Testimony of

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on behalf of the

American Benefits Council

for the

U.S. Senate
Health, Education, Labor and Pensions
Subcommittee on Primary Health and Retirement Security

Hearing on

Retirement Plan Options for Small Businesses

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As the Senate Subcommittee on Retirement Security considers retirement plan formation and sponsorship among small businesses, the Principal Financial Group®, on behalf of the American Benefits Council (the "Council"), is pleased to offer our insights based on our work with thousands of small business retirement plan clients. Principal is a member of the Council's Board of Directors.

The Council is a national nonprofit organization dedicated to protecting and fostering privately sponsored employee benefit plans. Its members include large multistate U.S. employers that provide employee benefits to active and retired workers and their families as well as organizations that provide employee benefit services to employers of all sizes. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans covering virtually all Americans who participate in employer-sponsored benefit programs.

As a leading provider of retirement plans and a global investment management leader, the Principal Financial Group provides comments based on more than 70 years in the retirement industry and our experience with small- to medium-sized businesses and their employees. We currently provide retirement services to more than 43,000 retirement plans and 4.2 million employee participants, including more than 38,000 retirement plans of small businesses[1] and their 1.6 million participants.

For millions of Americans, a workplace retirement plan is the primary vehicle, beyond Social Security benefits, for accumulating savings to generate comfortable income in retirement. According to data from the Bureau of Labor and Statistics[2], 76% of full-time private sector workers have access to a workplace retirement plan, and 78% of those with access participate. Furthermore, government and the industry have made great strides at enhancing the system and improving retirement readiness among participants.

But there is still a significant portion of the working population that does not have access to a workplace retirement savings plan. The gap in workplace retirement plan coverage is most pronounced among employees of small businesses. For workers without access to a workplace retirement plan, 57.8% work for companies with fewer than 100 employees[3].

ADDRESSING THE CHALLENGE

Tackling the retirement coverage gap will require a multi-faceted approach focused on America's small employers. Our recommendations mirror many of those outlined in

[1] Retirement plans of small business defined as those with less than 500 participants.
[2] Bureau of Labor Statistics, U.S. Department of Labor, National Compensation Survey, March 2015.
[3] Employee Benefit Research Institute, Issue Brief No. 405, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2013."

the Senate Finance Committee's Savings & Investment Bipartisan Tax Working Group's July 2015 report.

- First, we must expand access by encouraging more small businesses to establish workplace retirement plans and multiple employer plans (MEPs) should serve a key role. A MEP is a single retirement plan that is adopted by multiple, unrelated employers that want to significantly reduce the administrative burdens and fiduciary responsibilities of sponsoring a plan on their own. MEPs also afford small businesses the opportunity to band together with others to gain scale and realize benefits available to larger plans.

- Second, we must address the dual challenges of improving participation and savings rate adequacy among single-employer plans sponsored by small businesses. Automatic feature plan designs are significantly underutilized and of those plans that have adopted automatic enrollment, the default deferral rate is typically set at 3% of pay with no automatic escalation.

- Finally, effective incentives are needed to encourage small plan formation with particular emphasis on encouraging adoption of progressive automatic feature designs.

We will address each of these approaches in the context of the subcommittee's specific questions below.

What are some policy recommendations you can offer which would open up multiple employer plans to allow small businesses more flexibility?

A number of regulatory and legislative changes are necessary to open up MEPs to the broader small business community.

- Current guidance from the Department of Labor requires a nexus or bona fide relationship between each adopting employer to consider a MEP a single plan and afford certain administrative and expense efficiencies, such as a single 5500 filing and plan audit. New guidance or legislation should expand MEP availability to small businesses with no formal, joint relationship — given conditions are established to ensure appropriate ERISA protections. We recommend the approaches discussed in the Senate Finance Committee's Savings & Investment Bipartisan Tax Working Group's July 2015 report.

- The Internal Revenue Code, while recognizing multiple employer plans, applies many requirements to each adopting employer. Referred to as the "bad apple rule," any adopting employer failing to meet tax-qualified plan criteria can disqualify the entire MEP's tax-qualified status. The IRS or Congress should provide that the adverse consequences of a non-compliant employer are limited to that employer and allow the MEP to spin the offending employer out of the MEP.

- Employers adopting a plan should be permitted — to the extent workable — to shift the fiduciary responsibility to third parties to make is easier for employers and to ensure appropriate expertise. We stand ready to work with Congress and regulators to establish appropriate and workable rules.

What could the federal government be doing to encourage small businesses to help employees with retirement savings?

We know that automatic features can work in driving improved retirement outcomes for participants. And adoption has become virtually mainstream for many large businesses. However, among small businesses auto-feature adoption is significantly underutilized. A report from Vanguard[4] found that approximately 60% of large employers utilize automatic enrollment but only between one-quarter and one-third of smaller plans (under 1,000 employees) do so. Other studies focused on micro-plans show even lower adoption rates. And for those small businesses who do utilize automatic enrollment, the default deferral is most often set at 3% of pay with no automatic escalation feature. Such a design gets employees enrolled in plans, but does not generate adequate savings rates.

A regulatory safe harbor design, the Qualified Automatic Contribution Arrangement (QACA), was created in an effort to incorporate adequate automatic enrollment and escalation features (minimum 3% deferral escalated to at least 6%), while offering the plan sponsor the ability to forgo nondiscrimination testing. The design requires a minimum 3% automatic deferral escalated to at least 6% and a minimum two-tier matching formula of 100% on the first 1% of pay and 50% on the next 5% of pay. Unfortunately, take-up has been limited. The Principal's own block of clients that utilize automatic features, only 8% use the safe harbor design. We feel this is due to two reasons; the inflexibility and complexity of the matching formula and the fundamental increase in matching cost for most plans (the minimum employer match contribution is 3.5% of pay).

In an effort to encourage increased coverage, wider adoption of auto-feature designs, and increases in automatic feature adoption rates with provisions to drive adequate savings levels, we urge Congress to support additional automatic arrangement safe harbor designs that will appeal to the majority of small business plan sponsors, designs that are simple and sensitive to increased costs. The Council supports recent bipartisan proposals and looks forward to working with Congress as the

[4] Vanguard's Center for Retirement Research, How America Saves 2014.

legislative process continues.

Tax credits such as those outlined in The Savings & Investment Bipartisan Working Group's July 2015 report are another tool that is important to encouraging small plan formation and adoption of successful designs. The credits include increased tax credits for new plan formation and new credits tied to adoption of progressive auto-feature plan designs, specifically those with default deferrals of 6%.

Please elaborate on any current regulatory or statutory challenges you have experienced (or observed) offering retirement plans to your employees in your small business.

From the broader perspective of a retirement services provider of many small businesses, the common statutory and regulatory challenges that we hear from small businesses relate to administrative burden, fiduciary liabilities, and specifically, nondiscrimination testing. Regarding the latter, small business sponsors of plans with low participation rates often fail nondiscrimination testing, requiring owners and highly compensated employees to receive refunds limiting their ability to adequately save for retirement in their own plan.

The recommendations we have laid out in this statement directly address challenges identified by small businesses. Multiple employer plans are excellent choices for small businesses seeking to offer a retirement benefit to their employees but do not have the resources, time or expertise to feel comfortable sponsoring their own plan. A workable auto-feature safe harbor, with incentives including safe harbors from nondiscrimination tests and additional tax incentives, will appeal broadly to small businesses and particularly those who have been challenged by testing failures. Such changes will result in good public policy, increasing auto-feature adoption among small plans, increasing plan participation among workers, and establishing adequate savings rates.

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[6] As of April 2015.