf/choosing.pdf>. The content of this table is reproduced from the Labor/IRS publication without alteration, with the following exceptions: GAO updated some dollar amounts to reflect changes made for 2012, where applicable (specifically, the maximum annual contributions to the defined contribution plans and SEP IRA plans, and the maximum compensation upon which contributions to non-DB plans may be based), reordered the columns, and omitted information about payroll deduction IRA plans, which are beyond the scope of this review. GAO did not independently verify the legal accuracy of the information contained in the table.

Appendix II: Some Retirement Plans Available to Small Employers

Table 2: Some Retirement Plans Available to Small Employers

IRA-Based Plans		Defined Contribution Plans			Defined Benefit
SEP	SIMPLE IRA Plan	Traditional 401(k)	Safe Harbor 401(k)	Automatic Enrollment 401(k)	Profit Sharing
Key Advantage Easy to set up and maintain.	Salary reduction plan with little administrative paperwork.	Permits high level of salary deferrals by Employees.	Permits high level of salary deferrals by employees without annual discrimination testing.	Provides high level of participation and permits high level of salary deferrals by employees. Also safe harbor relief for default investments.	Permits employer to make large contributions for employees.
Employer Eligibility Any employer with one or more employees.	Any employer with 100 or fewer employees that does not currently sponsor a retirement plan.	Any employer with one or more employees.	Any employer with one or more employees.	Any employer with one or more employees.	Any employer with one or more employees.
Employer's Role May use IRS Form 5305-SEP to set up and maintain. No annual filing requirement for employer.	May use IRS Form 5305-SIMPLE to set up the plan. No annual filing requirement for employer. Bank or financial institution handles most of the paperwork.	No model form to establish this plan. Financial institution or employee benefit adviser may be necessary. Annual filing of Form 5500 is required. Requires annual non-discrimination testing for all plan participants. Not discriminate in favor of highly compensated employees.	No model form to establish this plan. Financial institution or employee benefit adviser may be necessary. A minimum amount of contributions is required. Annual filing of Form 5500 is required.	No model form to establish this plan. Financial institution or employee benefit adviser may be necessary. Annual filing of Form 5500 is required. Some plans require annual non-discrimination testing to ensure they do not discriminate in favor of highly compensated employees.	No model form to establish this plan. Financial institution or employee benefit adviser would be necessary. Annual filing of Form 5500 is required. An employer must determine annual contributions.
Contributors To The Plan Employer contributions only.	Employee salary reduction contributions and employer contributions.	Employee salary reduction contributions and maybe employer contributions.	Employee salary reduction contributions and employer contributions.	Employee salary reduction contributions and maybe employer contributions.	Annual employer contribution is discretionary.
					Primarily funded by employer.

Appendix II: Some Retirement Plans Available to Small Employers

IRA-Based Plans		Defined Contribution Plans			Defined Benefit
SEP	SIMPLE IRA Plan	Traditional 401(k)	Safe Harbor 401(k)	Automatic Enrollment 401(k)	Profit Sharing
<p>Up to 25% of compensation* but not more than \$50,000 for 2012.</p> <p>See http://www.irs.gov/ep for annual updates.</p>	<p>Employee: \$11,500 in 2012. Additional contributions can be made by participants age 50 or over up to \$5,500.</p> <p>Employer: Either match employee contributions 100% of first 3% of compensation (can be reduced to as low as 1% in any 2 out of 5 yrs), or contribute 2% of each eligible employee's compensation*.</p>	<p>Employee: \$17,000 in 2012. Additional contributions can be made by participants age 50 or over up to \$5,500.</p> <p>Employer/Employee Combined: Up to the lesser of 100% of compensation* or \$50,000 for 2012. Employer can deduct (1) amounts that do not exceed 25% of compensation for all participants and (2) all salary reduction contributions.</p>	<p>Employee: \$17,000 in 2012. Additional contributions can be made by participants age 50 or over up to \$5,500.</p> <p>Employer/Employee Combined: Up to the lesser of 100% of compensation* or \$50,000 for 2012. Employer can deduct (1) amounts that do not exceed 25% of compensation for all participants and (2) all salary reduction contributions.</p>	<p>Employee: \$17,000 in 2012. Additional contributions can be made by participants age 50 or over up to \$5,500.</p> <p>Employer/Employee Combined: Up to the lesser of 100% of compensation* or \$50,000 for 2012. Employer can deduct (1) amounts that do not exceed 25% of compensation for all participants and (2) all salary reduction contributions.</p>	<p>Up to the lesser of 100% of compensation* or \$50,000 in 2012. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.</p>
<p>Employer can decide whether to make contributions year-to-year.</p>	<p>Employee can decide how much to contribute. Employer must make matching contributions or contribute 2% of each employee's compensation.</p>	<p>Employee can decide how much to contribute pursuant to a salary reduction agreement. The employer can make additional contributions, including matching contributions, as set by plan terms.</p>	<p>Employee can decide how much to contribute pursuant to a salary reduction agreement. The employer must make either specified contributions or a 3% contribution to all participants.</p>	<p>Employees, unless they opt otherwise, must make salary reduction contributions specified by the employer. The employer can make matching contributions, including matching contributions as set by plan terms.</p>	<p>Employer makes contribution as set by plan terms.</p>
<p>Must be offered to all employees who are at least 21 years of age, employed by the employer for 3 of the last 5 years and had compensation of \$550 for 2012.</p>	<p>Must be offered to all employees who have earned income of at least \$5,000 in any prior 2 years, and are reasonably expected to earn at least \$5,000 in the current year.</p>	<p>Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.</p>	<p>Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.</p>	<p>Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.</p>	<p>Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.</p>
<p>Contributor's Options</p>	<p>Contributor's Options</p>	<p>Contributor's Options</p>	<p>Contributor's Options</p>	<p>Contributor's Options</p>	<p>Contributor's Options</p>
<p>Minimum Employee Coverage Requirements</p>	<p>Minimum Employee Coverage Requirements</p>	<p>Minimum Employee Coverage Requirements</p>	<p>Minimum Employee Coverage Requirements</p>	<p>Minimum Employee Coverage Requirements</p>	<p>Minimum Employee Coverage Requirements</p>

Appendix II: Some Retirement Plans Available to Small Employers

		Defined Contribution Plans				Defined Benefit
		IRA-Based Plans	Traditional 401(k)	Safe Harbor 401(k)	Automatic Enrollment 401(k)	Profit Sharing
Withdrawals, Loans & Payments	<p>SEP Withdrawals permitted anytime after a specified event; income taxes subject to an additional tax.</p> <p>SIMPLE IRA Plan Withdrawals permitted anytime after a specified event; income taxes subject to an additional tax.</p>	<p>Withdrawals permitted after a specified event occurs (e.g., plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.</p>	<p>Withdrawals permitted after a specified event occurs (e.g., plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.</p>	<p>Withdrawals permitted after a specified event occurs (e.g., plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.</p>	<p>Withdrawals permitted after a specified event occurs (e.g., plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.</p>	<p>Payment of benefits after a specified event occurs (e.g., plan termination, etc.). Plan may permit loans; early withdrawals subject to an additional tax.</p>
Vesting	<p>Contributions are immediately 100% vested.</p>	<p>Employee salary reduction contributions and employer contributions are immediately 100% vested.</p>	<p>Employee salary reduction contributions are immediately 100% vested according to plan terms.</p>	<p>Employee salary reduction contributions are immediately 100% vested according to plan terms.</p>	<p>Employee salary reduction contributions are immediately 100% vested according to plan terms.</p>	<p>May vest over time according to plan terms.</p>

Sources: Department of Labor and IRS.

*Maximum compensation on which 2012 contributions can be based is \$250,000.

**Maximum compensation on which 2012 employer 2% nonselective contributions can be based is \$250,000.

Appendix III: IRS Form 5498 IRA Contribution Information

2828		<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0747		2011 Form 5498 IRA Contribution Information	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2-4, 8-10, 13a, and 14a)		\$			
		2 Rollover contributions		\$		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.	
		3 Roth IRA conversion amount		\$			
TRUSTEE'S or ISSUER'S federal identification no.		PARTICIPANT'S social security number		5 Fair market value of account		6 Life insurance cost included in box 1	
				\$		\$	
PARTICIPANT'S name		7 IRA <input type="checkbox"/> SEP <input type="checkbox"/> SIMPLE <input type="checkbox"/> Roth IRA <input type="checkbox"/>		8 SEP contributions		9 SIMPLE contributions	
				\$		\$	
Street address (including apt. no.)		10 Roth IRA contributions		11 Check if RMD for 2012 <input type="checkbox"/>			
		\$					
City, state, and ZIP code		12a RMD date		12b RMD amount		13c Code	
		\$		\$			
		13a Postponed contribution		13b Year		13c Code	
		\$					
		14a Repayments		14b Code			
		\$					
Account number (see instructions)							

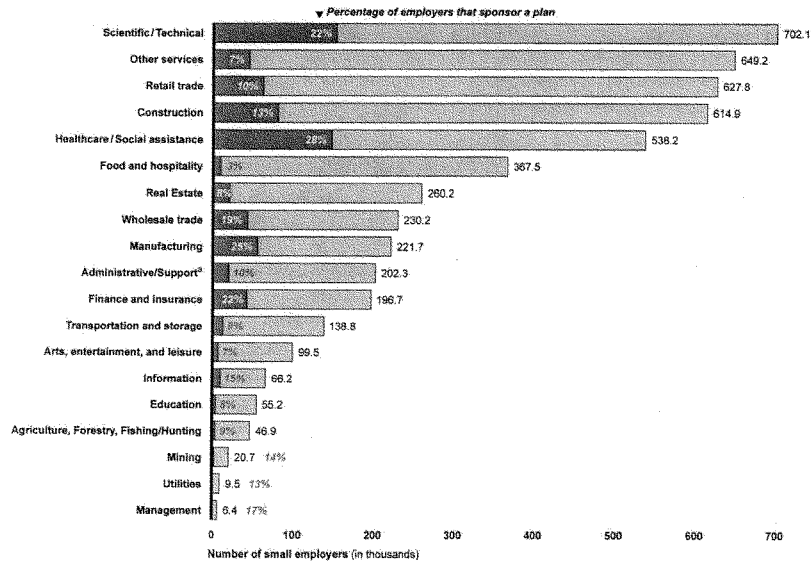
Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service
Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Source: IRS.

Appendix IV: Small Employer Plan Sponsorship Rate by Industry

In analyzing small employer retirement plan sponsorship by industry, we found that small employers in health care and manufacturing were most likely to sponsor a retirement plan, while small employers in the food and hospitality industry were least likely to sponsor a plan. See figure 8 for the sponsorship rate by industry and table 3 for a sample list of businesses contained within each industry type.

Figure 8: Small Employer Plan Sponsorship Rate by Industry Type in 2009



Source: GAO analysis of Labor and IRS data.

Note: All employers counted in the table employed from 1 to 100 employees.

**Appendix IV: Small Employer Plan
Sponsorship Rate by Industry**

Table 3: Composition of Industry Classifications

Industry category	Examples
Scientific/technical/ professional	Legal services, accounting, architecture, engineering, computer systems design, scientific research, advertising, public relations
Other services	automotive repair and maintenance, barber shops and beauty salons, civic and professional organizations, funeral homes, laundry services, personal goods repair and maintenance
Retail trade	Automobile dealers, book and music stores, building material and garden equipment dealers, clothing stores, electronics and appliance stores, food and beverage stores, gasoline stations, sporting good stores
Construction	Construction of buildings, heavy and civil engineering construction, specialty trade contractors
Health care/social assistance	Child day care services, hospitals, nursing and residential care facilities, offices of health care practitioners (physicians, dentists, chiropractors, optometrists, etc), outpatient and home health care centers
Food and hospitality	Restaurants and taverns, accommodation services
Real estate and rental and leasing	Real estate agents and brokers, automotive equipment rental and leasing, consumer good rental
Wholesale trade	Durable and nondurable goods wholesalers, wholesale electronics market
Manufacturing	Computer and electronic product manufacturing, food manufacturing, machinery and metal product manufacturing, petroleum and chemical manufacturing, textile product mills
Administrative support and waste management and remediation services	Office administrative services, employment services, travel arrangement and reservation services, waste collection, waste treatment and disposal
Finance and insurance	Commercial banking, funds and trusts, savings institutions, securities and commodities exchanges, insurance carriers
Transportation and warehousing	Air transportation, couriers and messengers, postal service, sightseeing transportation, transit and ground passenger transportation, water transportation, warehousing and storage
Arts, entertainment, and recreation	Spectator sports, amusement parks, gambling, promoters and agents
Information and communication	Broadcasting, data processing, motion picture and sound recording, publishing industries, telecommunications
Education	Computer and management training, educational support services, technical and trade schools
Agriculture, forestry, fishing/hunting	Animal and crop production, fishing, forestry, hunting, trapping
Mining, quarrying, and oil and gas extraction	Mining, oil and gas extraction
Utilities	Electric power, natural gas distribution, water and sewage
Management	Management of companies and enterprises, offices of bank holding companies

Source: U.S. Bureau of Labor Statistics, 2007 North American Industry Classification System, last revised February 28, 2011.

Note: This list contains examples for illustrative purposes and is not a complete list.

Appendix V: Small Employer Plan Sponsorship Rate by State in 2009

State	Sponsorship percentage	Census region
Alabama	11.7	South
Alaska	14.0	West
Arizona	12.1	West
Arkansas	10.6	South
California	13.0	West
Colorado	13.3	West
Connecticut	19.7	Northeast
Delaware	17.3	South
District Of Columbia	22.5	South
Florida	9.5	South
Georgia	11.4	South
Hawaii	16.0	West
Idaho	12.6	West
Illinois	14.4	Midwest
Indiana	15.4	Midwest
Iowa	18.1	Midwest
Kansas	15.5	Midwest
Kentucky	14.4	South
Louisiana	13.3	South
Maine	14.2	Northeast
Maryland	17.6	South
Massachusetts	19.2	Northeast
Michigan	16.2	Midwest
Minnesota	18.0	Midwest
Mississippi	9.6	South
Missouri	13.4	Midwest
Montana	13.8	West
Nebraska	16.8	Midwest
Nevada	10.1	West
New Hampshire	18.0	Northeast
New Jersey	14.3	Northeast
New Mexico	11.9	West
New York	12.8	Northeast
North Carolina	12.8	South
North Dakota	16.4	Midwest
Ohio	18.1	Midwest

**Appendix V: Small Employer Plan Sponsorship
Rate by State in 2009**

State	Sponsorship percentage	Census region
Oklahoma	11.6	South
Oregon	15.5	West
Pennsylvania	16.9	Northeast
Rhode Island	16.4	Northeast
South Carolina	11.5	South
South Dakota	14.6	Midwest
Tennessee	11.7	South
Texas	10.5	South
Utah	10.2	West
Vermont	18.1	Northeast
Virginia	14.9	South
Washington	13.8	West
West Virginia	11.9	South
Wisconsin	19.6	Midwest
Wyoming	12.6	West
Puerto Rico	5.0	NA
Other U.S. territories	5.5	
American Samoa		NA
Federated States Of Micronesia		NA
Guam		NA
Northern Mariana Islands		NA
Virgin Islands		NA
National Small Employer Average, including Puerto Rico and other U.S. territories	13.8	NA

Source: GAO analysis of Labor and IRS data.

Appendix VI: Regression Results

Table 4: Results of Bivariate Analysis

Category	Percentage of businesses	Percentage of businesses sponsoring retirement programs	Odds ratio from bivariate model	Significance of odds ratio
Overall U.S. small business	100.0%	13.8%	1.00	
	(N=5,344,369)	(N=735,098)		
Employee count				
1 to 4	51.9%	5.5%	0.20	**
5 to 11	24.9%	17.6%	1.49	**
12 to 25	13.6%	25.9%	2.60	**
25 to 100	9.7%	31.3%	3.39	**
Average wage per employee				
Less than \$10,000	31.8%	2.8%	0.12	**
\$10,000 - \$29,999	43.6%	12.6%	0.84	**
\$30,000 - \$49,999	15.0%	28.4%	3.16	**
\$50,000 - \$99,999	7.2%	34.5%	3.81	**
\$100,000 or greater	2.5%	25.8%	2.23	**
NAICS				
11 = Agriculture, Fishing, Forestry	0.9%	9.1%	0.63	**
21 = Mining	0.4%	14.4%	1.05	*
22 = Utility	0.2%	12.8%	0.92	**
23 = Construction	11.5%	13.2%	0.95	**
31 = Manufacturing (incl. 33 and 34)	4.2%	25.3%	2.21	**
42 = Wholesale Trade	4.3%	18.9%	1.49	**
44 = Retail Trade (incl. 45)	11.8%	10.0%	0.67	**
48 = Transportation/Warehousing	2.6%	9.20%	0.63	**
51 = Information	1.2%	15.3%	1.14	**
52 = Finance and Insurance	3.7%	21.8%	1.80	**
53 = Real Estate and Rental and Leasing	4.9%	8.2%	0.55	**
54 = Professional, Scientific, and Technical Services	13.1%	21.9%	1.96	**
55 = Management of Companies and Enterprises	0.1%	16.9%	1.28	**
56 = Administrative and Support and Waste Management and Remediation Services	3.8%	10.1%	0.70	**
61 = Education Services	1.0%	8.4%	0.57	**
62 = Healthcare	10.1%	27.5%	2.73	**
71 = Art, Entertainment, and Recreation	1.9%	7.3%	0.49	**
72 = Accommodation and Food Service	6.9%	2.7%	0.16	**

Appendix VI: Regression Results

Category	Percentage of businesses	Percentage of businesses sponsoring retirement programs	Odds ratio from bivariate model	Significance of odds ratio
81 = Other Services	12.2%	7.0%	0.44	**
99 = Invalid	0.2%	1.7%	0.11	**
00 = Missing	0.4%	1.6%	0.10	**
Census Bureau regions and divisions				
Region 1 = Northeast	20.0%	15.3%	1.17	**
Division 1: New England	5.3%	18.4%	1.45	**
CT	1.2%	19.7%	1.55	**
ME	0.6%	14.2%	1.04	*
MA	2.3%	19.2%	1.51	**
NH	0.5%	18.0%	1.38	**
RI	0.4%	16.5%	1.23	**
VT	0.3%	18.1%	1.39	**
Division 2: Middle Atlantic	14.7%	14.2%	1.05	**
NJ	3.3%	14.3%	1.05	**
NY	7.4%	12.8%	0.91	**
PA	4.0%	16.9%	1.29	**
Region 2 = Midwest	21.8%	16.3%	1.30	**
Division 3: East North Central	14.3%	16.4%	1.28	**
IN	1.9%	15.4%	1.15	**
IL	4.3%	14.4%	1.06	**
MI	3.0%	16.2%	1.22	**
OH	3.3%	18.1%	1.40	**
WI	1.9%	19.6%	1.54	**
Division 4: West North Central	7.5%	16.1%	1.22	**
IA	1.1%	18.1%	1.39	**
KS	1.0%	15.5%	1.15	**
MN	2.0%	18.0%	1.39	**
MO	2.0%	13.4%	0.97	**
NE	0.7%	16.8%	1.27	**
ND	0.3%	16.4%	1.23	**
SD	0.4%	14.6%	1.07	**

Appendix VI: Regression Results

Category	Percentage of businesses	Percentage of businesses sponsoring retirement programs	Odds ratio from bivariate model	Significance of odds ratio
Region 3 = South	33.6%	11.9%	0.78	**
Division 5: South Atlantic	19.0%	12.2%	0.85	**
DE	0.3%	17.3%	1.31	**
DC	0.2%	22.5%	1.82	**
FL	6.7%	9.5%	0.65	**
GA	2.8%	11.4%	0.81	**
MD	1.8%	17.6%	1.35	**
NC	2.8%	12.8%	0.92	**
SC	1.3%	11.5%	0.82	**
VA	2.5%	14.9%	1.10	**
WV	0.5%	11.9%	0.85	**
Division 6: East South Central	4.8%	12.1%	0.85	**
AL	1.3%	11.7%	0.83	**
KY	1.2%	14.4%	1.06	**
MS	0.7%	9.8%	0.68	**
TN	1.6%	11.7%	0.83	**
Division 7: West South Central	9.8%	11.0%	0.76	**
AR	0.9%	10.6%	0.74	**
LA	1.3%	13.3%	0.96	**
OK	1.2%	11.6%	0.82	**
TX	6.5%	10.5%	0.72	**
Region 4 = West	24.0%	13.0%	0.92	**
Division 8: Mountain	7.6%	12.2%	0.86	**
AZ	1.7%	12.1%	0.86	**
CO	2.1%	13.3%	0.96	**
ID	0.6%	12.6%	0.90	**
NM	0.6%	11.9%	0.85	**
MT	0.6%	13.8%	1.00	**
UT	1.0%	10.2%	0.71	**
NV	0.7%	10.1%	0.71	**
WY	0.3%	12.6%	0.90	**

Appendix VI: Regression Results

Category	Percentage of businesses	Percentage of businesses sponsoring retirement programs	Odds ratio from bivariate model	Significance of odds ratio
Division 9: Pacific	16.4%	13.4%	0.97	**
AK	0.3%	14.0%	1.02	
CA	11.8%	13.0%	0.93	**
HI	0.4%	16.0%	1.20	**
OR	1.5%	15.5%	1.15	**
WA	2.4%	13.8%	1.00	

Source: GAO analysis of Labor and IRS data.
 ** denotes p-value < 0.01.
 * denotes p-value < 0.05.

Table 5: Results of Multivariate Analysis

Category	Odds ratio from multivariate model	p-value	95 percent Wald Confidence Limits (lower)	95 percent Wald Confidence Limits (upper)
Employee count				
1 to 4	0.23	<.0001	0.22	0.23
5 to 11	Ref.			
12 to 25	1.92	<.0001	1.91	1.94
26 to 100	3.13	<.0001	3.10	3.15
Average wage per employee				
Less than \$10,000	0.23	<.0001	0.23	0.23
\$10,000 - \$29,999	Ref.			
\$30,000 - \$49,999	2.58	<.0001	2.56	2.60
\$50,000 - \$99,999	3.62	<.0001	3.59	3.66
\$100,000 or Greater	3.23	<.0001	3.19	3.28
NAICS				
11 = Agriculture, Fishing, Forestry	0.98	0.2414	0.95	1.01
21 = Mining	1.12	<.0001	1.07	1.17
22 = Utility	0.71	<.0001	0.66	0.76
23 = Construction	Ref.			
31 = Manufacturing (incl. 33 and 34)	1.63	<.0001	1.60	1.65
42 = Wholesale Trade	1.45	<.0001	1.43	1.47
44 = Retail Trade (incl. 45)	1.05	<.0001	1.04	1.06
48 = Transportation/Warehousing	0.77	<.0001	0.75	0.78

Appendix VI: Regression Results

Category	Odds ratio from multivariate model	p-value	95 percent Wald Confidence Limits (lower)	95 percent Wald Confidence Limits (upper)
51 = Information	1.20	<.0001	1.17	1.23
52 = Finance and Insurance	2.70	<.0001	2.66	2.74
53 = Real Estate and Rental and Leasing	1.04	<.0001	1.02	1.06
54 = Professional, Scientific, and Technical Services	2.39	<.0001	2.36	2.41
55 = Management of Companies and Enterprises	1.32	<.0001	1.22	1.42
56 = Administrative and Support and Waste Management and Remediation Services	1.03	0.0007	1.01	1.05
61 = Education Services	0.60	<.0001	0.59	0.63
62 = Healthcare	2.59	<.0001	2.56	2.61
71 = Art, Entertainment, and Recreation	0.86	<.0001	0.84	0.88
72 = Accommodation and Food Service	0.29	<.0001	0.29	0.30
81 = Other Services	0.75	<.0001	0.74	0.76
89 = Services, Not Elsewhere Classified	0.35	<.0001	0.30	0.41
00 = Missing	0.41	<.0001	0.36	0.45
Census Bureau regions and divisions				
Division 1: New England	1.37	<.0001	1.35	1.39
Division 2: Middle Atlantic	Ref.			
Division 3: East North Central	1.28	<.0001	1.26	1.29
Division 4: West North Central	1.50	<.0001	1.48	1.52
Division 5: South Atlantic	0.88	<.0001	0.87	0.89
Division 6: East South Central	0.83	<.0001	0.82	0.85
Division 7: West South Central	0.67	<.0001	0.66	0.68
Division 8: Mountain	0.92	<.0001	0.91	0.93
Division 9: Pacific	0.89	<.0001	0.88	0.90

Source: GAO analysis of Labor and IRS data.

Note: "Ref." denotes a reference (or an omitted) category.

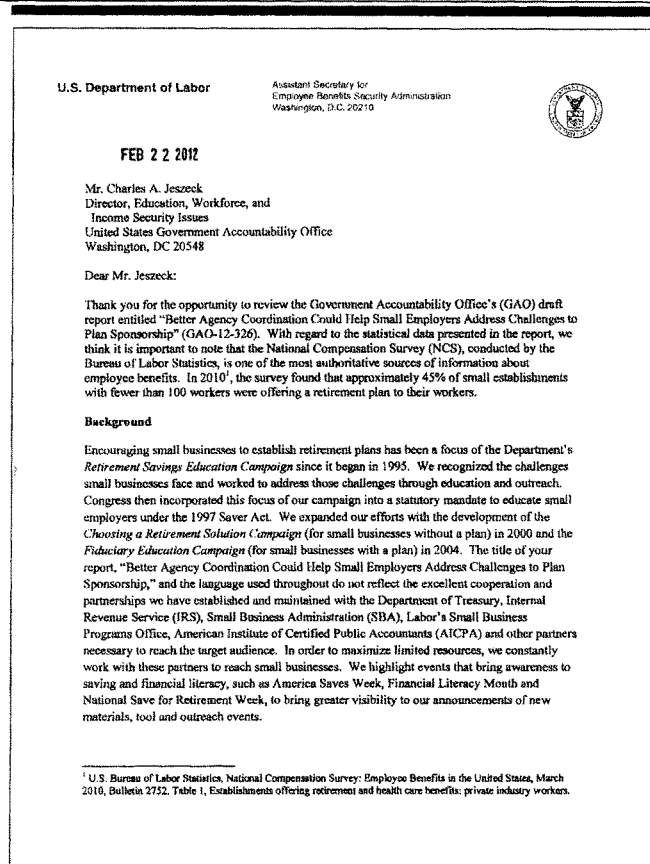
Appendix VI: Regression Results

Table 6: Results of Block Test

	-2*Log-likelihood	Model explanatory power (Pseudo-R2)	Contribution of block (percent)
Intercept only	4,280,669.8		
Full model	3,190,599.3	0.34	
Models with one block deleted			
Size	3,656,960.9	0.17	14.62
Average wage	3,507,782.2	0.22	9.94
Industry classification (NAICS)	3,316,274.3	0.29	3.94
Geographic location	3,214,590.3	0.33	0.75

Source: GAO analysis of Labor and IRS data.

Appendix VII: Comments from the Department of Labor



Appendix VII: Comments from the Department
of Labor

We began our campaign focusing on small businesses by partnering with the SBA and the U.S. Chamber of Commerce to target those businesses. When we began receiving feedback from the small businesses that they looked to their accountants for help in determining if they should offer plans, what type of plans to offer, and for assistance in setting them up, we initiated a partnership with the AICPA to educate their members about the retirement plan options for small businesses. Members of the AICPA joined the local workshops we conduct in coordination with the IRS and helped promote the events and our materials. A successful example of our collaboration is a video developed with members of the AICPA, some of their small business clients, and the employees of these businesses, who talk about their experience in selecting various plan types and provide the peer perspective.

Additionally, we developed and launched an interactive website, <http://www.choosingaretirementsolution.org/>, in conjunction with the AICPA that helps small employers determine which plan options may be appropriate for them. The user answers a few questions about their situation (such as how many employees they have, whether they want to make contributions, and/or want their employees to contribute, etc.) and then it provides those plan options that are most suitable for their needs. It then provides links to more detailed information on each of those options. The site contains a chart comparing key features of all options available. We received so much demand for a print version of this chart that we included it in our *Choosing a Retirement Solution* publication.

EBSA continues its efforts to expand these campaigns and provide comprehensive and current materials in a variety of formats. Together with the IRS and Treasury, we developed a series of publications and educational materials geared to small businesses that describe all of the plan options available to small businesses and the highlights of each option. We provide workshops and webcasts on this topic in conjunction with the IRS and work with the SBA to make our information and upcoming events available to the intended audience. The SBA promotes all of our events through web postings, blast emails, tweets, blogs, and promotion through their regional offices including regional newsletters. We also contribute a column for IRS' monthly electronic newsletter for small businesses that provides updates on new guidance, web tools, and upcoming seminars and workshops.

We also conduct annual webcasts to reach the small business audience we cannot reach in person at our workshops due to limited resources. On these webcasts we are joined by the IRS and AICPA as well as The Electronic Payment Association (NACHA) who discusses how direct deposit will make it possible to save for retirement. We work closely with the SBA, DOL's Small Business Programs Office and local chambers of commerce along with state CPA societies, local Society for Human Resource Management chapters and other organizations to promote the webcasts and workshops. We have partnered with the Consumer Federation of America to help highlight small business retirement solutions as part of America Saves Week.

Finally, our *Fiduciary Education Campaign* assists small businesses once they have established a retirement plan and is intended to increase awareness and understanding of the basic fiduciary responsibilities related to operating a retirement plan. The issues addressed cover the key responsibilities for the plan, including those that the small business owner is responsible for, and mistakes we frequently see in our enforcement efforts that can be avoided if aware of the

 Appendix VII: Comments from the Department of Labor

responsibilities. Once again, we developed publications in conjunction with the IRS and conduct full day seminars with the IRS to discuss the key areas of the law and both agencies' voluntary correction programs. Annually, we also conduct a two part webcast series with the IRS.

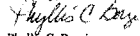
Recommendations

With regard to your recommendation to convene an interagency taskforce with representatives from Treasury, IRS and SBA and other agencies deemed appropriate to review, analyze and address the challenges facing small business retirement security in the United States, we believe the partnerships highlighted above have made significant progress towards educating and encouraging small business owners to offer a retirement plan to their employees and providing assistance to them once they do offer a plan. We are committed to continuing our coordination with the named agencies with respect to plan research and proposals for mitigating barriers to small employer retirement plan sponsorship. However, we do not believe a new web portal focusing on the narrow issue of retirement plans for small business owners is necessary especially in light of the Administration's desire to consolidate web portals and eliminate redundancy. As mentioned above we have launched an interactive website <http://www.choosinyourretirementsolution.org/>, and there is already a site that serves the small business audience, www.business.gov, maintained by the SBA. It is currently the central portal for small businesses to obtain information on a wide variety of issues of interest to small businesses and where small businesses are likely to go for information. The site also attracts service providers to small businesses looking to assist their clients. For years we have posted information on this website and will work with the SBA to ensure that all education and outreach materials developed for small business owners about retirement plan options, fiduciary responsibilities, and self-correction programs by the IRS and EBSA is posted on this site and organized in a user-friendly manner.

For the information we post on our website, we intentionally try not to overwhelm small businesses with a long list of links which make establishing and operating a plan seem too complicated. Rather, we have worked with the IRS to develop publications that provide simple overviews of the law (IRC and ERISA) with a list of resources for more information. On our website we link to the IRS materials included in the resources section of the publications so that a small business owner who is interested in finding out more information has easy access to it. We want to provide information in manageable portions since establishing and operating a plan is voluntary. We have also developed tools, such as tips, a video, and an interactive website, to help small business owners follow through on these actions. The tools have received very positive feedback.

Again, thank you for the opportunity to review the draft report and provide comments. Should you or your staff have any questions concerning the statements included herein, please do not hesitate to contact us.

Sincerely,



Phyllis C. Borzi
Assistant Secretary

Appendix VIII: GAO Contact and Staff Acknowledgments

GAO Contact

Charles Jeszeck, (202) 512-7215 or jeszeckc@gao.gov

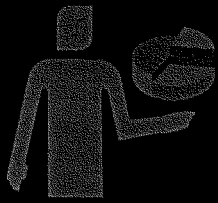
Staff Acknowledgments

In addition to the contact named above, individuals making key contributions to this report include David Lehrer, Assistant Director; Edward Bodine, Analyst-in-Charge; Curtis Agor; Kun-Fang Lee; and David Reed. Susan Aschoff, Susan Baker, James Bennett, Sarah Cornetto, Cynthia Grant, Catherine Hurley, Anna Kelley, Gene Kuehneman, Karen O'Connor, Dae Park, Aron Szapiro, Frank Todisco, James Ungvarsky, and Walter Vance also provided valuable assistance. SOI (IRS) provided valuable assistance in extracting small employer data from the CDW.

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LEVERAGING MULTIPLE SMALL EMPLOYER PLANS

to close the Retirement Coverage Gap

John J. Kalamarides
Senior Vice President,
Institutional Investment Solutions

Closing the Retirement Coverage Gap

Market turbulence has undeniably demonstrated the need for greater retirement security. As a result of nearly unprecedented market volatility, many American workers are facing the stark reality of having to work longer, attempting to re-enter the workforce after retiring, or accepting decreased standards of living in retirement. In short, change is needed.

Debates about how to fix or enhance workplace retirement plans abound. But there is a more critical, albeit less reported, issue facing 78 million Americans: a lack of access to a workplace retirement savings plan.¹ This is even greater than the number of Americans who lack health care coverage, an issue that has consumed resources in Washington of late.

There is no one solution that will completely solve this country's retirement coverage gap. But we believe there are several prominent ideas, including the recently proposed Automatic Individual Retirement Account (IRA), which together could help us take a significant step forward. This paper presents another idea, the Multiple Small Employer Plan (MSEP). We believe the MSEP should be offered as a complementary alternative to the Automatic IRA, allowing small employers to choose the appropriate option for their workforce.

MSEPs are designed to address concerns about costs and administrative burden—the two issues most cited by small employers that discourage them from offering a retirement plan. By allowing employers with fewer than 100 employees to pool their resources under a single plan, MSEPs could provide lower costs and simplified administrative requirements to sponsors. Participants would likewise benefit from cost savings via access to institutionally priced investments, as opposed to the retail offerings available in IRAs.

MSEPs also offer many of the best features of traditional defined contribution plans, including:


- Mandatory automatic enrollment, contribution escalation and default investments into a Qualified Default Investment Alternative.
- Streamlined administration through standardized plan design and reporting.
- A named fiduciary for each plan to ensure it is managed in the best interest of its participants.

The pooling aspect of MSEPs would play a critical role in drawing existing recordkeepers and plan providers to the small end of the market, which they previously may have found uneconomical to serve. With this market generating \$1.4 trillion in annual payroll,² the ability to serve it profitably could attract a significant number of plan providers.

In turn, small employers would be able to select the retirement offering and provider best suited to their employees. Participants would benefit from the price pressure that competition brings. And, perhaps most importantly, millions of Americans would finally receive access to a qualified workplace retirement plan.

Similar to the Automatic IRA, MSEPs require legislation to accelerate meaningful adoption. However, the urgent need to help close the coverage gap in this country demands action. We applaud Representatives Ron Kind and Dave Reichert for recently reintroducing the Small Businesses Add Value for Employees (SAVE) Act and leading the charge in these efforts. Now is the time to help restore Americans' faith in the U.S. retirement system—and that begins with access.

Respectfully,



John J. Kalamarides
Senior Vice President, Institutional Investment Solutions
Prudential Retirement

¹Employee Benefit Research Institute, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010", Issue Brief No. 363, October 2011, p. 9.

²U.S. Census Bureau, "Statistics of U.S. Businesses" 2009 data. Calculation based on employers with less than 100 employees.

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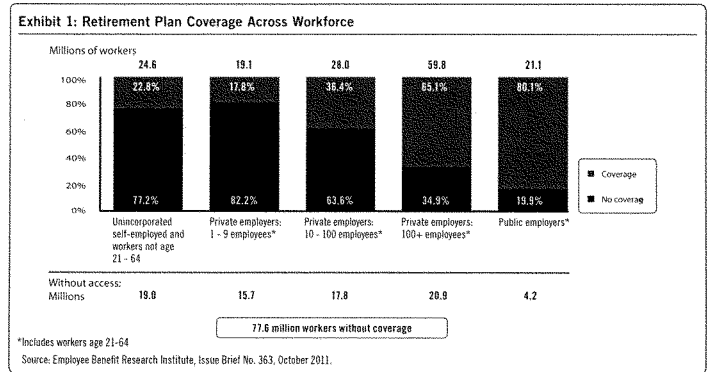


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Introduction

Conversations about how to bolster Americans' retirement security often focus on the need to encourage individuals to save more within workplace retirement plans, such as 401(k)s or other defined contribution (DC) plans. However, a more basic problem confronts the 51% of workers, or 78 million individuals, who have no access at all to a workplace-based retirement plan.¹ This "coverage gap" is preventing nearly half the American workforce from beginning to systematically save and invest for retirement. According to a recent survey, 58% of workers who do not participate in a retirement savings plan at work have saved less than \$10,000,² significantly lower than the average DC account balance of \$59,000,³ which itself is inadequate. Left unaddressed, the coverage gap will result in many individuals entering retirement with insufficient savings to sustain their pre-retirement standard of living.

The lack of access to a workplace retirement plan is most acute among smaller employers, as shown in Exhibit 1. Two-thirds of workers who work for private employers with more than 100 employees have access to a workplace retirement plan, compared to only 36% of those who work for employers with 10 - 100 employees, and 18% of those who work for employers with fewer than 10 employees. Moreover, because the average employee of an employer with fewer than 100 employees earns 25% less than the average employee of an employer with 500 or more employees,⁴ a disproportionate number of lower-paid Americans lack access to a workplace retirement plan. This is demonstrated by a Government Accountability Office (GAO) study that indicates that 62% of the lowest earning quartile of workers lack access to a workplace plan,⁵ as compared to the 51% that lack access across the entire working population.



¹ Employee Benefit Research Institute, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010," Issue Brief No. 363, October 2011, p. 9.
² Employee Benefit Research Institute, "2011 Retirement Confidence Survey Fact Sheet #2," March 2011, p. 4.
³ As of December 31, 2009. Employee Benefit Research Institute, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009," Issue Brief No. 350, November 2010, p. 11.
⁴ U.S. Census Bureau, "Statistics of U.S. Businesses." Calculation based on employers with less than 100 employees compared to those with 500 or more employees; 2009 data.
⁵ U.S. Government Accounting Office, "Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges," October 2009, p. 5.

Many small employers are reluctant to offer retirement plans because of concerns about cost and administrative overhead.⁶ The purpose of this white paper is to introduce a new solution, the Multiple Small Employer Plan (MSEP), which addresses these concerns to help close the coverage gap. The MSEP is based on a proposed set of enhancements to today's multiple employer plans (MEPs); MEPs enable groups of employers to join a single DC plan sponsored by an affinity group or similar organization. Although today's MEPs partially address the needs of small employers, further enhancements are needed to accelerate the adoption of qualified retirement plans across small employers.

The MSEP builds on today's MEPs by simplifying and strengthening these plans to better address the needs of small employers and their employees. This new solution is intended for employers with no more than 100 employees, who collectively generate \$1.4 trillion in annual payroll⁷ and employ 47 million workers—of which more than 30 million lack access to a workplace retirement plan.⁸

The MSEP will open up new markets for financial services firms and DC recordkeepers, allowing them to utilize their existing investment platforms and retirement products to serve small employers. The pooling aspect of MSEPs may also attract new providers who previously found the smallest end of the market uneconomical to serve. As a result, the MSEP has the potential to significantly increase the number of retirement plan providers available to small employers.

The remainder of this paper explores the retirement plan objectives of small employers, describes how the MSEP can fulfill these objectives to help close the coverage gap, and details legislative and regulatory actions that can facilitate the adoption of MSEPs.

⁶ SunTrust, "SunTrust Small Business Owners 401(k) Survey," 2009, p. 29.

⁷ U.S. Census Bureau, "Statistics of U.S. Businesses," 2009 data. Within this population, the MSEP is targeted for employees who have received at least \$5,000 in compensation from their employer in the previous year.

⁸ Employee Benefit Research Institute, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010," Issue Brief No. 363, October 2011, p. 12.

Understanding Small Employers' Retirement Plan Objectives

Today, small employers who would like to provide their employees with a retirement offering must choose between a 401(k) or similar plan and Individual Retirement Account (IRA)-based offerings. 401(k) plans can be heavily customized and usually provide access to institutionally priced, professionally managed investment products. However, these plans typically require substantial employer resources to administer and manage. IRA-based offerings are self-directed accounts that generally have lower employee contribution limits, are less customizable and have higher investment fees than 401(k)s or similar plans.

These options force small employers to choose between plans that meet their needs but may be costly and hard to manage, and offerings that do not have all the capabilities they seek. Ideally, retirement plans would enable these employers to fulfill three primary objectives:

- **Reduce costs and administrative burden.** Most small employers do not have the time and resources to manage a complex retirement plan. A survey of small employers indicated that the most common reasons for not offering a retirement plan were concerns about cost (54%) and administrative overhead (43%).⁹

- **Provide better retirement outcomes for employees.** A recent survey indicated that 87% of small business owners agree that planning for retirement is an important issue for their employees.¹⁰

Workplace retirement plans help employees in achieving retirement security by encouraging them to begin saving for retirement in a cost-effective vehicle, offering access to diverse investments and providing investor education.

- **Compete with larger companies for talent.** Small employers compete for talented employees with organizations of all sizes. Ninety percent of employees working for small employers consider a 401(k) or other employee self-funded plan to be an important benefit,¹¹ and 43% strongly agree that benefits are a very important reason why they remain with their employers.¹²

⁹ SunTrust, "SunTrust Small Business Owners 401(k) Survey," 2009, p. 29.

¹⁰ SunTrust, "SunTrust Small Business Owners 401(k) Survey," 2009, p. 15.

¹¹ Transamerica Center for Retirement Studies, "10th Annual Transamerica Retirement Survey: Employers—Strengthening Retirement Savings in a Weak Economy," April 14, 2009, p. 17.

¹² MetLife, "Building a Better Benefits Program Without Breaking the Budget," 2010, p. 3.

New Options Are Needed to Meet the Needs of Small Employers

An MEP is a qualified retirement plan in which two or more unrelated employers join together under a single plan. MEPs may be sponsored by an affinity group, trade association or geographic organization. A participating employer or another fiduciary chooses a plan provider, selects an investment menu, and bears many of the same responsibilities that they would if offering a traditional 401(k) plan. As a result, today's MEPs place a significant burden on participating employers and other fiduciaries, and have been used infrequently to date.

MEPs can be enhanced to better meet the needs of small employers. The proposed MSEP is based on a modified version of the Savings Incentive Match Plan for Employees (SIMPLE) 401(k) plan structure.

The following are the key features and terms of the MSEP.

From the employer's perspective:

- Available only to participating employers with no more than 100 employees; more than one employer can participate in the plan.
- Each plan has a named fiduciary.
- No employer contributions required or permitted.
- Simpler plan design through required use of an Internal Revenue Service (IRS) model document.
- Non-discrimination testing not required.
- Simpler annual reporting, participant disclosure, and participant reporting through regulations to be issued by the U.S. Department of Labor (DOL).
- Investor education (e.g., asset allocation guidance, online calculators and educational brochures) may be provided in ways that are cost-effective and convenient for participants (e.g., e-delivery).
- Contributions for participants may default into a Qualified Default Investment Alternative (QDIA). QDIA fiduciary protections are available for contributions invested in a QDIA.

From the employee's perspective:

- Contributions made solely via employee salary deferral.
- Employees must have received at least \$5,000 in compensation from their employer in the prior year to participate.
- \$10,000 annual contribution limit, with adjustments by the IRS to reflect cost-of-living changes. No catch-up contributions permitted.
- Automatic enrollment of participants and automatic escalation of contributions.
- Contributions can be rolled into an IRA or other qualified retirement plan upon separation from employer.
- Participant loans are not permitted. Participant hardship distributions are limited to those falling under existing IRS safe harbor hardship standards.

Exhibit 2 provides additional details on the MSEP structure.

Exhibit 2: Overview of the Proposed Multiple Small Employer Plan (MSEP)

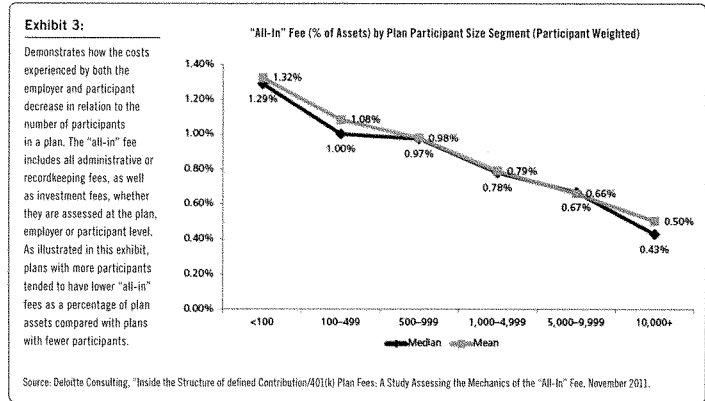
Segment served	<ul style="list-style-type: none"> • Small employers with no more than 100 employees
Plan structure	<ul style="list-style-type: none"> • Formed by affinity groups, trade organizations, or other organizations to group multiple employers • Established as a centrally administered trust with one plan provider to serve all participating employers • Named fiduciary will have full responsibility for the plan
Features	<ul style="list-style-type: none"> • Funded by employees only, with no matching employer contributions • Contribution limit of \$10,000 in 2012, with annual cost-of-living adjustments as determined by the IRS • No catch-up contributions • Automatic enrollment starts at a 3% contribution level, with auto-escalation up to 6% of salary; employees can opt out • No participant loans permitted • Hardship withdrawals permitted only under IRS safe harbor conditions • Can be rolled into an IRA or other qualified retirement plan upon separation from employer
Investment options and pricing	<ul style="list-style-type: none"> • Contributions for new participants can be defaulted into a QDIA that is a principal preservation product • After four years, contributions can be defaulted to another QDIA, such as a target-date fund • Low investment fees (e.g., may qualify for institutional pricing) • Greater possibilities for investor education (e.g., asset allocation guidance, online calculators, educational brochures)
Fiduciary and administrative responsibilities	<ul style="list-style-type: none"> • QDIA fiduciary protections are available for contributions invested in a QDIA • Non-discrimination reporting is not required • Simpler annual reporting, participant disclosure and participant reporting through guidance to be issued by the DOL • Plan document based on IRS model, providing MSEP sponsors with a roadmap for plan design and implementation • New IRS regulations that would permit overall plans to remain "qualified" even if qualification violations by one or more participating employers takes place
Costs	<ul style="list-style-type: none"> • No employer contributions • Low administrative costs due to economies of scale and simplified plan design

The MSEP helps fulfill the primary objectives of small employers:

- Reduce costs and administrative burden.** The MSEP eliminates the time-consuming administrative features of traditional 401(k) plans, such as participant loans and employer contributions. Administrative costs to the employer are further minimized because employers benefit from the economies of scale achieved by joining a single, larger plan instead of managing their own plan. Benefit funding costs are eliminated because employer contributions are not required or permitted. In addition, the cost to plan participants, attributable to investment and administrative expenses, is reduced through the pooling of assets with other employers; reductions that, in turn, result in greater retirement savings.
- Provide better retirement outcomes for employees.** The MSEP helps workers prepare for a more secure retirement in three ways. First, the MSEP encourages savings through automatic enrollment and automatic contribution escalation. Second, the MSEP helps to encourage appropriate investment behavior by providing a choice of investment defaults. Contributions for new participants can be defaulted into a QDIA that is

a principal preservation product, such as a stable value fund; after four years, contributions can be defaulted into another QDIA, such as a target-date fund. This approach helps to manage market fluctuations in newer participants' account values, which may motivate these individuals to continue participating. QDIA fiduciary protections are also available for contributions invested in a QDIA. In addition, with the advantage of pooled resources, MSEPs have greater possibilities to provide investor education in cost-effective ways that are convenient to participants. Finally, MSEPs are portable, meaning that employees are able to roll their accounts into an IRA or other qualified retirement plan upon separation from their employer.

- Compete with larger companies for talent.** The MSEP enables small employers to offer their employees a tax-advantaged way to save for retirement. These qualified plans would include many of the same features found in 401(k) plans offered by larger employers, such as default investments, automatic enrollment and contribution escalation, and, most likely, investor education. The pooling aspect of MSEPs could also enable smaller employers to offer their employees access to institutionally priced investment products.



Multiple Small Employer Plans: An Innovative Solution

The MSEP is being introduced to enable small employers to offer their employees a qualified retirement plan that has many of the advantages of a traditional 401(k) plan, but that is substantially easier and less expensive to implement and maintain. In order to assess whether the MSEP achieves this goal, this section compares the MSEP to the other retirement offerings available to small employers, namely IRA-based offerings, such as the SIMPLE IRA and the Simplified Employee Pension (SEP) IRA, 401(k)s and similar plans.

This comparison also includes the Automatic IRA, a recent proposal which would enable employees at small employers to contribute to IRA accounts through automatic payroll deductions.

Exhibit 4 compares the full range of small employer retirement offerings from an employee's perspective.

Exhibit 4: Comparison of Retirement Plan Offerings from an Employee's Perspective

	IRA-based		Multiple Small Employer Plan (proposed)	401(k)-based	
	Automatic IRA (proposed)	SIMPLE IRA and SEP IRA		SIMPLE 401(k) Plan	Traditional 401(k) Plan
Plan Setup					
Plan structure	• Not a plan; employer acts as forwarding agent	• Employer-sponsored, IRA-based design	• Employers join MSEP sponsor's plan	• Employers are the plan sponsors	• Employers are the plan sponsors
Contributions and Savings					
Source of funding	• Employee only	• SIMPLE IRA: employee and employer • SEP IRA: employer only	• Employee only	• Employee and employer	• Employee; employer optional
Employee contribution limit (2012)	• \$5,000, with catch-up of \$1,000	• SIMPLE IRA: \$11,500, with catch-up of \$2,500 • SEP IRA: not applicable	• \$10,000, with no catch-up	• \$11,500, with catch-up of \$2,500	• \$17,000, with catch-up of \$5,500
Automatic enrollment and escalation	• Auto enrollment availability mandated; employee can opt out	• SIMPLE IRA: availability optional • SEP IRA: not applicable	• Auto enrollment and escalation availability mandated; employee can opt out	• Availability optional	• Availability optional
Loans/hardship withdrawals	• No	• No	• No participant loans • Hardship withdrawals permitted that meet safe harbor criteria	• Yes	• Yes
Investments and Fees					
Investment selection	• Wide selection driven by IRA provider; defaults to pre-determined selection	• Wide selection driven by IRA provider	• Allows defaults to principal preservation products and QDIAs	• Wide selection driven by employer; allows defaults to QDIAs	• Wide selection driven by employer; allows defaults to QDIAs
Investment management and administrative fees (to participant)	• Retail; some defaults may have institutional pricing • Administrative costs potentially high because of separately held accounts; participant may pay account fees	• Retail pricing • Administrative costs potentially high because of separately held accounts; participant may pay account fees	• May qualify for institutional pricing • Administrative costs low because of economies of scale and simplified structure	• May qualify for institutional pricing • Administrative costs moderate because of simplified structure, but possibly offset by lack of scale	• May qualify for institutional pricing • Administrative costs moderate because of economies of scale, but possibly offset by customized plan features

The MSEP includes many of the same features of more-sophisticated 401(k) plans, and helps put participants on the path to a secure retirement by:

- **Promoting savings.** Participants are encouraged to save within a MSEP up to the annual contribution limit of \$10,000. As shown in **Exhibit 4**, this level is higher than that of IRA-based plans and slightly lower than that of SIMPLE or traditional 401(k) plans. Furthermore, the MSEP mandates automatic enrollment and automatic contribution escalation. These features are only found in the 401(k) plans that voluntarily offer them. The Automatic IRA may include automatic enrollment, but not automatic escalation, as a mandatory feature. As with other plans that offer automatic features, participants in MSEPs will retain the ability to opt out if they so choose.
- **Encouraging appropriate investment behavior.** The MSEP adopts the best attributes of 401(k) plans, such as default investments and, most likely, investor education. These features help ensure employees are appropriately invested according to their risk tolerance and time horizon. Such features are typically unavailable in IRA-based plans, which often require employees to choose their own investments. Defaulting contributions for new participants into principal preservation products will ensure they are not exposed to fluctuations in account values, and will help motivate these participants to continue saving. In addition, MSEPs enable small employers to pool their resources, which increases the feasibility of delivering investor education in ways that are both cost-effective to plan sponsors and convenient to participants.

- **Reducing costs borne by the employee.** MSEPs enable small employers to pool their purchasing power to provide their employees access to the institutionally priced investment products that are available in some 401(k) plans.

Institutionally priced investment products are usually not available in SIMPLE 401(k) plans or IRA-based plans. In addition, employees can potentially benefit from lower administrative costs than 401(k) or IRA-based plans because of the economies of scale achieved by having multiple employers join a single plan.

Finally, as in other 401(k)-based plans, the MSEP provides participants with the protection of a named fiduciary to ensure that the plan is implemented and managed with the participants' best interests in mind.

Exhibit 5 compares the retirement offerings from an employer's perspective.

Exhibit 5: Comparison of Retirement Plan Offerings from an Employer's Perspective

	IRA-based		401(k)-based		
	Automatic IRA (proposed)	SIMPLE IRA and SEP IRA	Multiple Small Employer Plan (proposed)	SIMPLE 401(k) Plan	Traditional 401(k) Plan
Resources Required					
Administrative responsibilities	<ul style="list-style-type: none"> Minimal No annual return (Form 5500) No non-discrimination testing No loans No hardship withdrawals 	<ul style="list-style-type: none"> Minimal No annual return No non-discrimination testing No loans No hardship withdrawals 	<ul style="list-style-type: none"> Minimal Simplified annual reporting No non-discrimination testing No loans Hardship withdrawals permitted that meet safe harbor criteria 	<ul style="list-style-type: none"> Minimal/moderate Annual reporting No non-discrimination testing Loans Hardship withdrawals 	<ul style="list-style-type: none"> Moderate Annual reporting Non-discrimination testing Loans Hardship withdrawals
Administrative costs	<ul style="list-style-type: none"> Low 	<ul style="list-style-type: none"> Low 	<ul style="list-style-type: none"> Low/moderate Economies of scale for multiple employers 	<ul style="list-style-type: none"> Moderate 	<ul style="list-style-type: none"> Moderate/high Economies of scale for large employers
Fiduciary responsibilities	<ul style="list-style-type: none"> Limited 	<ul style="list-style-type: none"> Limited 	<ul style="list-style-type: none"> Moderate MSEP sponsor responsible for choosing and monitoring provider and its services, fees and investment options Employer not responsible for other participating employers Model plan documents provide a roadmap for plan design and implementation 	<ul style="list-style-type: none"> Moderate/high Employer responsible for investment selection, including defaults, and choosing and monitoring provider 	<ul style="list-style-type: none"> Moderate/high Employer responsible for investment selection, including defaults, and choosing and monitoring provider
Funding costs	<ul style="list-style-type: none"> No employer contributions 	<ul style="list-style-type: none"> Mandatory employer contributions 	<ul style="list-style-type: none"> No employer contributions 	<ul style="list-style-type: none"> Mandatory employer contributions 	<ul style="list-style-type: none"> Optional employer contributions

The MSEP achieves the goal of providing employers with a qualified retirement plan option that is relatively easy to implement and maintain through:

- **Streamlined plan administration.** MSEPs do not require non-discrimination testing or the maintenance of vesting schedules because employer contributions are not permitted, and automatic enrollment and automatic contribution escalation are mandated. Plan administration is further streamlined by eliminating participant loans and only allowing hardship withdrawals that meet safe harbor criteria. These features frequently consume significant resources for employers who offer 401(k) plans. The MSEP will still require some annual reporting for each participating employer; however, the reporting will be streamlined as compared to traditional and SIMPLE 401(k) plans. All other reporting and administrative requirements are similar to those of IRA-based plans.
- **Lower costs.** Economies of scale are achieved by having many employers pool their resources in one plan. As a result, the administrative costs for employers participating in a MSEP are expected to be slightly higher than an IRA-based plan, lower than a SIMPLE 401(k) plan, and substantially lower than a traditional 401(k) plan. Employer costs are further minimized through the elimination of employer contributions.

- **Simplified fiduciary responsibility.** Each MSEP will require a named fiduciary, similar to other 401(k) plans. However, the DOL is being asked to issue guidance clarifying that fiduciary responsibilities are limited to prudently selecting and monitoring a MSEP provider and its services, fees and investment options. As a result, employers participating in MSEPs will have greater certainty about their fiduciary responsibilities than they would if they offered a traditional or SIMPLE 401(k) plan.

The MSEP will provide employers with 100 or fewer employees with a new and compelling option for inexpensively and easily offering a robust retirement plan that is comparable to the plans offered by much larger employers.

Facilitating Adoption Through Legislative and Regulatory Actions

More than 75% of adults say that helping people save for retirement should be a high-priority issue for Congress and the President.¹³ Current regulations already provide a framework for the MSEP. However, additional legislation that directs regulatory actions by the DOL and IRS is necessary to support the formation of the MSEP and its adoption by small employers. Exhibit 6 outlines these legislative and regulatory actions.

Exhibit 6: Legislative and Regulatory Actions Necessary to Establish the MSEP

	Current MEP	Proposed Legislation to Effect Regulatory Changes
Plan design	Plan sponsor is required to make plan design decisions regarding contribution types and levels, plan features (e.g., participant loans and hardship distributions), and choice of plan document	Minimize plan design decisions by requiring automatic enrollment and escalation, requiring use of a model plan document developed by the IRS, and prohibiting participant loans, hardship distributions (other than those made under an existing IRS safe harbor), employer contributions and employee catch-up contributions
Administrative responsibilities	Plan administrator is required to file full annual return (Form 5500), distribute a detailed summary plan description and provide quarterly participant statements	Direct the DOL to issue regulations providing simplified alternatives for MSEP plan administrators to satisfy their duties to file an annual return and provide summary plan descriptions and participant statements
Fiduciary risks	Plan fiduciary bears fiduciary responsibility for selection of MEP provider, plan investment options, and investments when a participant provides no investment direction	Direct the DOL to clarify the nature of fiduciary responsibilities of participating employers and other designated fiduciaries. Direct the DOL to amend the QDIA regulations to include principal preservation products for the first four years of plan participation
Tax risks	Noncompliance by a single participating employer potentially jeopardizes tax-exempt status of entire plan, with loss of tax benefits by other participating employers and their employees	Direct the IRS to issue regulations that insulate compliant participating employers and their employees from harmful effects of noncompliance by other employers

¹³ AARP Knowledge Management, "Opinion Research on Retirement Security and the Automatic IRA," September 30, 2009, p.2.

Conclusion

The fact that nearly one-half of the U.S. workforce lacks access to a workplace retirement plan is a major deficiency in today's retirement system that should be quickly addressed. The MSEP is an innovative solution to increase retirement coverage across more than 30 million individuals working for small employers that do not offer a retirement plan today.¹⁴

By providing an opportunity to utilize the existing capabilities of established financial services organizations and recordkeepers, the MSEP will attract many of these firms to the small end of the market. Providers will benefit from access to new markets, while small employers and their employees will benefit from expanded choice and access to new solutions. The ability to offer a qualified retirement plan will help strengthen small employers, and enhance their employee value propositions.

Most importantly, the MSEP will provide individuals who lack access to a workplace retirement plan with the opportunity to participate in an offering with many of the features and advantages of today's best designed retirement plans.

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¹⁴ Employee Benefit Research Institute, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010," Issue Brief No. 363, October 2011, p. 12.



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**WRITTEN TESTIMONY FOR THE RECORD
OF PATRICIA THOMPSON, CPA
ON BEHALF OF THE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
1455 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20004-1081**

SPECIAL COMMITTEE ON AGING

U.S. SENATE

HEARING ON

**OPPORTUNITIES FOR SAVINGS: REMOVING OBSTACLES FOR
SMALL BUSINESSES**

MARCH 7, 2012 AT 2:00 P.M.

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
WRITTEN TESTIMONY FOR THE RECORD
SPECIAL COMMITTEE ON AGING
U.S. SENATE**

HEARING ON MARCH 7, 2012

The American Institute of Certified Public Accountants ("AICPA") would like to thank Chairman Kohl, Ranking Member Corker and Members of the Committee for the opportunity to submit this statement for the record of the hearing on Opportunities for Savings: Removing Obstacles for Small Businesses, held on March 7, 2012. I am Patricia Thompson, Chair of the AICPA's Tax Executive Committee; and a partner with Piccerelli, Gilstein & Company, LLP, located in Providence, Rhode Island.

The AICPA is the national professional association of certified public accountants comprised of approximately 377,000 members. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate the Committee's efforts to promote retirement savings and provide small businesses an opportunity to set up and maintain retirement plans for their owners and employees. Our remarks, which are supportive of this objective, focus on tax and simplification issues impacting many small businesses, specifically: (1) the various types of retirement plan options; (2) top-heavy provisions; and (3) vesting upon partial plan terminations.

Retirement Plan Options

Current Law: The Internal Revenue Code provides for more than a dozen tax-favored employer-sponsored retirement planning vehicles,¹ each subject to different rules pertaining to plan documents, eligibility, contribution limits, tax treatment of contributions and distributions, the availability of loans, portability, nondiscrimination, reporting and disclosure. Although some consolidation of the rules governing these options has been introduced in recent years, further simplification of the confusing array of retirement savings options should be undertaken.

Reasons for the change: When a small business grows and begins to explore options for establishing a retirement plan, the alternatives, and the various rules, can become overwhelming. There are too many options that businesses need to consider before deciding which plan is appropriate for them. Some plans are only available to employers with a certain number of employees, whereas other plans require mandatory contributions or create significant administrative burdens. Such administrative burdens include annual return filings,

¹ Currently the following plans are representative of the variety that may be sponsored by an employer: simplified employee pension (SEP), salary reduction SEP, savings incentive match plan for employees of small employers (SIMPLE), SIMPLE-401(k), profit sharing, money purchase pension, 401(k), 403(b), 457, target benefit, defined benefit, cash balance and the new defined benefit / 401(k) combination created in the Pension Protection Act of 2006 (Pub. L. 109-280).

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discrimination testing, and an extensive list of notice requirements with associated penalties for failures and delays in distributing such notices to employees.

To determine which plan is right for their business, owners must consider their cash flow, projected profitability, anticipated growth of the work force, and expectations by their employees and co-owners. The choices are overwhelming, and many are too complex or expensive for small business owners.

Proposal: We recommend that the multiple types of tax-favored retirement plans currently available and the many rules governing such plans be consolidated and simplified to minimize the cost and administrative burden for employers.

Top-Heavy Provisions

Current Law: The top-heavy rules were enacted under the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), and subsequently amended, to protect employees when an employer offers a retirement plan which primarily benefits its "key employees."² Section 416³ imposes a minimum vesting period of either 6-year graded or 3-year cliff and requires a minimum contribution of generally 3% for "top-heavy" plans. Retirement plans are considered top-heavy for a year, and therefore subject to the above rules, if the aggregate value of the key employees' accounts exceeds 60% of the aggregate value of all of the employees' accounts under the plan.⁴

Reasons for the change: Based on our members' experiences, the imposition of the top-heavy rules for retirement plans is causing some employers to (1) cease employer contributions to their plan, (2) terminate existing plans, or (3) not adopt a plan at all to cover their employees. This is primarily an issue with small and family-owned businesses sponsoring a 401(k) plan which consists of employee deferrals only, or employee deferrals and employer matching contributions.

Many small business retirement plans inevitably become subject to the top-heavy provisions for two reasons. First, most small businesses are owned by family members or a close group of individuals. Due to this type of ownership, it is common that the owners remain relatively static over the life of the business. As such, there is frequently very low or no turnover of its key employees. Second, in today's work environment, employee turnover is commonplace. It is not unreasonable for employees to change jobs multiple times over their working careers as personal goals change, their skills improve, or they move geographically. Due to the static ownership of small businesses and the increasingly transitory employee base, it is becoming a certainty that most retirement plans sponsored by small businesses will become top-heavy at some point during the life of the plan.

² Generally, a key employee is defined as an officer with compensation in excess of \$130,000 (indexed annually), a 5%-or-more owner, or a 1%-or-more owner with compensation in excess of \$150,000. IRC section 416(i)(1)(A).

³ Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended (the "Code"), and to the treasury regulations (the "Regulations" or "Reg.") promulgated pursuant to the Code.

⁴ IRC section 416(g)(1)(A)(ii).

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Some small businesses can satisfy the top-heavy requirements. The businesses adopt provisions for their retirement plans to meet safe-harbor designs, such that they either provide for a matching contribution that rises to a statutory level (i.e., 4% for a 401(k) plan) or they provide for a non-elective contribution of at least a statutory rate (i.e., 3% for a 401(k) plan).

Unfortunately, many small businesses cannot afford to meet the strict contribution requirements imposed by the top-heavy rules. Their profitability margins and financial situation are such that these contribution levels cannot be attained. During the recent economic downturn, retirement plan contributions – specifically matching contributions – were an issue for many employers. Many employers which were able to satisfy the safe harbor requirements in the past, were no longer able to continue making the same contributions. In too many cases, top-heavy rules become a financial burden by imposing an employer contribution for deferral only plans – where there was never intent for an employer contribution, or by requiring an additional contribution of 3% on top of the matching contribution the employer previously determined as being affordable to their budgetary and cash-flow constraints. As a result, the employers terminate the plan, which significantly diminishes the ability of their employees to save for retirement.

Prior to the top-heavy provisions, some employers terminated employees prior to vesting in order to use the forfeited dollars to reduce their contributions to the plan for current and future years. However, at the time these rules were passed, vesting schedules were 10-year cliff and 15-year graded. Employer plans are now subject to minimum vesting periods of either 3-year cliff or 6-year graded. The Pension Protection Act of 2006 changed the non-top-heavy defined contribution vesting schedule to generally coincide with the top-heavy schedule for contributions made after December 31, 2006. As a result, many defined contribution plans are unaffected by the top-heavy vesting requirements.

We recognize that the top-heavy rules were enacted to address the concern that employers will “churn” their employee base prior to the participants becoming fully vested. However, based on our members’ experiences, smaller employers suffering from these top-heavy rules employ moderate matching formulas – less than those offered in safe-harbor 401(k) designs. Their actual cost of hiring and training employees is much greater than any benefit they might gain from this practice.

Although employees who find themselves not covered under an employer-sponsored 401(k) plan could contribute to an individual retirement account (IRA), the AICPA thinks that an employer-provided retirement plan is a better option for employees. First, the employees can contribute a higher amount to a 401(k) plan – up to \$17,000 for 2012 (or \$22,500 for individuals age 50 or older) for pre-tax contributions compared to the contribution limit for IRAs of \$5,000 (or \$6,000 for individuals age 50 or older).⁵ Next, 401(k) plans generally offer access to more competitive investment alternatives than are accessible to an IRA investor. Finally, in an employer-

⁵ IR-2011-103, Oct. 20, 2011; Notice 2011-90.

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sponsored plan the employer often pays at least a portion of the fees and the employee is part of a larger group that is likely to be charged a lower fee.

The AICPA supports the protection of employees and their ability to save for retirement. However, the top-heavy rules have become unnecessary due to the enactment of other provisions which protect the interests of employees. For example, section 401(k) plans are generally subject to special discrimination rules (the average deferral percentage test and average contribution percentage test, commonly referred to as the ADP/ACP testing) designed to prevent highly compensated employees⁶ from receiving too much in contributions as compared to other employees.⁷ These plans are also subject to general nondiscrimination rules designed to prevent qualified plans from covering too many highly compensated employees as compared to non-highly compensated employees.⁸ As a result, the non-key employees are protected from employer discrimination regardless of whether the minimum contribution requirements for top-heavy plans are in effect.

Proposal: The AICPA recommends an exception from the top-heavy rules for certain defined contribution plans. We think that retirement plans which provide for employee deferrals only and plans which provide for employee deferrals and matching contributions should not be subject to the strict minimum contribution requirements as other top-heavy plans.

Vesting Upon Partial Plan Termination

Current Law: Section 411(d)(3) requires qualified retirement plans to provide for immediate 100% vesting upon a partial plan termination. In general, a partial plan termination may be deemed to have occurred when significant reductions in the workforce occur in a plan sponsor's business.

Reasons for the change: This section was added to the Code as part of the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"). At that time, most qualified retirement plans were primarily or entirely employer-funded, and permitted vesting schedules were much longer than schedules that exist today. In the 1970s work environment, the vesting rule was necessary to protect the workers' retirement balances.

However, the funding of retirement plans has changed significantly over the last forty years. In the present 401(k) environment, most, and sometimes all, retirement benefits are funded by employees' own contributions which are by law immediately 100% vested and not affected by the vesting rules. In addition, the maximum permitted vesting schedules have been greatly shortened. As a result, to the extent there are employer contributions in a retirement plan, most workers are partially or even fully vested by the time an issue of partial termination arises.

⁶ A highly compensated participant is, in general, a more-than-5% owner in the current or preceding plan year or any employee who in the prior plan year earned in excess of \$110,000 (indexed annually). IRC sections 401(k)(5) and 414(q).

⁷ IRC section 401(k)(3) and m(2).

⁸ IRC section 410(b).

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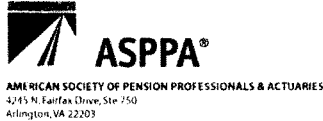
The immediate vesting rule unfairly punishes small businesses. It is not uncommon for all employers to face a certain amount of turnover in their employee population. Employees can change jobs multiple times over their working careers as personal goals change, their skills improve, or they move geographically. For some employers, their employee base is sufficiently large that their experience closely follows the statistical performance of the labor pool as a whole. However, for small businesses, normal turnover can inadvertently create problems with the partial termination rules.

Furthermore, employers have not been given a clear and specific definition of what constitutes a partial plan termination. Employers must instead attempt to apply a series of narrow IRS rulings to their own situation, often by retaining outside counsel. The resulting uncertainty and expense creates an additional administrative burden when small businesses may lack the time and resources to resolve such a legally ambiguous situation.

Proposal: We recommend an amendment to section 411(d)(3) to provide for an exception for "small plans" – under 25 participants – such that the partial termination rules do not apply.

* * * * *

We appreciate the Committee's efforts to promote retirement savings and are available to provide additional input on ways Congress can make further improvements in this area in general and with respect to small businesses.



American Society of Pension Professionals & Actuaries

**Statement for the Record
For the
Senate Special Committee on Aging Hearing on
“Opportunities for Savings:
Removing Obstacles for Small Business”**

**Held at 2:00 P.M. on
March 7, 2012**

The American Society of Pension Professionals & Actuaries (ASPPA) thanks the Senate Special Committee on Aging (the Committee) for holding a hearing on ways to improve retirement savings opportunities for small business. ASPPA is a national organization of more than 8,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants and attorneys, united by a common dedication to the employer-based retirement system. ASPPA is particularly focused on the issues faced by small- to medium-sized employers, and so is well-qualified to comment on the concerns addressed in this hearing.

There are two myths about small business and retirement savings plans that we would like to address up front:

Myth #1: Service providers are not interested in helping small business set up or operate a retirement plan.

Some providers that focus on the larger plan market may not be interested in small business retirement plans but for decades there have been service providers that make their living by focusing on the small plan market. The proof is in the more than 12 million American workers covered by over 621,000 small business-sponsored retirement plans.¹

Myth #2: It is cost prohibitive for a small business to sponsor a retirement plan.

Providers that focus on efficiently servicing small plans, coupled with dramatic improvements in technology, have made the small 401(k) plan market very competitive. As a result, a small

¹ U.S. Department of Labor, *Private Pension Plan Bulletin: Abstract of 2009 Form 5500 Annual Reports 5* (Dec. 2011), available at <http://www.dol.gov/ebsa/PDF/2009pensionplanbulletin.PDF> (reflecting the number of number of retirement plans and participants in those plans for plans with fewer than 100 participants in 2009).

business can set up and operate a 401(k) plan at a very modest cost. For example, one provider will set up a 401(k) plan for less than \$500, and will administer a plan with up to 10 employees for about \$100 per month, and with little effort required from the employer. The plan start-up credit of up to \$500 per year for three years makes the employer's out-of-pocket cost minimal. Asset charges of less than 1% are also typical for this provider. SIMPLE IRA plans are also available from many providers at very low administrative cost.

If the cost of plan setup and administration, and a lack of willing providers, is not the problem, what is the reason more small businesses do not sponsor retirement plans? In some cases, it is the *perception* that a retirement savings plan will be expensive and complicated to set up and operate, and that the small business owner is too busy with other matters to investigate low cost options. In other cases it is not the administrative cost, but the *contribution requirements* that make a plan too expensive for a small business that is already struggling to survive. As noted in the GAO report, there is also concern about the fiduciary responsibility that plan sponsorship entails.²

ASPPA supports efforts to expand sponsorship of workplace plans by removing real and perceived obstacles to plan sponsorship among small business owners, including the automatic payroll deduction IRA proposal developed by the Brookings-Heritage Foundation Retirement Security Project.³ Multiple employer plans (MEPs) have also recently been promoted as an approach that could address some small business concerns, and the Committee is to be commended for investigating how these arrangements could be helpful to efforts to expand small business coverage.

MEPs have been around for a very long time, usually sponsored by an association for members of that association. More recent activity has included the marketing of "open" MEPS – arrangements where the participating employers' only relationship may be the adoption of the same retirement plan, usually a defined contribution plan. MEPs are being promoted as a way to lower costs and reduce a plan sponsor's potential fiduciary exposure under the Employee Retirement Income Security Act of 1974, as amended (ERISA) by "outsourcing" responsibilities to the MEP sponsor. However, in her testimony, Assistant Secretary Borzi indicated concern about whether or not an "open" MEP is a single plan under ERISA.⁴ (There is no such confusion under the Internal Revenue Code.) Marketing materials from MEP promoters indicate there is also some confusion as to what fiduciary responsibilities are retained by an adopting employer, and what responsibilities fall on the MEP provider (or who that provider might be).

A lack of guidance from the Department of Labor (DOL) on defined contribution retirement plan MEPs has lead to inconsistent views on who can participate in a MEP and who is responsible for

² Statement of Charles A. Jeszeck, Director Education, Workforce, and Income Security, Government Accountability Office (GAO) to the House, Committee on Education and the Workforce, *Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship* 9-10 (Mar. 7, 2012), available at <http://gao.gov/assets/590/589109.pdf>.

³ J. Mark Iwry and David C. John, *Making Saving for Retirement Easier through Automatic IRAs*, Brookings Institute (Jun. 26, 2008), available at http://www.brookings.edu/testimony/2008/0626_ira_iwry.aspx.

⁴ Testimony of Phyllis C. Borzi, Assistant Secretary of Labor, Employee Benefits Security Administration, Before the Special Committee on Aging, United States Senate, available at <http://www.dol.gov/ebsa/newsroom/ty030712.html>.

carrying out fiduciary duties within the arrangement. To facilitate the responsible growth of MEPS, there is a need to clarify the rules and improve the reporting for these plans.

- DOL should formally comment on the status of open MEPs under ERISA, and clarify the fiduciary role of an adopting employer. If necessary, ERISA should be amended to clearly permit employers who share no other common interest to band together in a multiple employer defined contribution plan.
- Reporting requirements for MEPs also should be revised to require that the MEP provider and all participating employers be identified on Form 5500, *Annual Return/Report of Employee Benefit Plan*. Currently, there is no reporting of the employers who are participating in a MEP or of the entity that is marketing and/or providing administrative services to the MEP. Often, the “plan sponsor” reported on the Form 5500 filing is the first employer to adopt the plan, and Internal Revenue Service (IRS) and DOL have no way to know who is marketing or operating the arrangement, and what other employers are involved. To facilitate the growth of new MEPS, the small plan audit exception should be extended to start-up MEPS. For example, a MEP with fewer than 1000 participants should be covered by the small plan audit exception so long as no single participating employer has more than 100 participants.

Finally, to maintain a competitive marketplace for small plan services, legislative proposals to simplify reporting or create new contribution safe harbors for small plans should apply equally to MEPS and to single employer plans. Although MEPs provide efficiencies in theory, in practice a MEP will not necessarily provide better value than a single employer plan just because it is a MEP. Congress should not, therefore, artificially steer employers toward participation in a MEP, as opposed to a single employer plan. For example, Reps. Kind and Reichart’s SAVE Act (HR 1534) includes a special, deferral-only automatic enrollment safe harbor for multiple employer SIMPLE plans. This special deferral-only safe harbor should also be available for single employer 401(k) arrangements.

Thank you for the opportunity to submit these comments. ASPPA would be pleased to work with the Committee to further develop proposals to expand small business participation in the private employer-based retirement system.

National Federation of Independent Business Statement for the Record

U.S. Senate Special Committee on Aging

“Opportunities for Savings: Removing Obstacles for Small Business”

March 7, 2012

Thank you Chairman Kohl, Ranking Member Corker, and Members of the Committee for holding this hearing. The National Federation of Independent Business (NFIB) appreciates the Special Committee on Aging focusing on the challenges small businesses face when offering retirement plans for their employees. We are thankful for the opportunity to offer the following facts on retirement accounts in the small business community.

According to an NFIB Small Business Poll, 27 percent of small businesses offer an employee retirement plan. However, for enterprises employing 10 or more people, the proportion almost doubles. The study found that 53 percent of larger firms (20-249 employees) have retirement programs while only 20 percent of smaller firms (1-9 employees) have retirement programs. Of all the small businesses that sponsor retirement programs, 40 percent use a 401(k) while 29.8 percent use a SIMPLE plan.¹

Additionally, the U.S. Government Accountability Office (GAO) has found that wages have a large bearing on whether small employers provide retirement plans. According to the GAO, in their report on "Private Pensions" from March 2012, "small employers with average annual wages of \$50,000 to \$99,999 had the highest rate of retirement plan sponsorship at 34 percent while small employers with average wages under \$10,000 had the lowest sponsorship rate – 3 percent." In this report, the GAO additionally found many reasons why a low percentage of small businesses offer retirement plans. Plan complexity and resource constraints were the most frequently cited barriers to offering retirement plans.²

Many small businesses say that the complexity of administrative requirements for starting retirement programs can be a deterrent to sponsoring plans. An NFIB Small Business Poll found that only 25% of small employers think they have either a good or moderate understanding of the tax rules governing pension and/or profit sharing plans.³ Furthermore, searching through numerous plan options and then reviewing plan paperwork once a choice is made can be a substantial administrative burden. When statutes and regulations change, some sponsors may be required to modify plan documentation resulting in additional time-consuming paperwork.⁴

Fiduciary responsibilities of small businesses sponsoring qualified retirement plans pose a significant challenge to small employers and often discourage them from program sponsorship. According to the GAO, "Fiduciaries have a number of responsibilities, such as duty to act prudently, in the sole interest of the participants and beneficiaries, and to diversify the investments of the plan." This responsibility can be difficult as employers are entrusted with balancing risk and selecting proper investment funds for their participating employees. Many small business owners have limited experience in financial investment so finding the best options

¹ NFIB Research Foundation. *National Small Business Poll – Payroll Vol. 6 Issue 1*. 2006.

² U.S. Government Accountability Office. *Private Pensions: Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship*. Washington: Government Printing Office, March 2012, pg.21.

³ NFIB Research Foundation. *National Small Business Poll – Tax Complexity and the IRS Vol. 6 Issue 6*. 2006.

⁴ GAO, *Private Pensions*, 22.

for a diverse workforce is difficult. Consulting with plan professionals can help small employers understand fiduciary rules and make better investment decisions but doing so costs money. Additionally, some employers have an exaggerated sense of liabilities as a fiduciary and therefore avoid sponsoring a plan out of fear of litigation.⁵

Small employers often cite lack of financial resources as barriers to offering retirement plans. The first priority of small employers, especially those with lower profit margins or unstable cash flow, is to stay in business. Such businesses are generally less willing to sponsor a retirement plan because of the plan's start-up costs and on-going costs involved with maintaining the plan. In the GAO report, small employers state that "general economic uncertainty makes them reluctant to commit to such long-term expenses." As such, these businesses generally need to reach a certain level of profitability before feeling confident about offering a plan to their employees.⁶

Time and personnel considerations also deter small employers from sponsoring retirement plans as they themselves do not have time to spend on plan implementation and lack the personnel to take on the extra responsibilities. Many small employers believe that a retirement plan would require daily attention and that is extra time that they cannot fit into their busy schedules.⁷

Small employers are less likely to sponsor retirement plans if their employees show limited interest in such a program. In an NFIB Small Business Poll, 82 percent of small employers believed that employees would prefer a compensation increase equivalent to \$1.00 per hour in added wages or salaries over increasing employee benefit programs.⁸ Also, numerous small employers stated that employees were more concerned and interested in healthcare benefits than they were in retirement benefits. An NFIB Small Business Poll confirmed this preference as 79% of small business owners offered health insurance before pension benefits.⁹

Again, NFIB appreciates the Special Committee on Aging taking a closer look at both the challenges small employers face regarding retirement plans as well as the different options small businesses have available to them for offering retirement. We look forward to working with you on these issues in the future.

⁵ GAO, *Private Pensions*, 22.

⁶ *Ibid.*, 27.

⁷ *Ibid.*, 28.

⁸ NFIB Research Foundation. *National Small Business Poll – Compensating Employees Vol. 3 Issue 2*. 2003.

⁹ NFIB Research Foundation. *National Small Business Poll – Retirement Vol. 5 Issue 3*. 2005.



PAi

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Michael Kiley, Founder of PAi

Statement for the Record

For the

Senate Special Committee on Aging Hearing on

**“Opportunities for Savings:
Removing Obstacles for Small Business”**

**Held at 2:00 P.M. on
March 7, 2012**

My thanks to the Committee for conducting the March 7 hearing to explore the opportunities to expand workplace savings programs among small employers. I was fortunate enough to assist this Committee with its past work on Fee Disclosure – a VERY effective body of work that is making a real and positive difference in the lives of plan participants even today before the July 1 effective date. I’m writing in hopes of helping to create that same effect on expanding coverage.

According to EBRI, nearly 40 million American workers in small companies do not have access to a workplace savings program and unless that changes, they will not enjoy their current standard of living through retirement.

My company, PAi, has been focused on bringing affordable retirement plans to small employers for nearly 30 years. In that time we have and continue to provide services to tens of thousands of employers and hundreds of thousands of their employees. We have partnered with many different financial services firms as well as other “Business to Business” brands.

To date, most efforts to inspire small businesses to adopt workplace savings plans have been focused on the wrong problem – plan design and products.

Having worked with tens of thousands of employers over the years through a number of different brands and partners we can confidently state that small business plan adoption has two phases. Phase one is the decision to have a plan. Phase two is the implementation of a plan.

Phase One is the problem. As an industry and as policy makers, we've spent too much time on Phase Two. It's time to change that and work together on Phase One.

Before I expand on Phase One, allow me to dispel the myths around Phase Two in one simple statement. *For the last ten years, any small business in the country, on a mobile device or computer, can install a full service 401k plan from a recognizable brand with online service, professional call center support and best in class assets – in approximately ten minutes – for about the same price you'd pay monthly for a cell phone bill or cable television bill.*

When we were contacted by the Committee about the March 7 hearing, we surveyed our customer base and we looked at our customer data and found the following to be true.

1. Small businesses decide to adopt a workplace savings program – when “it's time”. Not before. “It's time” has three consistent definitions. “I have enough employees”, “I have enough revenue” or “I have enough profit”. There is no consistency to the definition of “enough” – it's personal and circumstantial.
2. When a small business decides that “it's time”, they buy a plan in 90 days after talking to no more than three people and commonly 1 person.
3. When they decide to buy a plan, they have no difficulty finding a suitable option among current plan designs – low deductible contributions with little administrative burden or high deductible contributions with fees associated with administration. There are plenty of options today for individual choices and individual needs.

As an industry and as policy makers we need to work together to take the focus off of Phase Two and concentrate on Phase One. Phase One – “It's Time” is a bigger problem with a bigger audience and fewer definite solutions.

How do we accelerate the “It's Time” campaign? Some ideas follow -

- The Auto IRA jointly proposed by Brookings and Heritage and captured in various bills over the years is the fastest and simplest and most effective. It works in other countries. It clearly represents the problem – “If you're working, you should be saving.” The Auto IRA will reduce the cost of distribution – the largest cost in the system today in small plans. If I may adapt a phrase from history – “The Auto IRA is the worst form of national workplace savings policy with the exception of everything else anyone has tried.” While it's an unpopular proposal, its effectiveness has been proven in other countries.
- Wall Street and Washington need to stop talking to each other and start talking to Main Street. As an industry we too often allow the technical work – important work that it is – take up our message space. Rather than talk about target date funds and the various science and philosophy around them, we should be talking to Main Street about automatic enrollment and retirement readiness. Time spent by industry firms debating

and adjusting to new plans and regulatory proposals should instead be put into talking to our customers about retirement readiness.

- We need to shift the perception of “it’s time” from a business cycle to an individual life cycle. When we shift the business owners thinking from “this year” to “this life” – they will install one of those “ten minute cable bill” types of plans. No one company can be successful in that. We need a joint industry and government campaign to link the problem (retirement readiness) with the available solution. “Business Owners are Participants too.” We need to be creative and innovative and get into the social media space.

I’ll close with a couple of observations.

Multiple Employer Plans (MEPs) – their potential greatest value is in adding voices to the visibility campaign. We think the rules should be clarified for the public. There are good MEPs and bad MEPs just as in anything. In truth, there is little cost or structure advantage to a MEP anymore. In days past, small plans were only offered expensive share classes. Today, small plans can choose from a wide variety of fund choices and pay for those choices in a manner that suits them. MEPs should be viewed as additional messaging and distribution opportunities. They should in all respects have a level playing field with non-MEPs for purposes of limits, testing, etc... MEP’s are not less expensive to run (as a matter of fact, if poorly designed, they can add tremendous expense). Fiduciary services available in MEP’s are available to individual plans.

And finally, our private retirement system is going through evolution just like every other industry. What started out as complex and mysterious and exclusive has become easier, more transparent and more affordable. The brands, brokers, advisers and business groups that have participated in this industry have moved “401k” from an obscure section of the tax code to mainstream thinking and mainstream media. Their success has been undeniable and we’ve very much enjoyed being a part of that. The fact that nearly 40 million American small business workers do not have access to a workplace savings program cannot be blamed on an industry not spending enough, not being creative enough or not caring enough.

To paraphrase Victor Hugo - “All the armies of the world are no match for an idea whose time has come.”

The private retirement system will continue on its path of success. Education and innovation will see to that. To accelerate the evolution we must actively shift the public focus from Phase Two to Phase One and from the business cycle to the life cycle of the workers we serve. It will take a joint effort by the government, the retirement industry and the business community generally to raise awareness and engage small business owners in “the cable bill that pays”. And – “It’s Time” for us to get together and do so.



100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

**ON: OPPORTUNITIES FOR SAVINGS: REMOVING OBSTACLES
FOR SMALL BUSINESS**

TO: UNITED STATES SENATE SPECIAL COMMITTEE ON AGING

DATE: March 7, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 71 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 – numbers more than 10,000 members. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 101 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. Currently, some 1,800 business people participate in this process.

Statement on
OPPORTUNITIES FOR SAVINGS: REMOVING OBSTACLES FOR SMALL BUSINESS
before
The Senate Special Committee on Aging
on behalf of the
U.S. CHAMBER OF COMMERCE
March 7, 2012

The U.S. Chamber of Commerce would like to thank Chairman Kohl, Ranking Member Corker, and members of the Committee for the opportunity to provide a statement for the record of the hearing entitled "Opportunities for Savings: Removing Obstacles for Small Business," which is being held on March 7, 2012.

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 Consequently, 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 significant efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.³

Despite the obstacles, however, 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, there is still more that can be done to encourage small business owners to participate in the private retirement system.

¹U.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 in 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.

⁴Patrick 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.

In April, the Chamber intends to release a white paper entitled "*Private Retirement Benefits in the 21st Century: A Path Forward*." The paper makes recommendations for all retirement plans and includes a special section for small business plans to address the unique challenges faced by small businesses. In our statement today, the Chamber would like to focus on one particular recommendation from the paper – facilitating the expansion of multiple employer plan designs.

Many small employers, like larger employers, offer benefits to their employees. Other small businesses would like to start retirement benefits but face significant burdens. One way to increase retirement plan sponsorship among small businesses that do not sponsor plans currently would be to facilitate and expand the use of multiple employer plans (MEPs). MEPs offer an attractive and cost-efficient alternative for small businesses for which a stand-alone 401(k) plan is not feasible.

A MEP is a single plan that is maintained by a MEP sponsor and one or more unrelated employers ("adopting employers"). Common sponsors of MEPs include professional employer organizations, human resource outsourcing organizations, and some associations. MEPs permit adopting employers to enjoy many of the features and benefits of a 401(k) plan, such as flexibility in plan design and higher deferral limits, without having to sponsor a stand-alone plan. Certain ERISA requirements, such as discrimination testing, must continue to be conducted by each adopting employer as if it were maintaining a separate plan. In addition, for tax purposes, each adopting employer may deduct the contributions it makes on behalf of its employees, including, in the case of a professional employer organization arrangement, worksite employees from whom it receives services.

The greatest advantage of the MEP is the centralized functions that the MEP sponsor can provide. Costs are shared among the adopting employers, regardless of the number. For example, one plan administrator, trustee and named fiduciary can act for the entire MEP. The MEP can provide centralized payroll, one investment line-up, and one annual report and audit for the entire plan. This translates to substantial economies of scale and cost efficiencies over stand-alone plans for small businesses.

However, there are also significant disadvantages to participation in a MEP. The biggest of these is that every employer is jointly liable for the testing and funding mistakes of every other employer in the MEP. This liability can be a daunting hurdle for many small employers. In addition, some employers may be discouraged by the inability to find a MEP sponsor or by the notice and disclosure requirements that are not completed by the plan administrator.

Changing several of the rules regarding MEPs could significantly expand their use. For one, the Chamber recommends the implementation of safe harbors for MEP sponsors and adopting employers that would immunize them from non-compliant adopting employers. Also, we recommend that the ERISA reporting and disclosure obligations be simplified. In addition, the Chamber recommends that the DOL clarify that "employer commonality" is not required to establish a MEP. While the Chamber believes that there is no basis to

apply this requirement to MEPs, there is sufficient ambiguity to create reluctance on the part of the employers who might otherwise consider participation in a MEP.⁵

The challenges facing small business plan sponsors 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, and MEPs could be a viable vehicle for doing so. 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.

⁵ Under ERISA's definition of an "employer" that can sponsor a retirement plan, the independent provider of a MEP can be construed as a person "acting indirectly" in the interest of an employer in relation to an employee benefit plan, and a group of participating employers can be reasonably construed as a group of employers acting in such capacity. (ERISA section 3(5)). By way of contrast, in two often-cited ERISA Advisory Opinions, the DOL found that certain organizations that were not organized primarily for the purpose of providing retirement benefits, and were open to membership by individuals and other non-employers, were not bona fide groups of employers, and therefore, were not employers under ERISA. (*See*, ERISA Adv. Op. 83-15A (March 22, 1983); and ERISA Adv. Op. 88-07A (March 28, 1988)). Thus, the Chamber believes that these Advisory Opinions can be differentiated in cases in which the "members" must be employers.