

# PENSION REFORM FOR SMALL BUSINESS

---

---

## HEARING BEFORE THE COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

WASHINGTON, DC, MARCH 28, 2001

**Serial No. 107-2**

Printed for the use of the Committee on Small Business



U.S. GOVERNMENT PRINTING OFFICE

72-257

WASHINGTON : 2001

COMMITTEE ON SMALL BUSINESS

DONALD MANZULLO, Illinois, *Chairman*

|                                     |   |
|-------------------------------------|---|
| LARRY COMBEST, Texas                | NYDIA M. VELAZQUEZ, New York                      |
| JOEL HEFLEY, Colorado               | JUANITA MILLENDER-McDONALD,<br>California         |
| ROSCOE G. BARTLETT, Maryland        | DANNY K. DAVIS, Illinois                          |
| FRANK A. LoBIONDO, New Jersey       | WILLIAM PASCARELL, New Jersey                     |
| SUE W. KELLY, New York              | DONNA M. CHRISTIAN-CHRISTENSEN,<br>Virgin Islands |
| STEVEN J. CHABOT, Ohio              | ROBERT A. BRADY, Pennsylvania                     |
| PHIL ENGLISH, Pennsylvania          | TOM UDALL, New Mexico                             |
| PATRICK J. TOOMEY, Pennsylvania     | STEPHANIE TUBBS JONES, Ohio                       |
| JIM DEMINT, South Carolina          | CHARLES A. GONZALEZ, Texas                        |
| JOHN THUNE, South Dakota            | DAVID D. PHELPS, Illinois                         |
| MIKE PENCE, Indiana                 | GRACE F. NAPOLITANO, California                   |
| MIKE FERGUSON, New Jersey           | BRIAN BAIRD, Washington                           |
| DARRELL E. ISSA, California         | MARK UDALL, Colorado                              |
| SAM GRAVES, Missouri                | JAMES P. LANGEVIN, Rhode Island                   |
| EDWARD L. SCHROCK, Virginia         | MIKE ROSS, Arkansas                               |
| GELIX J. GRUCCI, JR., New York      | BRAD CARSON, Oklahoma                             |
| TODD W. AKIN, Missouri              | ANIBAL ACEVEDO-VILA, Puerto Rico                  |
| SHELLEY MOORE CAPITO, West Virginia |   |

DOUG THOMAS, *Staff Director*

PHIL ESKELAND, *Deputy Staff Director*

MICHAEL DAY, *Minority Staff Director*

# CONTENTS

|  |           |
|--|-----------|
| Hearing held on March 28, 2001 .....   | Page<br>1 |
| WITNESSES  |           |
| Cardin, Ben, Member, U.S. House of Representatives .....                                 | 1         |
| Salisbury, Dallas, President and CEO, Employee Benefit Research Institute ...            | 9         |
| Calimafde, Paula, Small Business Council of America .....                                | 10        |
| Kelso, Michael, President and CEO, ELS .....   | 12        |
| Bachman, John, Managing Partner, Edward Jones Investments .....                          | 14        |
| APPENDIX   |           |
| Opening statements:  |           |
| Manzullo, Hon. Donald .....  | 26        |
| Velazquez, Hon. Nydia .....  | 27        |
| Prepared statements:   |           |
| Cardin, Ben .....  | 29        |
| Salisbury, Dallas .....  | 32        |
| Calimafde, Paula .....   | 47        |
| Kelso, Michael .....   | 62        |
| Bachman, John .....  | 64        |
| Additional Information:  |           |
| Prepared testimony of Honorable Rob Portman, U.S. House of Represent-<br>atives .....    | 69        |
| Prepared testimony of Kevin Brennan, President, JMI Software Consult-<br>ants, Inc ..... | 73        |
| Prepared testimony of Securities Industries Association .....                            | 75        |
| Prepared testimony of the Principal Financial Group .....                                | 78        |



## **PENSION REFORM FOR SMALL BUSINESS**

**WEDNESDAY, MARCH 28, 2001**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,  
*Washington, DC.*

The Committee met, pursuant to call, at 10:03 a.m. in room 2360, Rayburn House Office Building, Hon. Donald Manzullo [chairman of the Committee] presiding.

Chairman MANZULLO. The committee will come to order. We are going to move immediately to Congressman Cardin's testimony and then after his testimony the ranking minority member and I will have our opening statements.

Congressman Cardin, you are up.

Mr. CARDIN. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you for being here.

[Chairman Manzullo's statement may be found in appendix.]

### **STATEMENT OF HON. BENJAMIN L. CARDIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND**

Mr. CARDIN. It is wonderful to be back before this committee.

I come to you asking your support for H.R. 10, a bill that truly has been developed in a bipartisan manner. Rob Portman, the other person who is sponsoring the bill, could not be with us today because of some commitments within the Republican leadership, so he sends his apologies. But the two of us have worked together on both sides of the aisle to make sure that this bill would be produced and move forward as a bipartisan bill.

I am pleased to tell you we have 281 cosponsors to date, a strong showing on both sides of the aisle. A similar bill passed the House of Representatives twice with over 400 votes. So it is a bill that enjoys strong support on both sides of the aisle.

Mr. Chairman, I think it is a good omen that I am here today. In September 1995, I had a chance to testify before this committee on another pension bill that had been tied up for a couple of years. Right after testifying before this committee that legislation moved forward and was passed in 1996. And it really did mark the change of pension policy, I think, by this Congress.

We had suffered through a couple of decades of changes in the pension laws that made it more difficult, particularly for small employers, to be able to develop pension plans for their employees. The passage of that 1996 bill that was also sponsored by Congressman Portman and me started the trend, I think, of improving our pension laws to make it easier, particularly for small businesses, to provide pension benefits for their employees.

That is particularly important today. I think you all know the statistics. If you look at companies under 100 employees, only about 20 percent of their employees have employer-sponsored pension opportunities, whereas if you look at large companies today, three out of every four employees are covered by pension plans. So pension reform is of particular interest to small business and I very much appreciate your sensitivity, your committee's sensitivity, to that issue by having this hearing today.

As we look at the need for pension reform generally, I need not tell this committee what is happening with regard to the baby boomer generation, the number of people who will be eligible for Social Security.

Forty years from now, it is predicted that the number of people over 65 will grow from 12.8 percent of our population to 20 percent of our population. We all know the strain that will put on our Social Security system. One of the areas that we need to strengthen as far as income security for people who are retired is private savings and private retirement.

As we have gone through the most recent economic expansion of our country where we have seen low inflation, low unemployment rates, one of the trends that have been going the wrong direction has been private savings and private retirement. We have actually found that private savings has declined over the past two decades to last year where we actually had negative quarters of savings in this country.

So we need to do more to encourage private savings, private retirement, for many reasons: income security for individuals, to put less pressure on the Social Security system, for the strength of our economy. H.R. 10 was developed with that in mind, to try to deal with some of these problems.

Mr. Chairman, I will talk a few minutes about some of the provisions that are of particular interest to small businesses and then I would be pleased to answer any questions that you might have and I would ask that my entire statement be made part of your record.

Chairman MANZULLO. Without objection.

Mr. CARDIN. H.R. 10 contains hundreds of changes in the pension laws, but a large number are aimed at reducing complexity, which is particularly daunting for small companies. They find it very difficult to have a pension plan and then there are a lot of traps in the law that may trap them with penalties. So what we try to do is simplify the pension system, particularly for small business, and one of the changes is to change the top heavy rules.

It was identified as perhaps the number one obstacle for small businesses developing pension plans, the top heavy rules. The Department of Labor ERISA advisory committee actually recommended the repeal of the top heavy rules.

We have not suggested that. Instead, we have modified it to deal with, we think, the most difficult problems: the definition of key employee, that the contributions of the employer, the matching contributions, would count towards the required contributions under the minimum contribution rules.

The family attribution rules would be modified to take care of the top heavy rules and the 401(k) safe harbor that I mentioned ear-

lier, that if you have a 401(k) safe harbor currently the non-discrimination rules would not apply, H.R. 10 would expand that to the top heavy rules.

The legislation also significantly increases the amount of money that you can put into the pension plans. On the deferred compensation plans, it is raised from \$10,500 to \$15,000. On the defined contribution package, it is increased to \$40,000 and the considered compensation limits to \$200,000.

One provision that will be, I think, particularly interesting to your committee is the provision that allows for the catch-up contributions for those people who have turned 50 years of age so they can contribute an additional \$5,000. This is of particular interest to women, but it also affects all people in the workforce because we find that many times women who did not have the same earning ability because they were out of the workforce for part of their career need the opportunity to put more money in as they get closer to retirement.

They have taken care of their family, they now are in the workforce, they want to take care of their retirement and the contribution limits prevent them from reaching their goal. The extra \$5,000 will make it a little bit easier for them to reach their security goals when they retire.

There are also some specific provisions that apply only to small business: the IRS user fees, the PBGC premium, and the Form 5000s that we can get into. But these were put in at the request of small business to try to deal with their particular problems.

Mr. Chairman, I think you will find this legislation is a comprehensive bill to make it easier for individuals and companies to provide for their own retirement and for their employees' retirement and I thank you for your help in crafting the bill and we look forward to this legislation being enacted into law.

[Mr. Cardin's statement may be found in appendix.]

Chairman MANZULLO. I appreciate that.

[At this point, the bells ring, indicating a floor vote.]

Is it one vote?

Mr. PASCRELL. Budget resolution.

Chairman MANZULLO. Budget resolution?

Mr. PASCRELL. On the rule.

Chairman MANZULLO. It is on the rule?

[To Mr. Cardin:]

Ben, are you able to come back?

I think what we will do is go into recess now, take the vote, and then come right on back.

[Recess.]

Chairman MANZULLO. We will reconvene our meeting.

Congresswoman Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. I would like unanimous consent to enter my opening statement into the record.

Chairman MANZULLO. Without objection.

Ms. VELAZQUEZ. Thank you. Mr. Cardin, welcome to the Small Business Committee and thank you for your presentation and your interest in providing a retirement plan for small businesses.

When your bill was introduced in the last Congress, it contained many incentives for small businesses that currently do not provide

retirement plans to start a plan. However, as the bill was reported out of the committee and passed by the full House, several incentives were excluded; in particular, the tax credit that will allow small businesses to deduct some of the costs of establishing and administering a plan for the first five years.

I am a strong proponent of these tax credits and I believe they are very important in providing an incentive for small employers to start a pension plan.

As your bill works its way through the Ways and Means Committee, would you advocate to have these tax credit incentives put back into the bill?

Mr. CARDIN. Well, I very much appreciate that question and the answer is yes. I think that is a very important provision. You are correct. The credit for small business start-up costs was included in the original Portman-Cardin legislation. As it worked its way through the Ways and Means Committee, it was derailed for two basic reasons: one, the cost issue, but, secondly, because the committee at that time was reluctant to move forward with new tax credits.

I think that there is a changing attitude within the Ways and Means Committee on that particular issue. I think it is a very important provision. I know that Congressman Portman also supports that change.

For introduction purposes, we wanted to introduce primarily the same bill that passed the House by such a strong vote last year. We did not add that provision. We hope as the bill works its way through the house that that provision could be added. It is not that expensive and we think it would be a major help to small businesses in starting pension plans.

Ms. VELAZQUEZ. What do you think are the prospects of including it?

Mr. CARDIN. I think they are good. It is one of the major—it is on our list, on a very small list of things that we would like to see included that were not in the introduced bill, so I think we have a good chance to get that included. We know that the Senate has a somewhat different view on this bill. They support the thrust of the Portman-Cardin bill. Last year, they added a tax credit for low wage workers which is, again, something that Congressman Portman and I would support as long as it is part of the current pension system.

So I think as the bill works its way through the House and the Senate, it is very likely that some tax credits will be added to the mix and we think the small business start-up cost provision is an important provision to include.

Ms. VELAZQUEZ. Would you consider supporting an amendment that will expand the administrative relief provided under your bill to a greater number of small businesses by raising the asset threshold for exempting a business from filing Form 5500?

Mr. CARDIN. As you know, we did provide some special rules currently for 5500 filings and we would be glad to work with you and the committee as to additional relief. We clearly want to make it easier on the filings. We think that we made some improvement in this area, but we think we should make more and we would be very happy to work with you on that.



Ms. VELAZQUEZ. My final question is looking at the results of the 2000 survey, I have concerns about two groups of people. The first group is the small business owners that have unreliable or uncertain income flows and therefore cannot afford to start pension plans. I am concerned that those businesses will not be able to compete with large and even other small businesses for quality employees.

The second group I am concerned about is the seasonal worker. I am concerned that because of the nature of their work they are at risk of never having the opportunity to participate in a retirement plan.

What are the provisions in the bill that you see as benefiting these two groups?

Mr. CARDIN. Well, thank you very much for that question also. In regards to the small employer, there are two major obstacles in current law for why small employers will never set up a pension plan which will benefit not only the small employer's employees but himself or herself also. And the first problem that I mentioned is the complexity. There are a lot of traps in the law.

A small company cannot hire a pension consultant or a pension person to handle the pension system. Usually, the employer handles it himself or herself. And it is complicated, it is difficult and many of these tests were put in for large companies who could afford this administrative cost. So we have to get the administrative burdens reduced and this bill significantly reduces the administrative burdens overall for pension plans but particularly for small businesses through many of the provisions I mentioned earlier.

The second is that it has to pay for the owner to set up the plan and with the low limits, it just does not pay for an owner to set up a plan. The owner could get almost the same benefits from a non-employer sponsored pension plan. So why bother?

So one of the reasons we are recommending increasing the limits is for those individuals who make the decision whether the company will have a pension plan or not to realize that it is in their financial interests to do that.

In regards to seasonal workers, we have modified dramatically the portability rules and one of the things that we find is that a lot of people have small earnings here or small earnings there and it is difficult to justify keeping these accounts, particularly with the administrative costs, so what we do is provide complete portability between all types of plans, whether they are non-profit, for profit, government. You can have portability and merge the accounts into one pension plan.

Ms. VELAZQUEZ. Thank you.

[Ms. Velazquez's statement may be found in appendix.]

Chairman MANZULLO. I just have one question.

Congressman, about two or three years ago, I believe, we passed a bill to make a pool of money available for educating people about pension plans. Do you remember that?

Mr. CARDIN. Yes.

Chairman MANZULLO. Would any of that—and I think that was signed into law.

Mr. CARDIN. Well, there is no question that we need to do a better job of promoting what the pension laws provide so people can

take advantage of it. We know that with our own thrift plan here as federal employees. The more information we get to our workforce about the advantages of the thrift plan, the more employees sign up for the plan and our participation rates are pretty high.

There are two basic things. First, the government offers incentives for their employees to participate and, second, we have gotten the information out so people know that they can take advantage of it. It is clear that just passing the laws in and of themselves will not change behavior. We need to also get adequate information out.

You are going to hear in the next panel, you have a lot of people from the private sector which will tell you what they are doing in the private sector to get this information out to employees. They are professionals at it.

I think that if H.R. 10 were to be enacted that it would offer incredible incentives for companies working with the private sector to get information to their employees to take advantage of it, particularly younger employees, who have been our lowest percentage of participants.

Chairman MANZULLO. OK.

Mr. Brady.

Mr. BRADY. I have no questions; I have a statement.

Thank you. Thank you, Mr. Chairman, and Ranking Member Velazquez. I would like to thank you for calling this important hearing on H.R. 10.

I am wearing two hats here, being a congressman and also a member of organized labor, that this bill, bill 415, hopefully this will add to bill 415, that it will allow multi-pension people that work in unions, some people that work for the unions, they get capped out on a three-year basis and a lot of times their pension is more than their cap and they get penalized for working that hard.

As you well know, union people, the jobs that they have sometimes do not have longevity, they can work after 30, 40 years, so they are being penalized. And being penalized, that money is not being utilized. It goes back into the union pension fund and it just sits there and it gets either invested and rolls over and rolls over, probably to a next life with somebody else.

So I appreciate, Congressman, you bringing this to the light and having this bill brought up and I hope that we can get enough votes this time to pass it and I thank both of you for having this hearing.

Chairman MANZULLO. Thank you.

Mr. Pence.

Mr. PENCE. Thank you, Mr. Chairman, and Congresswoman Velazquez. Thank you for the opportunity to speak.

I want to congratulate my colleague, Congressman Cardin, for a visionary piece of legislation, one that as a new member of Congress I was very anxious to support. Coming from a midwestern district that is dominated by small business, coming out of a small business family and having built my own small business, I appreciate the struggles that you are addressing in this legislation and am delighted with the enthusiasm with which it is being embraced.

Specifically, I found very compelling your testimony about the catch-up provisions. We do see in Indiana, Congressman, we see a

great number of women who will make a decision to be at-home mothers, but then use their education or background to enter the workforce, oftentimes in small business, oftentimes as entrepreneurs and small business owners.

I wanted to ask you to address the provision of H.R. 10 that while it does not specifically address women in the workforce, I thought your comments to be very thoughtful in that regard.

How did you arrive at the \$5,000 catch-up provision number and what was the thinking going in the arriving specifically at that number?

Mr. CARDIN. Well, Congressman, thank you for that question. I appreciate your comments.

First of all, the age 50 we picked because that is normally the age where people get a lot more serious about making their retirement security a reality. And, secondly, it is normally the time that people have finished raising their families, sending their children to college and the home mortgage is much more manageable, if it is not paid off. So it is a time when people are thinking more about retirement.

It is also the age, as you pointed out, that many times people who have left the workforce to take care of their families are returning to the workforce and have adequate income where they can put money away for their retirement.

We were facing up to \$15,000 on the deferred compensation plans and we felt adding another one-third made some additional sense. There was no magic to the \$5,000, although we felt that it fit well in talking to the people in the private sector as to how much interest there would be and how much money could be contributed. We felt that was the right level.

There is always one consideration when you look at limits. You might ask why do we have limits? At one time, we did not have limits. You could defer as much of your compensation as you wanted to, other than your FICA taxes, you could defer. And the reason why we have limits was part of the compromise reached to keep this bill a very bipartisan bill because the higher the limits the argument is made that wealthier wage earners will put more money away than lower wage earners.

I do not think that is necessarily true, but we wanted to reach a balance that we could have a broad coalition in support of the legislation and one of the reasons that we used the \$5,000 rather than a higher number was to keep that broad coalition.

Mr. PENCE. One other follow-up question, if I may, Mr. Chairman.

I think that the statistics that you presented in your testimony about companies with fewer than 100 employees, as many as 80 percent of the workforce, have no retirement savings plan.

As you look at your legislation, Congressman, what do you believe or economists that you trust believe will be the effect on those size companies if your legislation is enacted by Congress?

Mr. CARDIN. That is a good question. I really do not know the answer to it. We are moving in the wrong direction now. There is actually an erosion of employer-sponsored pension plans, particularly with small business.

We think this legislation will certainly stop the erosion and we will find more people that will be covered by pension plans by small employers. I cannot give you any specific number because we really do not know that. And I think the chairman's question about trying to get information out is going to be a key to this.

One thing is absolutely certain and that is Social Security is not adequate for your retirement needs. It never was intended to be the sole source of people's retirement. We always assumed that individuals would also have private savings and private retirement. I think it is incumbent upon us to develop a system where every person in the workforce can put money away for their retirement in addition to Social Security. And certainly one of our objectives in H.R. 10 is to make that more of a reality. So we hope that it will make a significant improvement on the number of people who will have employer-sponsored pension plans or participate in IRAs.

Chairman MANZULLO. Mr. DeMint, did you have any questions?

[Mr. DeMint indicated no.]

Chairman MANZULLO. OK. Congressman Cardin, thank you very much for coming here this morning.

The question I wanted to ask you was what can we do to get the Senate to move this? I mean, it has died in, what, two Congresses now?

Mr. CARDIN. Yes. We have had some problems in the Senate. We are not the only people that have had problems in the Senate. It seems to be a common dilemma. We hope very much that this bill will move very shortly in the House as a separate tax bill and I think Chairman Thomas of the Ways and Means Committee is prepared to do that. And I think you will find a very strong bipartisan support on the House floor.

The problem in the United States Senate, as you know, it is difficult to move individual bills, particularly early in the session, unless you get unanimous consent which is almost unheard of in the Senate because every senator has his or her own individual agenda.

So I think the best thing we could do is continue to stress the importance of this legislation and that it needs to move quickly if it is going to have an impact on people shortly.

The next panel you have will, I think, help us in that argument. They can tell us what practical effect it will have. And I have found one of the best ways to get this legislation moving is to have the people in the private sector who know directly how this will affect behavior as far as retirement is concerned talking to the senators.

Chairman MANZULLO. OK. Thank you, Congressman.

Mr. CARDIN. Thank you.

Chairman MANZULLO. Ben, just a second.

[Pause.]

Chairman MANZULLO. OK. Thank you very much. Thank you, Congressman.

The second panel, if you could be seated, please?

While the second panel are taking their seats, let me briefly introduce who they will be.

Dallas Salisbury is the president and CEO of the Employee Benefit Research Institute here in Washington.

Paula Calimafde is an attorney with the Paley Rothman law firm out of Bethesda.

Mike Kelso, president and CEO of ELS, Inc., also a small business owner and engineering consultant from Arlington.

And John Bachmann, managing partner in charge of a major marketer, Edward Jones Investment Company out of St. Louis.

Mr. Salisbury, we will start with you. The clock in front of you starts at green, turns to yellow and then when it hits red, I will bring this down. It is on five minutes and I am sure we will have plenty of time for questions and answers thereafter.

Thank you for coming.

**STATEMENT OF DALLAS SALISBURY, PRESIDENT AND CEO,  
EMPLOYEE BENEFIT RESEARCH INSTITUTE**

Mr. SALISBURY. Thank you, Mr. Chairman, and members of the committee. It is a pleasure to be here. I know my entire statement will be printed in the record.

Chairman MANZULLO. All of the statements of the witnesses and any members of Congress will be submitted in the record without objection.

Mr. SALISBURY. So I would go directly to page 2 of my testimony and to the direct issue of the hearing which is what provisions of the Portman-Cardin act might well assist in expanding the realm of sponsorship of employer-sponsored plans in the small employer sector.

Chairman MANZULLO. Mr. Salisbury, could you move the mike up? Tip it—try that.

Mr. SALISBURY. I can do that.

Chairman MANZULLO. Thank you.

Mr. SALISBURY. And I refer you to the table that is in the testimony that relates to reasons for not offering a retirement plan by small employers that do not.

The most important of those reasons is employers noting that employees prefer wages and/or other benefits. I would note that this Congress enacted the Saver Act, the savings are essential for all employees, and that led to the 1998 summit on retirement savings.

There will be a 2000 summit on retirement savings. One of the issues carried forth in that summit and in our own Choose to Save Education program on the importance of savings is to increase employee understanding as to the virtue of employees being convinced to save and contribute, the Saver Act leading to that, and education. It is not necessary for employers, if you will, to have funds to contribute.

Obviously employer contributions plus employee contributions are the most desirable, but one of the issues at hand is simply to get employers to begin sponsoring these programs.

Too many government regulations is dealt with by the many simplification provisions of this act.

Vesting requirements causing too much money to go to short-term employees is dealt with by the alternative provisions in this act relative to top heavy provisions.

The issue of employers not knowing where to go for information on starting a plan, as the congresswoman noted, has been dealt

with partially by congressional action giving money to the Small Business Administration and the Department of Labor. That has led to the development of a combined website by those organizations, as well as new educational materials available through the Pueblo government information 800 number.

The website now created by SBA and DOL does allow any small employer to go there and to do a very thorough analysis of plan options available to them. That has only been available in about the last nine months.

Tax benefits for the owner that are too small are dealt with by the limits and by the catch-up contributions.

And so I think that looking at this issue of why small employers do not provide for plans, this act does provide provisions that deal with all of them.

Our survey also underlined that there are many small employers that say I am inclined to create a plan, which is shown on page 5 of the statement, and so it does, combined with past analysis that we have published, underline that with the types of changes contemplated in this act our econometric modeling suggests that you could readily see as many as 7 to 12 million employees who do not currently have pension coverage gain pension coverage.

Thank you, Mr. Chairman.

[Mr. Salisbury's statement may be found in appendix.]

Chairman MANZULLO. Thank you very much.

Is it Calimafalde?

Ms. CALIMAFDE. No, you did better the first time. Calimafde.

Chairman MANZULLO. Calimafde. Thank you very much. May I call you Paula so I do not butcher your name again?

Ms. CALIMAFDE. I have been called Paula since kindergarten.

Chairman MANZULLO. OK. Thank you very much. Go ahead.

**STATEMENT OF PAULA A. CALIMAFDE, ESQUIRE, PALEY,  
ROTHMAN, ET AL.**

Ms. CALIMAFDE. My name is Paula Calimafde. I am the chair of the Small Business Council of America. I am also a member of the Board of Directors of the Small Business Legislative Council. I am a practicing tax lawyer. I have been working in the field of qualified retirement plans for more than 20 years. I work with the pension tax laws day in and day out, whether I want to or not.

Today, I am here representing the Small Business Council of America, the Small Business Legislative Council and ASPA, the American Society of Pension Actuaries.

In our opinion, H.R. 10 will significantly promote small business plan formation and that is critical because, I think as you know, small business coverage lags dramatically.

According to the Small Business Administration, the small business sector employs more than 53 percent of all the workers in the private sector and yet coverage of those workers is somewhere in the 30 percent range. If you are with an employer who is more than 25 but less than 99 employees, you are somewhere in the 48 percent range. If you work for an employer with less than 25 employees, you are usually in the 19 percent range. So coverage is a serious issue.

This bill, in my opinion—I hate to refer to it as a tax law because what you are really doing is shoring up the retirement plan system, and if Portman-Cardin works the way it is intended, you will lose short-term tax revenue because people will be putting money into 401(k) plans and more money will be deferred—but if you look at this bill from a long-range perspective of where we should put our nation's money, in my opinion this bill may be one of the most important bills Congress will see this year. A young person 30, 35, who puts \$2000 into a 401(k) plan this year and gets a match, that money will grow significantly by the time they retire and it may be the difference between a comfortable retirement and no retirement at all.

I cannot convey to you how important small business plan coverage is. There is an interesting statistic that has evolved which is that when a small business plan is sponsored, participation in the plan is at the same level as a larger entity. In other words, if you build it, they will come. And what Portman-Cardin is doing is sort of building the field and hopefully small business will come and start joining the qualified voluntary retirement system.

Well, why doesn't small business sponsor more plans? Dallas Salisbury gave you some reasons. There is another reason which is if you look at the legislation of the 1980s and early 1990s, there was constant legislation that cut back on benefits and increased administrative burdens and small business was singled out for the harshest rules.

Somehow the concept arose that small business did not treat their employees fairly and even today you can hear people talking in terms of, well, we cannot do that kind of plan because the small businesses will not tell their employees that they are sponsoring it. There is a basic misunderstanding of what a small business is and how important the employees are to that small business.

With a retirement plan, it is a cost benefit analysis to the owners of that business whether they are going to sponsor it. It costs money to sponsor it.

So, yes, the employees have to appreciate it and Dallas is doing a phenomenal job, in my opinion, of getting the word out there that you had better start saving for retirement, Social Security cannot do it all for you.

But there has to be something in it for the company, so (a) the employees have to appreciate it, but (b) it has to provide some benefits for the owners also. And I think Portman-Cardin is trying to redress that cost benefit analysis. It went out of whack in the 1980s and early 1990s. This bill, I think, will bring it at least to neutral.

What major provisions in this bill will help small business? There are many, many provisions. In particular, the changes in the 401(k) area are very important. One provision right now, if employees make 401(k) contributions, that counts against the company's 15 percent overall deduction level to a profit sharing plan. What this means in the context of the small business world is if a company wanted to make a 15 percent contribution, the employees could not make a 401(k) contribution. And in the small business area, very often companies make significant contributions to these plans.

The 404 deduction level, increasing it to 20 percent helps.

There is 401(k) safe harbor match that is a very important provision which will really help small business.

Do we have enough plans right now? Does Congress have to come up with new plans? I do not think so. You have a very nice balance of plans. There is a start-up plan, the SIMPLE. It is basically an IRA. We just have to educate people about it.

If a company wants to move on, hopefully they will move on to the 401(k) safe harbor, a strong plan. Why? Because it keeps the employees' money in the plan until they actually retire, become disabled, die or leave.

There is a lot of flexibility out there and it is from simple to complex and I think the companies can work with it. This bill will really help small business plan formation.

[Ms. Calimafde's statement may be found in appendix.]

Chairman MANZULLO. Thank you very much.

Mr. KELSO.

**STATEMENT OF MICHAEL P. KELSO, PRESIDENT AND CEO,  
ELS, INC.**

Mr. KELSO. Mr. Chairman, and members of the committee, I appreciate the opportunity to speak before you. As you perhaps can tell by the brevity of the statement I provided, this is my first time testifying before the Congress.

My name is Mike Kelso and I am president and CEO of ELS, Inc., which is a small engineering consulting company in Crystal City. We provide engineering and consulting services to the federal government, mainly to the Department of Defense. We were founded in 1976. We are, as you can tell by the number of people, a small company. In 1987 we used an ESOP, an employee stock ownership plan, leveraged buyout of a retiring owner to purchase the company and today we are a 100 percent employee owned company.

One of the means of differentiating, as Congresswoman Velazquez indicated earlier, between large companies and small companies in attraction of employees is the benefit plan. A quality retirement plan for employees in a small business is a must if you are going to compete with the big businesses.

The latest study by the Profit Sharing/401(k) Council of America indicated that small firms, people with fewer than 50 people, those who do have retirement plans contribute up to almost 20 percent of net profit to these retirement plans.

I would like to summarize briefly what we are doing in the way of retirement planning for our people at ELS and how H.R. 10 will enhance these efforts.

First off, as I indicated earlier, we have an ESOP and that ESOP has been in place since 1987. We contribute 6 percent of covered salary per year into that plan. That 6 percent goes toward the 25 percent limit that is going to be relieved by H.R. 10.

Our 401(k) plan is rather unique in a lot of ways, but in particular in its matching feature. We do a dollar-for-dollar match up to 4 percent of salary or \$2000, whichever is greater. The significance of that \$2000 limit is that people who make less than \$50,000 a year receive a greater match than those who make more



then \$50,000. This is mainly the people that we are trying to attract to these 401(k) retirement plans. You do not have to convince the older folks to participate, you have to convince the younger ones. As an example, a person making \$40,000 a year who defers \$2000 will get a \$2000 match or 5 percent. The lower the salary, the higher percentage match the company provides.

The other thing we do is allocate the non-vested portions of people's accounts. If somebody leaves the company before they are 100 percent vested, they forfeit the non-vested portion of their accounts and, instead of using those funds to reduce future contributions for the company, we reallocate those to the participants. In 2001, this year, those forfeitures are going to be quite substantial, amounting to about 7.6 percent of salary. There is a corporate benefit to the company that I do not want to minimize that will derive from H.R.10.

As Ms. Calimafde indicated, the employee deferral counts toward the 15 percent corporate deduction. Anything over 15 percent, we pay an excise tax on that. So the fact that we have one highly compensated person, believe it or not, who is not participating in the plan, everybody else is, we have over 7 percent contributions of non-highly compensated people going into the plan on average. The 6 percent ESOP.

The company is providing the 18.6 percent of salary contribution to retirement plans in 2000 and 2001. Above the 15 percent limit, we pay an excise tax. That is the price we pay for that generosity. And, in addition to that, the employee deferral counts toward the 25 percent limit.

That is the benefit to the company, which I do not see as a major reason for me being here. The most important reason for me being here is the elimination of the 25 percent limit because of its effect on junior and mid-level, as opposed to senior people like me.

Last year, in the year 2000, I had to tell 75 percent of my non-highly compensated people that they had to stop deferring to the 401(k) plan because they were exceeding the 25 percent limit. It did not affect me and, with all due respect to the members of the committee, if you were employed by ELS last year, you would not have been affected by the 25 percent limit either.

The first person who was affected by that was a single mother of two who is over 50. She will benefit in multiple ways by H.R. 10. This woman who makes \$36,000 a year, Maria Pingree spoke at the introduction of the Portman-Cardin bill a couple of weeks ago.

I had to tell Maria last July to stop deferring into the 401(k) plan. She wanted to defer 10 percent of her salary, \$3,600 into the plan, and I had to tell her she had to limit that to \$2,500 last year. She will be similarly affected this year if H.R. 10 is not passed.

I apologize for running over.

[Mr. Kelso's statement may be found in appendix.]

Chairman MANZULLO. You do not have to apologize. Mr. Bachmann?

**STATEMENT OF JOHN BACHMANN, MANAGING PARTNER,  
EDWARD JONES INVESTMENT COMPANY**

Mr. BACHMANN. Thank you, Mr. Chairman. Like my colleagues, we appreciate the opportunity to have this forum to talk about what is clearly a very, very timely issue.

I really think that if you step back the heart of the matter that we are addressing here is that of demographics, which simply says we have an aging population.

My company, Edward Jones, has about 7500 offices in the United States, Canada and United Kingdom and it is not an American problem. This is a problem in most of the economically developed world, this shift from a young population to much more an aging population and the historic notion has always been that you fund retirement through wealth transfer where the people working support the people who are retired and that system simply does not work with the demographics and the expanding ages of people.

So we are confronted with what do you do? And we do know that people want a comfortable retirement. They do not want to work and then at the end of their lives have to dramatically change their life style.

Among our customers, and we have about 5 million, the most important concern of older people is family, second is health and third is freedom and dignity in retirement. So the only way we can see to do this is to give people as individuals the opportunity to take responsibility for their retirement and that is a matter, we believe, of public policy which should encourage people to be able to set aside for retirement. And we think that the time is not simply right, we think the time is overdue for this legislation.

It is difficult, frankly, for some of us to understand how legislation can go through the House of Representatives by such a massive majority and not be sufficiently an urgent need of the people to become a matter of law. I think we probably share that view with you all, but it is an important matter because delay is the silent thief.

Every year that goes by that people cannot set aside money for retirement is a year that it does not compound, that it is not helping them prepare for a more comfortable retirement. So we certainly believe that the legislation that Congressmen Cardin and Portman have put forward is urgent.

We are also grateful for the work of Congressmen Blunt and Bentsen who introduced legislation specifically targeting the very smallest businesses, and these are really the businesses that right now are almost economically forced into non-participation.

Going back to the summit of 1998, the retirement summit, two of the points that were made are that the system we have now is too complex for small businesses. You have both compliance issues and you have reporting issues that are far more complex than they should be and these lead to the second issue, which is cost. It is very expensive to support these when you have to comply with the same kinds of requirements that large businesses can where they can spread it over many employees.

So we believe that the simplification, the streamlining, the addressing of cost, the raising of the limits are all very, very important and we think that that importance is greatest among the very,

very smallest businesses which include many of our customers. And, as has been cited, less than 20 percent of the employees in these smallest organizations have an opportunity to participate in this and we believe that number would expand significantly and perhaps even dramatically if there were encouragement through the streamlining, simplification and perhaps some of the tax relief that I believe was mentioned by the congressman earlier.

I could go on, but why don't we stop there?

[Mr. Bachmann's statement may be found in appendix.]

Chairman MANZULLO. I appreciate it very much.

Congresswoman Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Salisbury, let me make sure I am reading the 2000 survey correctly. According to the survey, when small employers that do not currently offer pension or retirement plans were asked what would seriously make them consider sponsoring a plan, 65 percent of them responded that a tax credit for starting a plan will make them seriously consider offering a plan. Is that correct?

Mr. SALISBURY. That is correct.

Ms. VELAZQUEZ. And is it correct that this response was second only to an increase in business profits as to the incentives that would make them start a plan?

Mr. SALISBURY. That is correct.

Ms. VELAZQUEZ. So would you agree with me that the Cardin-Portman legislation as it is today will not be an avenue for this 65 percent who said that a tax credit will be an important tool for them to start a plan?

Mr. SALISBURY. Portman-Cardin would be more effective in achieving the objective based on the survey responses if it included the tax credit provision. Yes.

Ms. VELAZQUEZ. Thank you.

Ms. Calimafde, in light of the statistics I just cited from the 2000 small employer retirement survey regarding tax credits, what is your position on Congress returning the small business tax credit to the Portman-Cardin bill?

Ms. CALIMAFDE. I am in favor of it. I think there are very few things I would change with Portman-Cardin because I think it is important to get the bill passed through Congress this year, but that is one that I would definitely think should be added.

Ms. VELAZQUEZ. Are there any other legislative changes you would like to see made in an effort to make pension plans more accessible to small businesses?

Ms. CALIMAFDE. In addition to Portman-Cardin?

Ms. VELAZQUEZ. Yes.

Ms. CALIMAFDE. There are, but I would again say, first, I think Portman-Cardin is a giant step forward. After that, I think that we still need to roll back a lot of these sort of unnecessarily complex rules that are still layered in this area.

Most of them do not really do anything from a technical viewpoint and some of them, such as the top heavy rules, people feel really do a lot but when you are in the trenches you realize they do very little. So my opinion is that the next bill would continue to take away some of this unnecessary complexity.

There are a few little things needed for instance in the 3 percent 401(k) safe harbor which many of us are hoping will be like the next big plan for small businesses—right now, there is a notice requirement on the 3 percent 401(k) safe harbor. Well, the notice serves no rational purpose. In the 401(k) match it does because if you give notice, employees might change their behavior because they know there is a match. Whether an employer is going to make a contribution or not really would not change your behavior.

So that is the type of thing, but compared to what Portman-Cardin is achieving, this would be a clean-up type of bill.

Ms. VELAZQUEZ. Thank you.

Mr. Bachmann, in your testimony you mentioned your support for the Blunt-Bentsen bill and some of the reforms included in the Blunt-Bentsen bill have been included in the Portman-Cardin bill. However, the tax credit provisions of Blunt-Bentsen have not been included in Portman-Cardin.

You also mentioned in your testimony that many small businesses cannot afford to set up pension plans for their employees in the early years of the business. Could you explain to the committee how incorporating tax credit provisions into Portman-Cardin will help make pension plans more accessible to small businesses that are just getting started?

Mr. BACHMANN. Well, I think there are certain basic costs that are going to be incurred regardless of the size of the organization and the smaller it is and the newer it is the more onerous those become as a portion of the business expenses. New businesses are typically concerned about survival issues and to add any extra cost becomes an impediment. So I think that the larger the organization the less important these costs are. The smaller the organization, the more important these costs are. And I know there are exceptions.

Sadly, you have cited the very small business of the professional individual who has a very large income but that wipes out a lot of people who are in exactly the category that you are talking about, struggling, trying to make a go of things and many of these are operated from people's homes, they are very small, but they are the ones that tend to systematically be left out.

Ms. VELAZQUEZ. Thank you.

Mr. Kelso, in your testimony you stated that your company was founded in 1996?

Mr. KELSO. 1976. I am sorry.

Ms. VELAZQUEZ. And that in 1987 you used an employee stock ownership plan to purchase the company. Does that mean that between 1976 and 1987 your company did not have any type of pension or retirement plan?

Mr. KELSO. No. At that time, we had a defined benefit pension plan that existed. We used the assets of that plan to leverage the ESOP, the employee stock ownership plan.

There was a sole founder of the company back in 1976 and he did set up a defined benefit pension plan.

Ms. VELAZQUEZ. Had Congress provided tax credit incentives for small businesses to start pension plans back in 1976, do you think this would have encouraged your firm to do that earlier?

Mr. KELSO. Well, the best I could answer that is to tell you what happened in 1987. There were, as you are probably aware, in ERISA, the tax incentives that were granted to owners who would sell to employees through the ESOP legislation. It was very much the reason why that principal owner did sell the company to the employees.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman MANZULLO. Congresswoman Christian-Christensen.

Ms. CHRISTIAN-CHRISTENSEN. Thank you, Mr. Chairman.

Welcome to our panelists this morning.

I have two questions and I guess I will direct this to Ms. Calimafde, but anyone else can answer it.

According to the 2000 small business employer retirement survey, one of the reasons cited by small business employers when not offering the pension plans is that the employees prefer other benefits such as health care or vacation time. Actually, I think that was number one. Health care and retirement plans are equally important, and I am a physician, so therefore this question. How do you think we can avoid creating an either/or situation for small business workers when it comes to these two priorities?

Ms. CALIMAFDE. Boy, that is a tough question and actually I know your chairman is very involved in the health care cost issue which is a huge problem for small business and, in my opinion, is getting worse. It is going to be a bigger problem. And when we talk about how many dollars are available for benefits, I believe employees of small business choose health care first. That is their first choice, then the retirement plan. And the problem is compounded by a lack of education of understanding how dollars grow in a tax-free environment and how you can put relatively little in at an early date and have it really grow to a significant amount.

I was also at the National Retirement Summit and I think one of the most exciting things that came out of that Summit was this concept of educating employees about the need to save for retirement and to save early. I think Dallas Salisbury and his group and ASEC have done a terrific job of getting spots on TV and radio. Before they started doing this, no one ever talked about saving for retirement. It just was a non-issue. And if you think about how often people talk about Social Security and how seldom they talk about retirement savings, there is a disconnect somewhere and I am not sure I understand why.

So I think part of the problem with the bill we are talking about today is somehow the press has not picked up on how important this issue is. I mean, this is one of the most vital issues we have on the table today.

I am hoping that through education employees are going to realize how important this is.

Now, what I have seen in a number of my clients, my own firm, is once a 401(k) goes in and employees start seeing the money grow tax-free and they see their account balance growing and they have the option to pick among a number of mutual funds and they have an 800 number to call and they get investment advice, it is like a whole new world opens up and once that account balance gets large enough, and I am not sure what the magic number is, they do not want to touch it any more. They want to see it grow.

So I know that all you have to do is get it going and the thing works. But I still think if a small business is very tight on profits, they are going to have to provide health care first. I really do. To keep those employees. We have a labor shortage going on, so that is helping us in this goal to promote small business formation, plan formation. But somehow we are going to have to get our hands around the health care cost increase and I have a feeling your committee is going to do a lot to help that issue also.

Would anyone else want to respond to that question?

Mr. SALISBURY. I would just underline that if one looks at the small employer retirement survey, 98 percent of those with a pension plan also sponsor health benefits; 69 percent of those without a plan do have health benefits that they sponsor, which would suggest that there is a substantial population of small employers that are saying they are interested in starting a plan because they have already taken that next step of retirement benefits.

If we look at the surveyed group, we find that 20 percent of the employers, the small employers with plans have had them less than one year, a cumulative 33 percent less than two years, a cumulative 43 percent less than four years and a cumulative 52 percent less than six years. So I think one of the things to be stressed is small employers want to have these programs. They are continuing each and every year to put these programs in at the point they can afford to do so.

And I think the emphasis of all of the witnesses today is to the degree some of the barriers that would serve to be eliminated and would serve to bring down the cost of implementing a plan, there appears to be every reason to believe that more and more small employers would continue to put in particularly the 401(k) plans if that option was there.

I stress 401(k) because the other thing we found in this survey is of those that report having a plan, 9 percent report having a defined benefit plan, 91 percent report having a defined contribution plan. So even if one were to say the defined benefit plan is preferable, as a practical matter of life, it is the defined contribution plan that has been put in place.

[To Ms. Christian-Christensen]

Ms. VELAZQUEZ. Would the gentlelady yield?

Ms. CHRISTIAN-CHRISTENSEN. Yes.

Ms. VELAZQUEZ. Mr. Salisbury, I wonder if in those surveys at any time have you gathered any information that could tell us that when the unemployment rate is high there is less of a desire—or not a desire, but because the competition for worker retention is going to be less, if there is any correlation?

Mr. SALISBURY. We have not looked at that in a survey sense. I think that if one looks even with the slowing of the economy we have experienced thus far that where it does not yet seem to have shown up is in the unemployment rate. One of the reasons for that is you do have projections of relatively tight labor markets in terms of new entrants to the labor market at least for the next 18 years just on pure demographics.

So we may end up with a very strange situation: a slowing economy and weak markets without a tremendous up tick in the overall unemployment rate. But clearly business profitability and free cash

flow is essential to the creation of these programs and if a slowing economy cuts into small business revenues and profits, then clearly that will discourage the creation of new plans.

Ms. VELAZQUEZ. Thank you.

Ms. CALIMAFDE. Could I quickly respond to that question?

Chairman MANZULLO. Sure. Go ahead.

Ms. CALIMAFDE. I think small business suffers greatly when there is employee turnover and I have a sense it suffers more than a larger business does. I think small businesses try very hard to retain their employees. I have heard small business owners complain that they have a valuable employee and that employee left for a larger business because the benefits are better. So, you know, that is sort of a countervailing balance to, well, it is easy to get good labor out there so we do not have to offer the plan. I think small business, knowing its labor force so well and wanting to keep them, if the employees said we really want this, I think they would try to provide it.

Chairman MANZULLO. I have a question that really goes to marketing of the available plans. I practiced law for over 20 years and set up a lot of small businesses and corporations. I know the last thing they had in mind, or at least their attorney did, was to get them a quick introduction to pension plans that are available.

In fact, in my own law firm, which I established in 1977, it was not until 1977, it was not until five years later that I set up a defined benefit plan. I wish I had set it up earlier. But a lot of it is through—you know, in law school, we had no courses on this, even though I graduated in 1970. I do not know what law schools are doing today, but there just seems to be nothing practical, like how to close a real estate transaction, about doing the legals of setting up a business.

I mean, how do you tell small business people, how do you get out the word that there is an affordable plan out there? Anybody.

Mr. BACHMANN. Well, we make our living doing that. Some of us are doing it full time. It is interesting how the media is able to focus attention and make people aware of things that otherwise are much more difficult to sell. We conduct seminars, we go see business people. We are a part of the local chambers of commerce and other networking kinds of organizations, but—

Chairman MANZULLO. Does Edward Jones actually set up the plan for the individuals? How do you do that?

Mr. BACHMANN. We do not administer most of them ourselves.

Chairman MANZULLO. How do you go about it? If I am running a retail store in Freeport, Illinois and interested in setting up a plan, do you make blind calls, is that it? Or send out letters explaining that you can help?

Mr. BACHMANN. Yes.

Chairman MANZULLO. Okay. Could you answer that, Mr. Kelso?

Mr. KELSO. As a small company, in 1993, we set up our 401(k) plan. The way we went about doing it was exactly that. We contacted several who we knew were providers of 401(k) plans.

Chairman MANZULLO. But how did you know about it?

Mr. KELSO. How did I know about it? Hmm.

Chairman MANZULLO. Did you read it somewhere? Did you see it on TV?

Mr. KELSO. I do tend to read a lot in the business world and I guess I just picked it up in articles and, as an ESOP company, I also attended a number of ESOP conferences and there were lots of discussions about merging ESOP and 401(k) plans together.

Chairman MANZULLO. You had a head start on it.

Mr. KELSO. Probably.

Chairman MANZULLO. But do any of your colleagues that have small businesses not have pension plans?

Mr. KELSO. I would say the number in my industry is very small because the availability of other companies that do the same thing and the movement of people in between that industry is so pervasive right across the river in Crystal City that you have to have it in order to be able to attract the people.

Chairman MANZULLO. What about a company with, say, five employees? What is available out there? Anybody.

Mr. BACHMANN. These are what we are concerned about. There is very little available because the cost of administration eats into these things.

At Edward Jones, we had heard about an organization that had really solved the riddle of how you administer very small plans and so they flew to St. Louis from New York and sat down and announced that they could do plans for as few as 100 people. Well, we were thinking about five people. We were thinking about the truly—exactly what you are talking about. And this is why, frankly, we worked with Congressmen Blunt and Bentsen in designing the piece of legislation that affects the very small businesses because we see these as the ones that the system simply inadvertently works against.

Chairman MANZULLO. Well, there are 650,000 members of the NFIB and the average number of employees is three.

Mr. BACHMANN. Yes.

Ms. CALIMAFDE. Mr. Chairman, there is an answer and the answer is called SIMPLE. And Congress put this together, I think, two or three years ago and it is basically an IRA based plan and the company simply has to go to a brokerage house or a bank and ask for a SIMPLE plan and the brokerage house sets up IRAs for each of the employees. There is virtually no administration. It was designed to be the starter plan, to just get these companies used to putting money away.

I do not look at it as the end-all, but for a simple, beginning micro business, it is the obvious first step.

The reason why I would ultimately like to see those businesses move on to the 401(k) area or the 401(k) safe harbor is money in a 401(k) plan cannot be accessed at any time by the employee. It can only be accessed by a loan if the plan allows loans and that is a written loan or due to hardship and hardship is a difficult standard.

Chairman MANZULLO. You want to use it as a retirement, not a savings account.

Ms. CALIMAFDE. Exactly. And the SIMPLE, hopefully, is the starter plan that gets the small business in, there is no administration, it is really—you cannot get easier for a small business. And then you move them into the 401(k) hopefully.



Chairman MANZULLO. Mr. Bachmann, does your firm set up the SIMPLE plans?

Mr. BACHMANN. Yes.

Chairman MANZULLO. What is it, just a form that you can get from the IRS and you sign the bottom of it, or how does that work?

Mr. BACHMANN. I cannot tell you the details. I do not know exactly the detail, but I know that it is a very important part of our business because those are many of the people that we serve. When you mentioned Freeport, Illinois, that is one of the communities we are in and I believe we have a couple of offices there.

Chairman MANZULLO. You do.

Mr. BACHMANN. And it is intended to be available to the people in that community. So we will set up whatever we can for them and typically they start with a SIMPLE plan, but, you know, people do want more.

Chairman MANZULLO. Mr. Kelso.

Mr. KELSO. I can only offer conjecture on my part, again, because I did not found my company. We bought it through the ESOP. But I firmly believe that if some of the parts of H.R. 10 go through like raising the salary coverage to \$200,000 and the \$40,000 limit and the \$15,000, then you are going to be able to show the business owner that this is a benefit to him or her and if you do not show that benefit to him or her, then they are not going to put it in for the real small company. That is my opinion.

Chairman MANZULLO. Well, I like Congresswoman Velazquez's approach. When you have Republicans and Democrats talking about tax credit, you know, this is pretty bipartisan, and what Congresswoman Velazquez is saying is, hey, you have your choice: either you pay taxes or you start up the beginning of a retirement plan. Good point. That is a good hook.

Ms. VELAZQUEZ. Do not be so surprised. Democrats, we also support that tax credit.

Chairman MANZULLO. I know that. I know that.

Thank you.

Congressman Bartlett.

Mr. BARTLETT. Thank you very much. I spent a number of years of another life in the business world. I was a mid level manager in one of the larger companies, IBM, and then I had my own small business. I am one of probably 35 people in the Congress who belonged to NFIB, an active member of NFIB, before we came here. So I am very familiar with the problems of small business.

A startling statistic relative to the recovery from our last recession was that most of the new jobs were in companies that had from zero to four employees. Most of the new jobs that brought us out of that recession were in companies from zero to four employees. And that speaks to the importance of these companies.

Having worked in really big business and in a small business, I know that they are really very different. Regulations that simply require a person or two in a company the size of IBM are no burden that cannot be borne. If you have six employees and two of them have to be monitoring government regulations, that is a burden that buries you.

I am really concerned about the availability of these plans to the smallest of businesses and I know that this is a good bill, but my

question is do we need to do something after this to make sure that our smallest businesses can be players?

Ms. CALIMAFDE. I will start off, but this is an excellent panel so I am sure you are going to have some other opinions also.

I think that we are going to need to see if the SIMPLE and the 401(k) safe harbor plans are going to work. We have had the SIMPLE I think about three years, the 401(k) safe harbor, this is going on its third year but Treasury just worked with small business last year to try to make it more workable.

One of the key things, and I think you are all onto it is we have to get the word out to small business that there are easy plans that do not require a lot of heartache to put in. Dallas is working hard on that. DOL has a webpage on it. But we really need the brokerage houses out there making ads about we need SIMPLE and 401(k) plans, we can do this for you easily.

I do think that we have to see—if Portman-Cardin became law, we have to see whether the incentives in Portman-Cardin work. Some of the problem we had in the 1980s was that we were getting retirement plan law changes literally every year and almost all of them were negative. So what happened was it just brought the system to a halt. Now we are in an era, I would say the last five years, Congress has been passing favorable bills in this area. This is like the big one, but each step has been a good step forward.

And what I would like to see is let us see what the statistics show. Are we getting new plans? Most of the statistics out there are still based on 1997 data, so we do not even know if SIMPLE is working yet. But I guess my thinking is let us get this bill passed, get the brokerage houses doing more in the way of selling these plans, have ASEC and EBRI continue to explain to people why they have to save for retirement, get the press involved a little bit and see what happens.

There is a clean-up bill behind this one, it is clear to me, but then I think we should just see if the system catches on. This may be enough to revive the whole system.

Ms. VELAZQUEZ. Mr. Chairman, may I?

Chairman MANZULLO. Sure.

Ms. VELAZQUEZ. Ms. Calimafde, when you say to get this legislation passed, Portman-Cardin, would that mean that it will include tax credit or without the tax credit incentives?

Ms. CALIMAFDE. My belief is that when this goes through the Senate the tax credit will be back on. Congressman Cardin has indicated that would not be a deal breaker. I think they would be happy to have the tax credit back on.

Ms. VELAZQUEZ. The only problem that I have is just, I do not trust the Senate.

Ms. CALIMAFDE. Well, my problem is the Senate does not pass any bills.

Chairman MANZULLO. Mr. Bartlett, the time is yours.

Mr. BARTLETT. You know, when a government person comes to a small business and says I am from the government and I am here to help you, there maybe is outright laughter involved. Somehow we have to get the message out that, in spite of the government, that this is doable for small businesses, because they are just

very disbelieving that anything that is government run is going to be easy for them to do. This is going to be a hard sell.

Mr. BACHMANN. Well, I think that—in addition to my Edward Jones hat, I am involved with the Financial Services Roundtable, the Financial Services Forum, and the U.S. Chamber of Commerce. And the Portman-Cardin legislation is at the top of all of those agendas. I mean, those are very different organizations with different objectives, but this just crosses all of the traditional barriers.

I can say the same for the securities industry association, which I am a member there as well. And I think that the thing that is amazing to some of us is that this can have the kind of support it has. When it comes through the Congress the way it has come through the Congress, it clearly has the very broad support of the people. Now, what is needed to solve the riddle on the other side—

Mr. BARTLETT. Yes. That is my concern. Clearly with 280 co-signers and broad bipartisan support—

Chairman MANZULLO. You can say the word Senate in here.

Mr. BACHMANN. I was not sure I could, but I do not want to—I have to go over there and talk to them, too. I do not want to make them sore, but—

We at Edward Jones find that this is a far more emotional issue than people seem to realize it is. When you bring it to the attention of the small business people and they discover that these are here and they are not being moved forward, I think that there is going to be—there is ultimately going to be a strong reaction.

I think there was a strong feeling last year that this is going to get through and suddenly at the end of the year, it is not through. So I would expect each of the groups that I just mentioned to take a very active role in not only calling for it, but in mobilizing constituencies to speak out on the issue. We have done it in the past and we will continue to do it at Edward Jones.

Chairman MANZULLO. We appreciate that.

Mr. BARTLETT. So your general consensus is that we need to wait and see whether this fixes the problem for really small businesses, or do we need follow-on?

Mr. BACHMANN. I think you have to get legislation passed as quickly as possible. This is very, very important legislation.

Chairman MANZULLO. Okay. Let us move on to Mr. Issa.

Mr. BARTLETT. Okay. Thank you.

Mr. ISSA. Thank you, Mr. Chairman.

Last year, I was the CEO of a 200-person, \$100 million company; 18 years earlier, it was micro and somewhere in between those years I passed through what some people would call small, but I think I was still small when I left.

My predecessor told me that I would have to deal with two definitions of any bill: when a bill has something you do not like in it, you call it a bad bill and when there is something you like in it, you call it a good bill. Every bill would be definable either way depending on which part of the bill you look at. H.R. 10 is no exception. It is a bad bill if you look at the accelerated vesting provision, which is clearly a slam on the flexibility of employers to help stem the tide of quick turnover.

Many proponents of accelerated vesting have, in a defeatist way, said we cannot change the fact that everyone is going to leave every two years. I hope those who support this idea have the same attitude as a Member of Congress because it is exactly that same sort of a thing. The House of Representatives survives because some people stay longer and we would like to encourage good people to stay longer. That concerns me about H.R. 10.

One of the burdens that small business faces is unlimited liability with the IRS for something that you do not manage or control. Our plan was controlled by Principal Financial. All we did was wire transfer money every pay period, for which we still had full liability and IRS audits and the like.

I see what is wrong with this and I would appreciate it if you would comment on either of these two deficiencies in the bill. However before I give up my time, I would like to say that I am thrilled to see that H.R. 10 provides the opportunity for employees, like the 200 that I left behind, to save more. Many of my employees relatively senior but relatively low paid in the \$30,000 or \$40,000 range were trying to save much more than they could because they were catching up for a lifetime of not saving. So I leave the negative portion of H.R. 10 for you to comment on.

Mr. KELSO. If I may, I agree totally with Congressman Issa about the vesting. We have what we feel is a very reasonable vesting schedule, 20 percent a year over five and a half years, a year qualifying and then 20 percent a year. And, again, turnover is a horrendous problem for a small company. When I first heard about the safe harbor rules, about the 3 percent match and then a 2 percent match on the next \$2 and the like, I was ecstatic because I was already doing a dollar-for-dollar match up to 4 percent which exceeded the limits set by safe harbor.

The problem was I could not take advantage of safe harbor because of the immediate vesting. There is no way in my industry that I can support full vesting immediately because that is just one more incentive for someone to move down the street for more money. Vesting is a very, very important issue, I think, for small businesses in the way of retention.

Mr. BACHMANN. I have a different view. We are a fairly large company who was a very small company and have sort of made that move from about 50 people to about—we are over 20,000 workers. So we are a different company than then, but when we were a much smaller company, my predecessor who was the chief executive said I think people should have the right to vest immediately. We think that in effect it is their money.

So while I understand that you can tie people to the company with vesting periods, we found that most people did not stay or go because of whether they were vested or not. We found that if we created a workplace and were competitive in other things that—I cannot think of a single case where vesting was an issue one way or the other. It frightened me when my predecessor went to that because I thought we should have a five-year vesting and I have become persuaded that the money really does belong to the workers and I think portability is important.

We know that that cuts both ways and most people are going to have a number of jobs in a number of different places as society changes.

Chairman MANZULLO. Well, related to that is—I know in Congress we just changed it so that you are eligible to participate by payments, I think, by paying into the 401(k), I think it is 30 days now as opposed to year. Is that correct? I thought we changed it for federal workers. Does anybody want to help me out on it? For federal workers. The thrift savings plan, from 30 days to one year.

Ms. CALIMAFDE. Mr. Chairman, can I make a comment on that?

I am finding that when I discuss with my small business clients the 401(k) safe harbor, which I thought would be embraced by them, the biggest stumbling block is the 100 percent vesting and it is very interesting because if you think—a small business basically has two vesting choices: a three-year cliff, which means after three years they are 100 percent, or six-year graded, which means after two years they are 20 percent vested and then they get an additional 20 percent vesting each year thereafter until six years when they are 100 percent vested. To my mind, there was not a great deal of difference between three-year cliff vesting and immediate vesting, but I have found that to be a major stumbling block.

Now, you know, that is in the statute and I guess I would say let us see what happens and see if it works out, but the real life experience, I am finding out there is that small businesses are very reluctant to leave the three-year cliff vesting and it does come down to loyalty. They feel they do not want to be giving pension benefits to someone who is there for six to eight months and leaves.

Mr. SALISBURY. Mr. Chairman, I would note that as a small employer, we have 25 employees, in our 401(k) plan we do provide for full and immediate vesting on both the match and on the employee dollars. In our money purchase defined contribution plan, which we are the total contributor for, we use four-year graded vesting at 25 percent per year. Going to the survey data, if one looks at the respondents among small employers who do not have plans, 30 percent cite the vesting standards as a major reason for not making the decision, 22 percent cite it as a minor reason, 46 percent say that it has nothing to do with their decision making.

So I think as with the members of this panel, what it underlines is for many small employers, it is not an adverse issue, but if one is talking about barriers to decision making by some substantial portion of small employers, the vesting issue clearly is important to a large number of them.

Chairman MANZULLO. Does anybody else have any questions?

[No response.]

Chairman MANZULLO. Okay. Well, we really appreciate your coming. As Congresswoman Velazquez and I sat here listening to this testimony, it appeared to us that perhaps one of the things that we could do, the two of us, is appear before the Ways and Means Committee and request that they have an amendment on the tax credit and we would ask—our staff will probably be in contact with one or more of you for the exact language on that amendment. We really appreciate your taking the opportunity to be here.

This committee is adjourned.

[Whereupon, at 11:39 a.m., the committee was adjourned.]

**OPENING STATEMENT**  
**Donald A. Manzullo, Chairman**

**PENSION REFORM FOR SMALL BUSINESS**  
**Hearing before the Committee on Small Business**  
**of the United States House of Representatives**  
**Wednesday, March 28, 2001, at 10:00 a.m., 2360 Rayburn**

The Committee will come to order.

Today the Committee will examine the landmark pension reform bill introduced by my good friends, Rob Portman of Ohio and Ben Cardin of Maryland. I commend them for their leadership and hard work on this important legislation. In this hearing, we will focus on how the Portman-Cardin Plan will affect small businesses.

Currently, only about half of all private sector employees have any kind of pension. The situation is even more bleak for small business employees. Less than 20 percent of small businesses -- those with fewer than 25 employees -- offer any kind of pension coverage.

The Portman-Cardin Plan is designed to expand coverage of small business retirement plans. The bill also will encourage use of such plans by reducing regulatory burdens and allowing employees to save more money in their plans. Passage of the Portman-Cardin bill is critical to expanding private retirement savings to supplement any Social Security reform. This bill has at least 259 cosponsors, and I am proud to be one of them.

I look forward to the testimony of the witnesses before us. We have Representative Cardin and four witnesses from the private sector. On behalf of the Committee, I thank them all for coming.

I now yield for any opening statement by the gentlelady from New York, Ms. Velazquez.

**Congress of the United States**  
**House of Representatives**  
107th Congress  
**Committee on Small Business**  
2501 Rayburn House Office Building  
Washington, DC 20515-6115

**Nydia M. Velázquez**  
**Ranking Democratic Member**  
**Opening Statement**  
**March 28, 2001**

Today, with small businesses assuming a larger and larger share of the economy - - - a new set of challenges for these entrepreneurs and their employees are arising. Many Members who sit on this Committee are small business owners themselves. They know, from firsthand experience, that these companies are the models for efficiency, problem solving and innovation within the business world.

Indeed, when corporate America has a problem that needs to be solved - - - and solved quickly - - - they will - - - more often than not - - - turn to small businesses. However, despite this emerging role in the new economy, small businesses are at a crossroad that will impact their historic role as the foundation of the American economy. Talk to small business owners and they will tell you that worker retention is a priority in any economy. Small businesses are daily operating at a competitive disadvantage to their corporate counterparts in the areas of worker training, health care and other benefits packages.

The unfortunate result of small businesses inability to compete in this arena has been the loss of highly skilled and highly trained employees to larger corporations who offer comprehensive benefits packages. And nothing illustrates this challenge more than the need to provide small business owners with the ability to help their employee's plan for retirement.

Last year, the House passed a comprehensive pension reform bill that was sponsored by Congressman Ben Cardin of Maryland and Congressmen Rob Portman of Ohio. This legislation would have helped America's workers save more and allowed for greatly increased portability of retirement savings accounts. And the revised Portman-Cardin bill takes pension reform even further. It increases the contribution limit from the current \$2,000 per year to \$5,000 per year and further eases "roll-over" rules which enhance the ability of workers to move their pension savings to another type of plan when they change jobs.

This new legislation will help plan for the day when American workers can look forward to retirement, not just with a sense of accomplishment for a job well done, but with a real sense of financial security based on years of hard work. But as we move to pass comprehensive pension reform - - - we must ensure that it addresses the unique needs of small businesses.

Clearly, the greatest challenge for small companies is starting a pension plan - - - that is where the rubber meets the road and where they lose traction. The cost and complexity is such a dis-incentive that entrepreneurs simply cannot justify the expense. That is why any effort to reform pension plans must reduce both cost and burden to small business. Without it, we will bring about an unfortunate situation where small businesses are forced to make the tough choice of either retaining employees or watching their life's work sink into financial disaster. Frankly, it is a choice I hope no small business owner has to make. However, I would caution my colleagues that pension reform can never - - - and more importantly, will never - - - be achieved in a vacuum. Any legislative or regulatory change we propose must be done so within the context of the larger and more extensive debate on reforming the Social Security system.

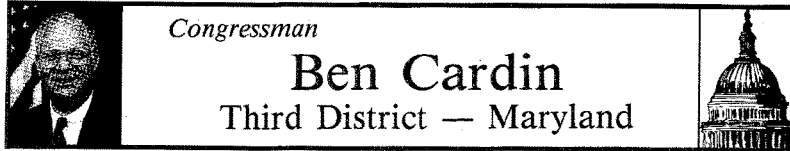
In my view, failing to address the problem of a financially strapped Social Security system is akin to owning a three-legged table - - - no matter how hard you try, you just can't balance the table. And without a doubt - - - the same will hold true for pension reform.

Consider this, for most small business owners and their employees - - - retirement planning is built out of the strength provided by Social Security. Therefore, reform of one component, that is pension reform, must go hand in hand with the retooling of the other, which is Social Security. Mr. Chairman, I would like to close by thanking the witnesses for appearing today. Their presence here and the knowledge they bring to this hearing will undoubtedly help shape the future of this debate and any legislation brought before Congress.

With that said, I urge all of you to continue to work with us to reach a reasonable solution on making pensions and retirement benefits more accessible and affordable for small business owners and their employees. By doing so, we are securing a better future for them and further strengthening America's economic foundations.

Thank you.





TESTIMONY OF THE HONORABLE BENJAMIN CARDIN  
BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS  
MARCH 28, 2001

Chairman Manzullo, Ranking Member Velazquez, members of the committee, I am pleased to have this opportunity to present testimony on a crucial issue facing our country, the ability of small business owners to provide pension plans for the millions of Americans who work for them. I especially want to commend you for holding this hearing and calling attention to America's pension crisis.

I would like to point out that I take this opportunity to testify before the House Committee on Small Business as a good omen for the passage of legislation on pension reform and expansion. The last time I testified before this panel was in September 1995. Later in that Congress, we enacted H.R. 3448, legislation which included the most significant advances in federal pension laws in nearly two decades. I am hopeful that we will have similar success in this Congress.

The 1996 Act marked a dramatic new direction in federal law governing private pension plans. Prior to that bill, the consistent direction of pension law had been to add layers of complexity and expense to the administration of pension plans.

What we accomplished in 1996 was a beginning in reversing that direction. The legislation we are here to discuss today, H.R. 10, which my friend Rob Portman and I have just reintroduced, will take the next major step in our effort to make it easier for Americans to save.

Common sense dictates that our efforts should take special notice of the problems facing small businesses and their employees. By most estimates, Americans who work in small businesses are much less likely to have pension coverage than those who work for larger companies. Among companies with fewer than 100 employees, as many as 80% of the workforce have no retirement savings plan available to them. Contrast that with the situation among larger companies, where three out of four workers have a retirement plan as part of their compensation package.

Mr. Chairman, we are at a crucial time in the consideration of this issue. The graying of the "baby boom" generation is upon us. Over the next forty years, the percentage of the U.S. population that is over age 65 will rise from 12.8% to more than 20%.

The importance of retirement savings has grown accordingly. Americans are more aware of the need to plan for their retirement. According to one survey, the percentage of workers who have attempted to calculate their income needs in retirement has risen from 34% to 56% since 1994.

A new survey by the New York Times underscored the increased concern Americans have about retirement savings. The Times found that the percentage of Americans who say

they have begun to save for their retirement has jumped from 47% five years ago to 73%. Even more important, the Times found that Americans are prepared to take responsibility for their own retirement security. More than half said they expected their major source of retirement income to come from their own retirement savings, rather than from Social Security or a pension plan.

H.R. 10 is designed to help those American workers who are determined to save for their retirement by removing limits and complexities in the law that make it more difficult for them to do so. We do that by expanding the savings opportunities within qualified plans as well as by making it easier for businesses to create plans. For small businesses, both approaches are needed.

I strongly believe that the creation of qualified retirement plans is essential if workers are going to be able to provide for their own retirement security. Despite the improvements we enacted in 1996, current law still imposes many burdensome and unnecessary requirements and restrictions that discourage small business owners from offering a retirement savings plan to their workers. H.R. 10 addresses this problem in a number of ways.

The "top heavy" rules have long been recognized as a significant obstacle to the creation of more retirement plans by small businesses. The top heavy rules were enacted in 1982, at a time when the differences between the top heavy rules and the general rules were much greater than they are today. Changes in the general rules, specifically as to faster vesting, have made the top heavy rules out-dated.

Those changes led the Department of Labor's ERISA Advisory Committee, as well as numerous small business organizations, to recommend the repeal of the top heavy rules. While our bill does not go that far, we have proposed a number of important changes that will streamline the rules to remove many of their more onerous requirements. Among the common sense provisions in our bill are a simplifying of the standards for who is a key employee. Another change would allow employers to count matching contributions toward meeting the top heavy minimum contribution requirements. Consistent with the changes in the 1996 Act, we would extend the repeal of family attribution rules to the top heavy regime.

I am particularly pleased that the bill would make clear that businesses that provide a qualified plan under the 401(k) safe harbor would not be subject to top heavy testing. When the safe harbor was created, we intended for the plans to be exempt from non-discrimination testing. To remove uncertainty about the administration of the safe harbor, it is important that we clarify that the generous matching or non-elective contributions required under the safe harbor carry an exemption from top heavy as well as non-discrimination testing.

In addition to the top heavy relief provided under the bill, we also provide important incentives to small businesses to create and expand plans. The bill would gradually increase the limits on contributions to 401(k) plans to \$15,000 from \$10,500. It would raise the maximum combined contribution from employer and employee to a defined contribution plan to \$40,000, and it would raise the considered compensation limit to \$200,000. These changes will make it possible for Americans to save more in a qualified plan, which will make it more attractive for small business owners to create a plan.

We will also allow for the first time a "catch-up" contribution to qualified plans. For many Americans, saving for retirement takes a back seat in their priorities to putting children through college or paying off a home mortgage. By the time they have met these obligations, they are approaching retirement age, frequently without having had the opportunity or the

means to save for retirement.

The "catch-up" provision of H.R. 10 will be very beneficial, and especially to small business owners and employees. It will allow individuals over age 50 to contribute an additional \$5,000, not subject to the contribution limits otherwise provided in law, as a means of making up for lost ground. This provision could prove especially beneficial to women, who are frequently in a position of returning to the workforce after raising children. The members of this committee know first-hand of the tremendous advances women have made in recent years in terms of starting their own small businesses.

The bill contains a number of other important provisions that will benefit small businesses and make it more likely that they will create a qualified plan. We would exempt small businesses from the existing requirement that they pay the IRS a "user fee" when the business requests a determination letter that its retirement plan is qualified under tax laws. We would lower the PBGC premium charged small businesses for new defined benefit plans they establish. This provision has had the support of the PBGC.

The bill includes a provision, first proposed by our colleagues Ken Bentsen and Roy Blunt, that would expand the amount of contributions to a qualified plan that can be deducted by the employer. The provision would be primarily of benefit to small businesses. Finally, we also include another proposal from the Blunt-Bentsen bill that would provide relief for small businesses with respect to the filing of Forms 5500's.

Mr. Chairman, while I believe our bill marks a major step forward in opening the door to the creation and expansion of qualified retirement plans by small businesses, there may be other issues we should also consider. For example, the original version of Portman-Cardin that was introduced in the 106<sup>th</sup> Congress included a version of the tax credit to help small businesses with the start-up administrative costs of launching a pension plan. I would hope that we would be able to restore that provision to this package as it works its way through the legislative process.

Again, Mr. Chairman, I applaud your leadership in holding this hearing, and I look forward to working with you and the members of the committee to enact strong, bipartisan legislation that will help small businesses and their workers plan for their retirement.



T - 125

Committee on Small Business  
United States House of Representatives

Hearing  
on  
**Pension Reform for Small Business**

Testimony of

Dallas L. Salisbury  
President and CEO, Employee Benefit Research Institute

Washington, DC

March 28, 2001

The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research Institute, its officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a nonprofit, nonpartisan, public policy research organization.

**Witness Disclosure Statement,  
pursuant to Clause 2(g)(4) of Rule XI of the Rules of the House:**

- **The Witness:**

Dallas Salisbury is president and CEO of the Employee Benefit Research Institute (EBRI), Washington, DC. Salisbury has headed the Institute since its founding in 1978.

- **The Organization:**

EBRI is a private, nonprofit, nonpartisan public policy research organization based in Washington, DC. Founded in 1978, its mission is to contribute to, to encourage, and to enhance the development of sound employee benefit programs and sound public policy through objective research and education. EBRI does not lobby and does not take positions on legislative proposals.

The Education and Research Fund (ERF), established in 1979, performs the charitable, educational, and scientific functions of the Institute. EBRI-ERF is a tax-exempt organization (under IRC Sec. 501(c)(3)) supported by contributions and grants. EBRI-ERF is not a private foundation (as defined by IRC Sec. 509(a)(3)).

EBRI-ERF has a number of programs:

- American Savings Education Council
- Choose to Save<sup>®</sup> Education Program
- Consumer Health Education Council
- Defined Contribution Research Program
- Fellows Program
- Health Confidence Survey Program
- Health Security/Quality Research Program
- Policy Forums
- Retirement Confidence Survey Program
- Retirement Security Research Program
- Social Security Research Program
- Education Programs--Policy Forums, Briefings, Round Tables
- Publication Programs--printed and online
- EBRI Issue Briefs, EBRI Notes, EBRI Databook on Employee Benefits, EBRI Health Benefits Databook, Fundamentals of Employee Benefit Programs, Policy Studies*

- **Contracts:**

EBRI does not have any contracts with the federal government in 2001, and did not in 1999 or 2000.

**STATEMENT BY DALLAS SALISBURY**

President and CEO, Employee Benefit Research Institute (EBRI)

Committee on Small Business

March 28, 2001

Mr. Chairmen and members of the committee: I am Dallas Salisbury, president and CEO of the Employee Benefit Research Institute (EBRI), a nonprofit research and education organization located here in Washington, DC. EBRI does not lobby or advocate for or against legislative proposals. Our work is intended to assist in evaluating potential results of proposals made by others.

It is my pleasure to appear before you today to discuss retirement plan sponsorship—and non-sponsorship—among small (100 or fewer) employees. EBRI has studied this issue extensively. Since 1998, we have conducted an annual Small Employer Retirement Survey (SERS) to explore small employer retirement plan sponsorship decisions. The survey is sponsored by EBRI, the American Savings Education Council, and Matthew Greenwald & Associates.

The bulk of my testimony today will focus on the results of the 2000 Small Employer Retirement Survey, the most recent we have analyzed. Results of the 2001 SERS will be released this June.

**Small Employer Retirement Survey Findings**

**Comparative Profiles: Companies With Retirement Plans and Those Without Plans**

- Small employers that sponsor retirement plans tend to be distinctly different from small employers without plans, in terms of revenue levels and the composition of their work force.
- Small employers that offer retirement plans tend to have higher revenues than small employers that do not have retirement plans.

| <i>Approximate Gross Revenue in Previous Year</i> | <i>Plan Sponsor</i> | <i>No Plan</i> |
|---|---------------------|----------------|
| Less than \$2 million                             | 37%                 | 70%            |
| \$2 million or more                               | 41                  | 16             |
| Not reported                                      | 22                  | 7              |

- Small employers offering retirement plans tend to employ different types of workers than those that do not sponsor a plan—their employees tend to be older, have higher earnings, have more formal education, and tend to remain with the company longer.

| <i>Age of Most Full-Time Employees</i> | <i>Plan Sponsor</i> | <i>No Plan</i> |
|--|---------------------|----------------|
| Under age 30                           | 15%                 | 27%            |
| 30–39 years                            | 53                  | 38             |
| Ages 40 and older                      | 27                  | 33             |

| <i>Annual Salary of Most Full-Time Employees</i> | <i>Plan Sponsor</i> | <i>No Plan</i> |
|--|---------------------|----------------|
| Less than \$20,000                               | 9%                  | 34%            |
| \$20,000-\$40,000                                | 71                  | 56             |
| Over \$40,000                                    | 17                  | 7              |

| <i>Educational Level of Most Full-Time Employees</i> | <i>Plan Sponsor</i> | <i>No Plan</i> |
|--|---------------------|----------------|
| High school or less                                  | 38%                 | 55%            |
| Some college   | 34                  | 32             |
| College degree or more                               | 27                  | 11             |

| <i>Length of Time Most Full-Time Employees Stay With Company</i> | <i>Plan Sponsor</i> | <i>No Plan</i> |
|--|---------------------|----------------|
| Less than 3 years  | 13%                 | 34%            |
| Between 3 and 9 years  | 56                  | 38             |
| 10 years or more   | 30                  | 24             |

#### **Obstacles to Plan Sponsorship**

- There are a number of reasons that come up in the Small Employer Retirement Survey on why more small employers do not offer retirement plans—it is not simply a matter of administrative cost and burden. The survey asked small employers to identify the most important reason for not sponsoring a plan, and to state whether a given reason was a “major” factor in evaluation. Twenty-one percent said that the most important reason was that employees prefer wages and/or other benefits. In fact, our value of benefits surveys have found that 76 percent of workers who can have only one employee benefit state a desire for health insurance. Eighteen percent of small employers say that the most important reason for not having a plan is the makeup of their work force, a large portion of workers are seasonal, part time, or high turnover. Twenty-four percent say that revenue is too uncertain to commit to a plan or the business is too new. Cost and administration-related issues do matter, with 20 percent saying that it costs too much to set up and administer a plan; that required company contributions are too expensive; or that there are too many government regulations. For most, therefore, the financial reality of running a small business is the primary impediment to having a plan.

| <i>Reasons for Not Offering a Retirement Plan</i>                        | <i>Most Important</i> | <i>Major</i> |
|--|-----------------------|--------------|
| Employees prefer wages and/or other benefits.                            | 21%                   | 38%          |
| A large portion of workers are seasonal, part time, or high turnover.    | 18                    | 40           |
| Revenue is too uncertain to commit to a plan.                            | 13                    | 45           |
| The business is too new.   | 11                    | 22           |
| It costs too much to set up and administer.                              | 9                     | 33           |
| Required company contributions are too expensive.                        | 8                     | 43           |
| Too many government regulations.   | 3                     | 24           |
| Vesting requirements cause too much money to go to short-term employees. | 3                     | 35           |
| Don't know where to go for information on starting a plan.               | 2                     | 5            |
| Tax benefits for the owner are too small.                                | 3                     | 23           |
| Other reasons.   | 9                     | 6            |

- Employee-related reasons are most often cited as the most important factor for not offering a plan, and business-related reasons, such as profitability, is also a main decision-driver. This may explain why plan sponsorship rates remain low despite repeated legislative efforts to boost them.

#### What Do Small Employers Know About Retirement Plans?

- Many nonsponsors are unfamiliar with the different retirement plan types available to them as potential plan sponsors, especially the options created specifically for small employers, which are designed to be less costly to establish and administer. One-third (33 percent) of nonsponsors said they have never heard of the savings incentive match plan for employees (SIMPLE) created specifically for small employers, and an additional 19 percent report that they are not too familiar with SIMPLE plans. The same holds for simplified employee pensions (SEPs); 54 percent of nonsponsors report that they have never heard of SEPs, and an additional 16 percent said they are not too familiar with SEPs. By comparison, very few nonsponsors said they have never heard of or are not too familiar with 401(k) plans.

| <u>Plan Type Asked of Nonsponsors</u> | <u>Never Heard Of</u> | <u>Not Too Familiar With</u> |
|---------------------------------------|-----------------------|------------------------------|
| SIMPLE plans                          | 33%                   | 19%                          |
| Simplified employee pensions (SEPs)   | 54                    | 16                           |
| 401(k) plans                          | 2                     | 8                            |

- The conclusion: many small employers simply lack information, or are even misinformed, about retirement plan options and what plan sponsorship actually entails. The majority of small employers without plans are largely unfamiliar with the plan options that have been created specifically for them.
- **These findings suggest what the “industry” has always said about retirement plans: they are *sold*, and not *bought*. Service providers must be sufficiently convinced of the prospect that small employers will be able to be sold on offering a plan to make the sales effort.**

#### Potential Motivators for Retirement Plan Sponsorship

- The potential exists for increased plan sponsorship. Those likely to start a plan are somewhat more likely to report that the most important reason they don’t currently have a plan is revenue uncertainty and less likely to say it is because a large portion of their workers are seasonal, part time, or high turnover. This therefore suggests that continued improvement in their business conditions will allow them to consider starting a plan in the future.

| <u>Likelihood of Starting a Plan in the Next Two Years</u> |     |
|--|-----|
| Very likely  | 16% |
| Somewhat likely  | 23  |
| Not too likely   | 29  |
| Not at all likely  | 31  |



- What would lead to increased plan sponsorship? Nonsponsors were read a list of items and asked if any would make them seriously consider sponsoring a retirement plan. The highest percentage, 69 percent, said an increase in business profits. Next, 65 percent said tax credits for starting a plan, and 52 percent said reduced administrative requirements.

Factors That Would Make Non-sponsors Serious Consider Sponsoring a Plan

|  |     |
|--|-----|
| An increase in business profits.                           | 69% |
| Tax credits for starting a plan.                           | 65  |
| A plan with reduced administrative requirements.           | 52  |
| Availability of easy-to-understand information.            | 50  |
| Demand from employees.                                     | 49  |
| Allowing key executives to save more in a retirement plan. | 5   |
| Lengthening of vesting requirements.                       | 27  |
| Other.   | 10  |

Why Do Small Employers Sponsor Retirement Plans?

- Several reasons are cited by those that do, but the top two are:
  - The competitive advantage for the company in employee recruitment and retention; and
  - The positive effect on employee attitude and performance.
- Sponsors are convinced, or have been convinced, that there are direct business benefits to the employer from sponsoring a retirement plan.

| <u>Reasons for Offering a Retirement Plan</u>                             | <u>Most Important</u> | <u>Major Reason</u> |
|---|-----------------------|---------------------|
| Competitive advantage for business in employee recruitment and retention. | 35%                   | 65%                 |
| Positive effect on employee attitude and performance.                     | 21                    | 64                  |
| Employers obligation to provide plan for employees.                       | 13                    | 36                  |
| Tax advantages for employees.   | 8                     | 40                  |
| Tax advantages for key executives   | 5                     | 27                  |
| Employees demand or expect it.  | 5                     | 27                  |
| Availability of employer tax deduction.                                   | 2                     | 20                  |

Implications for the Small Employer Issue

- Major drivers of low retirement plan sponsorship among small employers relate to who they employ and the uncertainty of revenue flows. While issues of administrative cost and burden matter, they are only part of the puzzle. Therefore, the solution is not simply "build it and they will come," by creating new types of retirement plans. Rather, it is build it and make it attractive enough for service providers to decide to work at selling it so that small employers will make the sponsorship decision once the

business reaches a certain level of profitability and stability, and once retirement planning and saving is more of a priority for the small employer's workers

- As the SERS finds, 39 percent of small employers without plans say they are very or somewhat likely to start a plan in the next two years. The SERS provides data on what points these employers will primarily focus upon in making that decision. And, SERS provides guidance to policymakers as to what factors can be affected by public pension policy.

---



---

### **Bibliography of EBRI Research on Retirement Issues**

#### ***Public Opinion Surveys:***

##### ***The 2000 Retirement Confidence Survey (RCS)***

The exercise of trying to figure out how much you need to save for retirement can put you ahead in the savings game, according to results of the 2000 Retirement Confidence Survey (RCS) released today. Workers who have attempted such a calculation appear to be doing a better job of preparing for retirement than those who have not.  
—May 16, 2000 EBRI press release

- *The 2000 Minority RCS*, which oversamples respondents in three minority groups (African-Americans, Hispanic-Americans, and Asian-Americans) as part of the Retirement Confidence Survey, shows many similarities as well as differences about retirement confidence, preparations and planning for retirement among individuals in these minority groups. Overall, the Minority RCS found that Hispanic-Americans tend to be less confident that they will have enough money to live comfortably throughout their retirement years than are other groups.  
—May 16, 2000 EBRI press release
- *The 1999 Women's Retirement Confidence Survey (WRCS)*, also an oversample of the Retirement Confidence Survey. A majority of American women are saving for their retirement and are confident of their retirement prospects, but more is still needed to ensure they will be able to afford life after work, according to a new survey by the nonpartisan Employee Benefit Research Institute (EBRI).  
—Feb. 2, 1999 EBRI press release

##### ***The 2000 Small Employer Retirement Survey (SERS)***

Are small businesses saying "no" to a retirement plan for their employees before knowing all the facts? According to the results of the 2000 Small Employer Retirement Survey (SERS) released today, nonsponsors may not be aware of all the options available to them, or of the potential business advantages of offering a plan. Currently, less than half (46 percent) of full-time employees at small private establishments (100 or fewer workers) are participating in an employment-based retirement plan.  
—April 4, 2000 EBRI press release

##### ***The 2000 Value of Benefits Survey***

EBRI conducted "value of employee benefits" surveys in 1991 and 1996 to determine the relative importance of different benefits to workers and to assess the role played by benefits in job choice and job change. Collaborating with WorldatWork, the survey was repeated in 1999. As earlier surveys have shown, employee benefits today remain "very important" in job selection, and workers continue to rank their health benefits as the most important of several benefits.  
—June 2000 EBRI Notes

##### ***1999 Youth and Money Survey***

Most American students feel confident in their money management skills, but many feel they need to know more about financial issues, according to results of a recent survey published in the August edition of EBRI Notes by the nonpartisan Employee Benefit Research Institute (EBRI). Significantly, the vast majority of students have financial

courses offered at school, but barely a third have chosen to take the course. Overwhelmingly, students say they depend on their parents for financial information.

—Aug. 16, 1999 EBRI press release

**EBRI Books/Special Reports:**

Andrews, Emily S. *The Changing Profile of Pensions in America*. Washington, DC: Employee Benefit Research Institute, 1985.

\_\_\_\_\_. *Pension Policy and Small Employers: At What Price Coverage?* Washington, DC: Employee Benefit Research Institute, 1989.

Employee Benefit Research Institute. *What Is the Future for Defined Benefit Pension Plans?* Washington, DC: Employee Benefit Research Institute, 1989.

Schieber, Sylvester J., and Patricia M. George. *Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement*. Washington, DC: Employee Benefit Research Institute, 1981.

| <b><u>EBRI Publications: Pensions</u></b>  |
|--|
| • Retirement Income  |
| <b><u>EBRI Issue Briefs</u></b>  |
| Copeland, Craig, and Jack VanDerhei. "Personal Account Retirement Plans: An Analysis of the Survey of Consumer Finances." <i>EBRI Issue Brief</i> no. 223 (Employee Benefit Research Institute, July 2000).  |
| Salisbury, Dallas L., and Ruth Helman, Pamela Ostuw, Paul Yakoboski. "Retirement Confidence Survey 2000. Including Results from the RCS Minority Survey and the Small Employer Retirement Survey." <i>EBRI Issue Brief</i> no. 222 (Employee Benefit Research Institute, June 2000). |
| Yakoboski, Paul. "Retirement Plans, Personal Saving, and Saving Adequacy." <i>EBRI Issue Brief</i> no. 219 (Employee Benefit Research Institute, March 2000).  |
| Yakoboski, Paul, and Pamela Ostuw, Bill Pierron. "The 1999 Small Employer Retirement Survey: Building a Better Mousetrap Is Not Enough." <i>EBRI Issue Brief</i> no. 212 (Employee Benefit Research Institute, August 1999).   |
| Copeland, Craig, and Jack VanDerhei, Dallas L. Salisbury. "Social Security Reform: Evaluating Current Proposals. Latest Results of the EBRI-SSASIM2 Policy Simulation Model." <i>EBRI Issue Brief</i> , no. 210 (Employee Benefit Research Institute, June 1999).                    |
| Gruber Jonathan, and David Wise. "Social Security, Retirement Incentives, and Retirement Behavior: An International Perspective." <i>EBRI Issue Brief</i> no. 209 (Employee Benefit Research Institute, May 1999).   |
| Quinn, Joseph F., Boston College and EBRI Fellow. "Retirement Patterns and Bridge Jobs in the 1990s." <i>EBRI Issue Brief</i> no. 206 (Employee Benefit Research Institute, February 1999).  |
| Olsen, Kelly A., and Dallas L. Salisbury. "Individual Social Security Accounts: Issues in Assessing Administrative Feasibility and Costs." <i>EBRI Special Report SR-34 and Issue Brief</i> no. 203 (Employee Benefit Research Institute, November 1998).                            |
| Yakoboski, Paul, and Pamela Ostuw. "Small Employers and the Challenge of Sponsoring a Retirement Plan: Results of the 1998 Small Employer Retirement Survey." <i>EBRI Issue Brief</i> no. 202 (Employee Benefit Research Institute, October 1998).                                   |
| Yakoboski, Paul, and Pamela Ostuw, Jennifer Hicks, Mathew Greenwald & Associates. "What Is Your Savings Personality? The 1998 Retirement Confidence Survey." <i>EBRI Issue Brief</i> no. 200 (Employee Benefit Research Institute, August 1998).                                     |

|  |
|--|
| Yakoboski, Paul, and Jennifer Dickemper. "Increased Saving but Little Planning: Results of the 1997 Retirement Confidence Survey." <i>EBRI Issue Brief</i> , no. 191 (Employee Benefit Research Institute, November 1997).   |
| Salisbury, Dallas L. and Ken McDonnell, Edina Rheem. "The Changing World of Work and Employee Benefits." <i>EBRI Issue Brief</i> , no. 172 (Employee Benefit Research Institute, April 1996).  |
| Milne, Deborah, and Jack VanDerhei, Paul Yakaoboski. "Participant Educations: Actions and Outcomes." <i>EBRI Issue Brief</i> , no. 169 (Employee Benefit Research Institute, January 1996).  |
| Milne, Deborah, and Jack VanDerhei, Paul Yakaoboski. "Can We Save Enough to Retire? Participant Education in Defined Contribution Plans." <i>EBRI Issue Brief</i> , no. 160 (Employee Benefit Research Institute, April 1995).   |
| EBRI and Public Agenda. "Promises to Keep: Leaders and the Public Look at Saving and Retirement." <i>EBRI Issue Brief</i> , no. 157 (Employee Benefit Research Institute, January 1995).   |
| EBRI and Matthew Greenwald & Associates. "Retirement Confidence in America: Getting Ready for Tomorrow." <i>EBRI Issue Brief</i> no. 156 (Employee Benefit Research Institute, December 1994).   |
| Yakoboski, Paul and Annmarie Reilly. "Salary Reduction Plans and Individual Saving for Retirement." <i>EBRI Issue Brief</i> no. 155 (Employee Benefit Research Institute, November 1994).  |
| Yakoboski, Paul, Paul Fronstin, Sarah Snider, Annmarie Reilly, David Scheer, Bill Custer, and Sarah Boyce. "Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey." <i>EBRI Issue Brief</i> no. 153 (Employee Benefit Research Institute, September 1994). |
| Yakoboski, Paul, and Celia Silverman. "Baby Boomers in Retirement: What Are Their Prospects?" <i>EBRI Issue Brief</i> , no. 151 (Employee Benefit Research Institute, July 1994).  |
| Boyce, Sarah. "Questions and Answers on Employee Benefit Issues." <i>EBRI Issue Brief</i> no. 150 (Employee Benefit Research Institute, June 1994).  |
| Saltford, Nancy, and Sarah Snider. "Characteristics of the Part-Time Work Force--Analysis of the March 1993 Current Population Survey." <i>EBRI Special Report SR-22/Issue Brief</i> no. 149 (Employee Benefit Research Institute, May 1994).  |
| Yakoboski, Paul. "Retirement Program Lump-Sum Distributions: Hundreds of Billions in Hidden Pension Income." <i>EBRI Issue Brief</i> no. 146 (Employee Benefit Research Institute, February 1994).   |
| Salisbury, Dallas L. "Pension Tax Expenditures: Are They Worth the Cost?" <i>EBRI Issue Brief</i> no. 134 (Employee Benefit Research Institute, February 1993).  |
| <i>EBRI Notes</i>  |
| Fronstin, Paul. "IRA and Keogh Asset Grew by 16 Percent During 1996." <i>EBRI Notes</i> , no. 12 (Employee Benefit Research Institute, December 1997): 1-3.  |
| Conte, Christopher. "Retirement Prospects in a Defined Contribution World: A Report on EBRI's April 30, 1997, Policy Forum." <i>EBRI Notes</i> , no. 7 (Employee Benefit Research Institute, July 1997): 1-3.  |
| Olsen, Kelly. "Retirement Annuity and Employment-Based Pension Income." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1997): 4-6.   |

|   |
|---|
| Yakoboski, Paul. "Understanding the Income of the Older Population." <i>EBRI Notes</i> , no. 7 (Employee Benefit Research Institute, July 1996): 1-3.   |
| Conte, Chris. "The Changing World of Work and Employee Benefits." <i>EBRI Notes</i> , no. 3 (Employee Benefit Research Institute, March 1996): 1-3.   |
| Rheem, Edina, and Ken McDonnell. "Benefits Are a Substantial Component of Total Compensation." <i>EBRI Notes</i> , no. 12 (Employee Benefit Research Institute, December 1995): 1-4.                            |
| Yakoboski, Paul. "Salary Reduction Arrangements as Primary Retirement Plans." <i>EBRI Notes</i> , no. 10 (Employee Benefit Research Institute, October 1995): 1-3.  |
| Salisbury, Dallas L. "Employee Benefits in a Flat Tax or Consumption Tax World." <i>EBRI Notes</i> , no. 9 (Employee Benefit Research Institute, September 1995): 1-11.   |
| Campbell, Sharyn. "Sources of Income of the Elderly Population." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1995): 4-7.   |
| Berg, Olena. "DOL to Launch Savings and Pension Education Campaign." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1995): 1-3.   |
| Conte, Chris. "Department of Labor Plans to Guide, Not Regulate, Employers in Providing Investment Education." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1995): 1-3.                  |
| Murray, Kathy Stokes, and Paul Yakoboski. "Congress Considers IRA Expansion." <i>EBRI Notes</i> , no. 4 (Employee Benefit Research Institute, April 1995): 1-5.   |
| Salisbury, Dallas L. "The Future Role of Pensions in Savings and Retirement Income." <i>EBRI Notes</i> , no. 3 (Employee Benefit Research Institute, March 1995): 1-3.  |
| Salisbury, Dallas L. "The Changing Employer Role in Retirement Security." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1995): 1-3.  |
| Salisbury, Dallas L. "Work Force Patterns and Pensions." <i>EBRI Notes</i> , no. 1 (Employee Benefit Research Institute, January 1995): 1-3.  |
| Greenwald, Mathew, and Paul Yakoboski. "Most Americans Are Confident About Retirement Security; Sizable Numbers Are Not." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1994): 1-3. |
| Fronstin, Paul and Celia Silverman. "IRA and Keogh Assets Grew 19 Percent During 1993." <i>EBRI Notes</i> , no. 10 (Employee Benefit Research Institute, October 1994): 1-3.                                    |
| Silverman, Celia. "Factors Influencing Employer Contributions to Defined Benefit Plans." <i>EBRI Notes</i> , no. 9 (Employee Benefit Research Institute, September 1994): 1-4.                                  |
| Silverman, Celia. "Income of the Elderly Continues to Change." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1994): 5-8.   |

|   |
|---|
| Pemberton, Carolyn Piucci. "Majority of Americans Support Social Security, But Confidence Is Low, According to New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1994): 10. |
| Salisbury, Dallas L. and Celia Silverman. "Social Security and Medicare Programs Face Reform." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1994): 1-6.   |
| Boyce, Sarah. "Pensions and Social Security Income, 1984-1991." <i>EBRI Notes</i> , no. 4 (Employee Benefit Research Institute, April 1994): 9-10.  |
| Pemberton, Carolyn Piucci. "Americans Are Saving for Retirement at Early Ages, According to New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 4 (Employee Benefit Research Institute, April 1994): 12.                   |
| Silverman, Celia. "IRA and Keogh Assets Reach \$775 Billion at Year-End 1992." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1993): 5.  |
| Piucci, Carolyn. "Public Attitudes on Retirement Planning-Results of New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 7 (Employee Benefit Research Institute, July 1993): 9.  |
| Yakoboski, Paul. "New Evidence on Lump-Sum Distributions and Rollover Activity." <i>EBRI Notes</i> , no. 7 (Employee Benefit Research Institute, July 1993): 6-8.   |
| Yakoboski, Paul. "Worker Attitudes Toward Retirement Financial Planning." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1993): 1-4.  |
| Piucci, Carolyn. "Public Attitudes on Investment Preferences-Results of New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1993): 7.  |
| VanDerhei, Jack. "Implications of Lowering the Compensation Limit for Qualified Retirement Plans." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1993): 1-4.                                      |
| Piucci, Carolyn. "Public Attitudes on Social Security, Results of Recent EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 3 (Employee Benefit Research Institute, March 1993): 6.   |
| Jones, Nora Super. "Benefits Issues Evolve in the 102nd Congress." <i>EBRI Notes</i> , no. 1 (Employee Benefit Research Institute, January 1993): 1-5.  |
| <ul style="list-style-type: none"> <li>• Participation and Coverage</li> </ul>  |
| <i>EBRI Issue Briefs</i>  |
| Ostuw, Pamela, and Bill Pierron, Paul Yakoboski. "The Evolution of Retirement: Results of the 1999 Retirement Confidence Survey." <i>EBRI Issue Brief</i> no. 216 (Employee Benefit Research Institute, December 1999). |
| Gruber, Jonathan, and David Wise. "Social Security, Retirement Incentives, and Retirement Behavior: An International Perspective." <i>EBRI Issue Brief</i> no. 209 (Employee Benefit Research Institute, May 1999).     |
| Copeland, Craig, and Paul Fronstin, Pamela Ostuw, Paul Yakoboski. "Contingent Workers and Workers in Alternative Work Arrangements." <i>EBRI Issue Brief</i> no. 207 (Employee Benefit Research Institute, March 1999). |

|   |
|---|
| Yakoboski, Paul. "Debunking the Retirement Policy Myth: Lifetime Jobs Never Existed for Most Workers." <i>EBRI Issue Brief</i> no. 197 (Employee Benefit Research Institute, May 1998).   |
| Yakoboski, Paul, and Jack VanDerhei. "Worker Investment Decisions: An Analysis of Large 401(k) Plan Data." <i>EBRI Issue Brief</i> no. 176 (Employee Benefit Research Institute, August 1996).  |
| Yakoboski, Paul, and Jack VanDerhei. "Contribution Rates and Plan Features: An Analysis of Large 401(k) Plan Data." <i>EBRI Issue Brief</i> , no. 174 (Employee Benefit Research Institute, June 1996).   |
| Campbell, Sharyn. "Hybrid Retirement Plans: The Retirement Income System Continues to Evolve." <i>EBRI Special Report SR-29/EBRI Issue Brief</i> , no. 171 (Employee Benefit Research Institute, March 1996).   |
| Milne, Deborah, and Jack VanDerhei, Paul Yakoboski. "Participant Education: Actions and Outcomes." <i>EBRI Issue Brief</i> , no. 168 (Employee Benefit Research Institute, January 1996).   |
| Yakoboski, Paul, Paul Fronstin, Sarah Snider, Annmarie Reilly, David Scheer, Bill Custer, and Sarah Boyce. "Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey." <i>EBRI Special Report SR-25/Issue Brief</i> no. 153 (Employee Benefit Research Institute, September 1994). |
| Yakoboski, Paul, and Celia Silverman. "Baby Boomers in Retirement: What Are Their Prospects?" <i>EBRI Special Report SR-23/Issue Brief</i> no. 151 (Employee Benefit Research Institute, July 1994).  |
| Boyce, Sarah. "Questions and Answers on Employment Benefit Issues." <i>EBRI Issue Brief</i> no. 150 (Employee Benefit Research Institute, June 1994).   |
| Saltford, Nancy, and Sarah Snider. "Characteristics of the Part-Time Work Force." <i>EBRI Special Report SR-22/Issue Brief</i> no. 149 (Employee Benefit Research Institute, May 1994).   |
| Yakoboski, Paul and Sarah Boyce. "Pension Coverage and Participation Growth: A New Look at Primary and Supplemental Plans." <i>EBRI Issue Brief</i> , no. 144 (Employee Benefit Research Institute, December 1993).   |
| Silverman, Celia. "Pension Evolution in a Changing Economy." <i>EBRI Special Report SR-17/Issue Brief</i> no. 141 (Employee Benefit Research Institute, September 1993).  |
| Anzick, Michael. "Demographics and Employment Shifts: Implications for Benefits and Economic Security." <i>EBRI Issue Brief</i> , no. 140 (Employee Benefit Research Institute, August 1993).   |
| <i>EBRI Notes</i>   |
| Yakoboski, Paul. "Worker Decisions in the Federal Thrift Savings Plan." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1996): 4-7.  |
| Yakoboski, Paul. "IRA Eligibility and Usage." <i>EBRI Notes</i> , no. 4 (Employee Benefit Research Institute, April 1995): 5-7.   |
| McDonnell, Kenneth. "Benefit Participation High Among Employees of State and Local Government, According to Latest BLS Survey." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1994): 3-5.   |
| Silverman, Celia. "Income of the Elderly Continues to Change." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1994): 5-8.   |

|   |
|---|
| Fronstin, Paul. "Dual Jobholders Less Likely to Have Health Insurance Coverage Than Single Jobholders." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1994): 1-3.  |
| McDonnell, Kenneth. "Benefit Participation Low Among Small Independent Businesses, According to a Recent BLS Survey." <i>EBRI Notes</i> , no. 7 (Employee Benefit Research Institute, July 1994): 5-6.  |
| Silverman, Celia. "Internal Revenue Service Data Provide A Look at Plan Creations and Terminations." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1994): 5-7.  |
| Silverman, Celia. "Changes in DB and DC Plans Occurring Mainly Among Small Plans." <i>EBRI Notes</i> , no. 3 (Employee Benefit Research Institute, March 1994): 1-3.  |
| Pemberton, Carolyn Piucci. "Public Opinion on ESOPs Related to Other Benefit Issues, According to New EBRI /Gallup Survey." <i>EBRI Notes</i> , no. 3 (Employee Benefit Research Institute, March 1994): 6-7.   |
| Pemberton, Carolyn Piucci. "Benefits Affect Americans' Job Decisions, According to New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1994): 8.  |
| McDonnell, Ken. "BLS Survey Shows Decline in Group Health and Retirement Plan Participation." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1993): 6-8.  |
| <ul style="list-style-type: none"> <li>• Assets and Funding</li> </ul>  |
| <i>EBRI Issue Briefs</i>  |
| VanDerhei, Jack, and Sarah Holden. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1999." <i>EBRI Issue Brief</i> no. 230. (Employee Benefit Research Institute, February 2001).  |
| VanDerhei, Jack, and Sarah Holden, Carol Quick. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1998." <i>EBRI Issue Brief</i> no. 218. (Employee Benefit Research Institute, February 2000).                                     |
| VanDerhei, Jack, and Russell Galer, Carol Quick, John Rea. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity." <i>EBRI Issue Brief</i> no. 205 (Employee Benefit Research Institute, January 1999).                                    |
| Olsen, Kelly, and Jack VanDerhei. "Defined Contribution Plan Dominance Grows Across Sectors and Employer Sizes, While Mega Defined Benefit Plans Remain Strong." <i>EBRI Issue Brief</i> , no. 190 (Employee Benefit Research Institute, October 1997). |
| Yakoboski, Paul. "Large Plan Lump-Sums: Rollovers and Cashouts." <i>EBRI Issue Brief</i> , no. 188 (Employee Benefit Research Institute, August 1997).  |
| Olsen, Kelly, and Jack VanDerhei, Dallas L. Salisbury. "A Framework for Analyzing and Comparing Social Security Policies." <i>EBRI Issue Brief</i> no. 183 (Employee Benefit Research Institute, March 1997).   |
| Scott, Jason, and John B. Shoven. "Lump Sum Distributions: Fulfilling the Portability Promise or Eroding Retirement Security?" <i>EBRI Issue Brief</i> no.178 (Employee Benefit Research Institute, October 1996).                                      |
| Boyce, Sarah. "Questions and Answers on Employee Benefit Issues." <i>EBRI Issue Brief</i> no. 150 (Employee Benefit Research Institute, June 1994).   |



|  |
|--|
| Yakoboski, Paul. "Retirement Program Lump-Sum Distributions: Hundreds of Billions in Hidden Pension Income." <i>EBRI Issue Brief</i> , no. 146 (Employee Benefit Research Institute, February 1994). |
| EBRI-ERF Staff. "Pension Fund Portfolio Turnover and Performance Evaluation," <i>EBRI Issue Brief</i> no. 143 (Employee Benefit Research Institute, November 1993).                                  |
| Salisbury, Dallas L. "Pension Tax Expenditures: Are They Worth the Cost?" <i>EBRI Issue Brief</i> no. 134 (Employee Benefit Research Institute, February 1993).                                      |
| <i>EBRI Notes</i>  |
| Yakoboski, Paul. "IRAs: Benchmarking for the Post-TRA '97 World." <i>EBRI Notes</i> , no. 12 (Employee Benefit Research Institute, December 1998): 1-3.  |
| Fronstin, Paul. "IRA Assets Grew by 23 Percent During 1997." <i>EBRI Notes</i> , no. 12 (Employee Benefit Research Institute, December 1998): 3-7.   |
| Yakoboski, Paul, and Bill Pierron. "IRAs: It's a Whole New Ballgame." <i>EBRI Notes</i> , no. 9 (Employee Benefit Research Institute, September 1997): 1-4.  |
| EBRI-ERF Staff. "Chilean Social Security Reform as a Prototype for Other Nations." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1997): 1-5.                                |
| Conte, Chris. "Assessing Social Security Reform Alternatives: EBRI's December 4, 1996, Policy Forum." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1997): 1-6.           |
| Fronstin, Paul. "IRA and Keogh Assets Grew by 25 Percent During 1995." <i>EBRI Notes</i> , no. 12 (Employee Benefit Research Institute, December 1996): 3-5.   |
| Olsen, Kelly. "Keeping Track of Social Security Reform Proposals: A Summary." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1996): 1-8.                                  |
| Pierron, Bill. "The Federal Budget Process." <i>EBRI Notes</i> , no. 9 (Employee Benefit Research Institute, September 1996): 1-5.   |
| Conte, Chris. "Comprehensive Tax Reform: Implications for Economic Security and Employee Benefits." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1996): 1-2.                 |
| Yakoboski, Paul. "Tax Reform and the Discipline of Employment-Based Relationship Plans." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1996): 5-7.                             |
| Fronstin, Paul. "IRA and Keogh Assets Grew by 6 Percent During 1994." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1995): 4-6.  |
| Salisbury, Dallas L. "Employee Benefits in a Flat Tax or Consumption Tax World." <i>EBRI Notes</i> , no. 9 (Employee Benefit Research Institute, September 1995): 1-11.                              |
| Campbell, Sharyn, and Paul Yakoboski, Dallas Salisbury. "The Challenge of Social Security and Medicare Funding." <i>EBRI Notes</i> , no. 8 (Employee Benefit Research Institute, August 1995): 1-5.  |

|   |
|---|
| Fronstin, Paul. "Pension Assets Grow 2.3 Percent Between Second and Third Quarter 1994." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1995): 3-4.   |
| Salisbury, Dallas L. and Celia Silverman. "Social Security and Medicare Programs Face Reform." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1994): 1-6.   |
| Pemberton, Carolyn Piucci. "Americans Have More Confidence in Pensions and Savings Than in Social Security, According to New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1994): 7-8. |
| Silverman, Celia. "Private Trusteed Pension Assets Reach \$2.5 Trillion by End of Third Quarter 1993." <i>EBRI Notes</i> , no. 2 (Employee Benefit Research Institute, February 1994): 5-7.                                       |
| Jones, Nora Super, and Kathy Stokes Murray. "Reflecting on 1993: Benefits Issues Take New Shape." <i>EBRI Notes</i> , no. 1 (Employee Benefit Research Institute, January 1994): 1-7.   |
| Silverman, Celia. "IRA and Keogh Assets Reach \$773 Billion at Year-End 1992." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1993): 5.  |
| Silverman, Celia, and Paul Yakoboski, Kathy Stokes Murray. "PBGRC Reform Proposed in Retirement Protection Act of 1993." <i>EBRI Notes</i> , no. 11 (Employee Benefit Research Institute, November 1993): 1-4.                    |
| Silverman, Celia. "Total Private and Public Pension Assets Reach \$4.4 Trillion by Year-End 1992." <i>EBRI Notes</i> , no. 6 (Employee Benefit Research Institute, June 1993): 4-6.   |
| Piucci, Carolyn. "Public Attitudes on Investment Preferences—Results of New EBRI/Gallup Survey." <i>EBRI Notes</i> , no. 5 (Employee Benefit Research Institute, May 1993): 7.  |

STATEMENT OF PAULA A. CALIMAFDE  
ON BEHALF OF  
THE SMALL BUSINESS COUNCIL OF AMERICA  
AMERICAN SOCIETY OF PENSION ACTUARIES  
and the  
THE SMALL BUSINESS LEGISLATIVE COUNCIL  
THE COMMITTEE ON SMALL BUSINESS  
UNITED STATES HOUSE OF REPRESENTATIVES

EXPANDING SMALL BUSINESS RETIREMENT PLAN FORMATION  
March 28, 2001

The Small Business Council of America (SBCA) is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which sponsor retirement plans or advise small businesses which sponsor private retirement plans. These enterprises represent or sponsor well over two hundred thousand qualified retirement plans and welfare plans, and employ over 1,500,000 employees.

The American Society of Pension Actuaries (ASPA) is an organization of over 4,000 professionals who provide actuarial, consulting, and administrative services to approximately one-third of the qualified retirement plans in the United States. The vast majority of these retirement plans are plans maintained by small businesses.

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. SBLC members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, tourism, and agriculture. Because SBLC is comprised of associations which are so diverse, it always presents a reasoned and fair position which benefits all small businesses.

I am Paula A. Calimafde, Chair of the Small Business Council of America and a member of the Board of Directors of the Small Business Legislative Council. I am also a practicing tax attorney (over 20 years) who specializes in qualified retirement plans. I can also speak on behalf of the Small Business Delegates to the 1995 White House Conference on Small Business at which I served as a Presidential Delegate. At this conference out of 60 final recommendations to emerge, the Pension Simplification and Revitalization Recommendation received the seventh highest ranking in terms of votes. H.R. 10, the Comprehensive Retirement Security and Pension Reform Act, introduced on March 14, 2001 with over 250 co-sponsors, incorporates many of the most important recommendations made by the delegates to the 1995 White House Conference on Small Business.

Why did the delegates consider this recommendation to be so important as to vote it as the seventh out of the final sixty recommendations? The reason is simple -- small business wants to be able to join the qualified retirement system. For small business, the qualified retirement plan is the best way to save for its employees' retirement. Based in part on the current tax law, many small businesses do not provide nonqualified plan benefits or stock option plans. Unfortunately, many, if not most, small businesses perceive the qualified retirement plan area to be a quagmire of complex rules and burdens. It is perceived as a system which discriminates against small business owners and key employees. The Conference Delegates understood that if the retirement system became more user friendly and provided sufficient benefits that they would want to join it. By doing so, they could provide for their own retirement security, while at the same time providing valuable retirement benefits for their other employees which would aid in recruitment and retention of those employees.

As a delegate appointed by Senator Trent Lott to the National Summit on Retirement Savings, I was able to share information and concerns with fellow delegates in break out sessions. Even though small business retirement plan experts, administrators and owners were not well represented, their ideas came through loud and clear in the break out sessions. Calls for repeal of the top heavy rules, increases in contribution limits, particularly the 401(k) limit, elimination of costly discrimination testing in the 401(k) area, and a return to the old compensation limits, were repeated in all of the break out sessions. Many individuals specifically called for support of a particular piece of legislation - the Portman-Cardin retirement plan bill (similar bills to the one we are discussing today have been reviewed by Congress for the last three years). Many excellent ideas emerged from this Summit, particularly in the area of increasing retirement education for the average American. An impartial observer would have noticed that the small business representatives were very united in their message - increase benefits, decrease costs. In other words, when undertaking a cost/benefit analysis, small business currently perceives the costs too high as compared to the benefits to be gained from sponsoring a retirement plan for its employees.

At the Summit, the following problems facing small businesses in the retirement plan area were brought up: staff employees' preference for cash or health care coverage rather than retirement plan coverage, uncertain or unstable business revenue, high costs of establishing and administering retirement plans, top-heavy minimum required company contributions considered excessive, accelerated vesting considered to skew benefits to transient employees at the expense of loyal employees, excessive governmental regulations and benefits for owners and key employees deemed too low in comparison to costs of sponsoring the plan. When asked what could break down these barriers, the following answers were given: reduce the cost by giving small businesses tax credits for starting up a plan; repeal the top-heavy rules; reduce administration; allow owners and key employees to have more benefits; and change lack of employee appreciation by educating employees about the need to save for their retirement now. Some micro small businesses believed that until they were more profitable nothing would induce them to join the system.

Today we are here to focus on the small business implications of H.R. 10 which is intended to expand opportunities for small businesses to offer pension plans to their employees. We will specifically address how small business would benefit from passage of H.R. 10. SBCA, ASPA and SBLC strongly support the landmark legislation, H.R. 10. **H.R. 10, if enacted, will promote the formation of new small business retirement plans, reduce unnecessarily complex and burdensome regulatory requirements, increase portability and provide more retirement security for the Americans who work for small business.**

I want to share with you two real life examples. A visiting nurses association in Vermont recently established a 401(k) plan. The average salary of the roughly 150 participants is \$17,000. 90% of the

employees decided to participate in the plan by saving some of their current salary for future retirement security. The average amount saved from their salaries and put into the 401(k) plan was 8%. Many were at the 10% to 15% levels. Some of the employees would have gone beyond 15% if they had been allowed to do so. Many of these employees live in very rural areas of Vermont and could certainly use the extra funds in their day to day life, but they understand that it is imperative to save now for their retirement security later. They understand it's not only the federal government's responsibility to provide for their retirement income.

A criticism sometimes aimed at the retirement plan system is that it is used disproportionately by the so-called "rich" or the "wealthy". Practitioners who work in the trenches know better. **The rules governing the qualified retirement system force significant company contributions for all non-highly compensated employees if the highly compensated are to receive benefits.** [It is interesting to note that despite the fanfare for retaining the top-heavy rules by a few groups, the top heavy rules have virtually no effect in increasing retirement plan benefits for staff employees. Unfortunately, they probably do serve as a major deterrent for new plan formation in the small business area.]

The 401(k) plan, in particular, is a tremendous success story. Employees of all income levels participate, even more so when there is a company match. Unfortunately, the rules in existence today conspire to reduce the incentive for small businesses to provide a match. H.R. 10 would go a long ways towards promoting matches in the small business plan environment. This would be a welcome change since it has been shown that even a small match does, in fact, promote increased 401(k) contributions by staff employees.

Here's a second real life example which is not unusual (though perhaps the level of savings is higher than normal). This is a company located in Bethesda, Maryland, specializing in testing new drugs, particularly those designed to prevent or slow down AIDS. The company started off about 20 years ago with roughly 20 employees. For each of the last 20 years, this company has made contributions to its profit sharing plan in the amount of 8% to 10%. The company has now grown to about 220 employees. Their long-timers now have very impressive retirement nest eggs. The company believes this money has been well spent. It enjoys the well-deserved reputation of being generous with benefits and employee turnover is way below the norm for this industry.

This is a retirement plan success story - a win-win situation. The company has a more stable and loyal workforce of skilled employees. The employees in turn will have retirement security. This plan benefits all eligible employees regardless of income level. Every eligible employee in the company has received in effect an 8% to 10% bonus every year which was contributed on their behalf into a qualified retirement trust where it earned tax free growth. Importantly, because this money was contributed into a qualified retirement plan, it was "locked away" from the employees so it was there when needed for retirement. As discussed below, this characteristic of a qualified retirement plan - locking the money in the plan until an employee terminates employment or later - distinguishes it from, and makes it superior to, the SIMPLE plan.

#### **Small Business Retirement Plan Coverage is Too Low**

Coverage of employees who work for small business lags far below that of the rest of the country even though they work full time. According to the Small Business Administration (SBA), in 1997 small businesses represented over 99% of all employers, created nearly all of the new net jobs and accounted for 51% of the

private sector output. Further, the SBA estimates that small businesses employ 53% of the private sector workforce.<sup>1</sup>

Yet, it is estimated that far less than half of the employees working for a small business have access to a retirement plan and as the size of the business decreases, the coverage figures decrease correspondingly. It is estimated that only 19% of employees working for firms with less than 25 employees are covered by a retirement plan and only 48% of employees working for firms with between 25-99 people are covered by a retirement plan. This is compared to 83% of employees working for firms with over 100 people.<sup>2</sup>

The actual retirement plan coverage picture may not be as bleak as these figures indicate, since retirement plans are not required to cover part-time employees, employees under age 21 and transient employees. The statistics cited for the low retirement plan coverage, however, most often include the entire workforce and do not differentiate between the entire workforce and that percentage of the workforce that is actually eligible to participate in a retirement plan. When these ineligible employees are excluded, the coverage numbers improve, but it is clear that small business retirement plan coverage is significantly lagging below that of its larger counterparts.

**Surprising Good News - Participation is High in Retirement Plans Sponsored by Companies with Fewer than 100 Employees and even with Fewer than 25 Employees**

Last year, the Congressional Research Service issued a Report for Congress, entitled "Pension Coverage: Recent Trends and Current Policy Issues", authored by Patrick J. Purcell, Analyst in Social Legislation. This report gives an excellent overview of the current coverage trends for retirement plans, though it is relying on data through 1997. Thus, in the small business area, it is not picking up any additional plan sponsorship and thus, coverage, due to the new SIMPLE and some of the real simplifications that have been accomplished in the last several retirement plan bills enacted by Congress. A quick review of the many shows small business lagging in many areas of coverage. For example, Table 3. Participation in Pension or Retirement Savings Plans by Size of Firm shows in Panel A, that in 1997, 83.3% of employees in firms with 100 or more employees had employers who sponsor a pension or retirement savings plan. This is contrasted to 58.1% of employees in companies with 25 to 99 employees have employers who sponsor such a plan. Worse, only 30.3% of employees in firms with under 25 employees have employers who sponsor such a plan. It is clear that the size of the company impacts retirement plan sponsorship. In the very next table, however, a very significant statistic emerges.

Table 3, Panel B, entitled "Percentage of Employees in Firms that Sponsored a Plan who Participated in the Plan" shows that in 1997, 88.2% of employees in firms with 100 or more employees that sponsor a pension or retirement savings plan participated in the plan. 85.5% of employees in companies with 25 to 99 employees which sponsor such a plan participated and 84.8% of employees in firms with under 25 employees participate. In short, when small businesses sponsor retirement plans, the employees participate at just about the same levels as in larger companies. **This is a very meaningful statistic and can be interpreted to mean**

---

<sup>1</sup>For the purposes of this Testimony, a small business is defined as a business with 100 or fewer employees. See Small Bus. Ass'n, *Small Business Answer Card*, [www.sba.gov/AVDO](http://www.sba.gov/AVDO).

<sup>2</sup> Christopher Come, American Savings Education Council, The National Summit on Retirement Savings: Agenda Background Materials (1998) (unpublished briefing) (on file with the American Savings Education Council).

that the key is to incentivize small business to sponsor retirement plans - once this occurs, meaningful participation results. Another way of saying this is it is critical to make the system attractive to small business. H.R. 10 does just this - it strips away unnecessary burdens and increases incentives to attract small businesses to the qualified retirement plan system.

#### Two Major Reasons Why Small Businesses Choose Not to Sponsor a Plan

There are two major reasons why a small business chooses not to adopt a retirement plan and H.R. 10 addresses both. **One of the major reasons why small businesses do not sponsor retirement plans is because the system is perceived (and deservedly so) as too complex and costly.** The devastating legislation of the 80's and early 90's layered additional requirements on small business with overlapping and unnecessarily complex rules aimed at preventing abuse in the system or discrimination against the non-highly compensated and non-key employees. In fact, it often comes as a shock to those trying to strengthen the retirement plan system for small business that the system has harsher rules designed specifically for small business. Probably the most offensive of these rules are the so-called "top heavy rules". Because of the mechanical tests associated with the top-heavy rules, almost all small business plans are top-heavy.

When a plan is top-heavy, the small business sponsoring the plan must make special required contributions which increase the cost of the small business plan and vesting is slightly accelerated. It is important to understand that the extra required contribution mandated by the top-heavy rules is probably never higher than what would be required by all of the other tests in place in the Internal Revenue Code which set forth the permissible differences between the contributions for the key employees and the non-highly compensated employees. Thus, aside from the area of defined benefit plans, which small business was largely driven away from by the legislation of the 80's and early 90's, the top-heavy minimum benefit adds nothing to what is already required by the existing law. Unfortunately, some groups lacking the technical expertise in the application of these rules do not understand this fact. The top-heavy rules bring along with them a myriad of complex and burdensome administrative requirements.

In addition to extra rules being placed on small business plans, all plans were being subjected to constant changes. These constant changes in the law and the regulations combined with reduced benefits, first brought the system stagnation and then decline. The legislation of the 80's and early 90's was prompted by the need to get short term revenue and where better to look than the pension system that no one understood and few were watching. It was also prompted by a need to rid the system of some real abuse (for instance back about 20 years ago it was possible for a retirement plan to only make contributions for employees who earned over the social security wage base, this rule was eliminated and for good reason). Unfortunately, rather than using a fly swatter, a nuclear bomb was detonated and we ended up with a system in real disrepair. **H.R. 10 preserves the safeguards for non-highly compensated employees so that they are fully protected, while stripping away the unnecessary and overlapping rules so that true simplification is achieved. This legislation is a vital step towards recovery of the voluntary qualified retirement system for small business, but further stripping away of these cumbersome and unnecessary plans will be required.**

H.R. 10 provides reasoned answers. By stripping away needless complexity and over-regulation in the form of micro management, the system will have a chance to revive. This bill would go a long way towards removing the significant burdens imposed on small business by the top heavy rules. It would simplify portability. It would repeal the absurdly complex and unnecessary multiple use test. It would truly simplify the system while leaving in place the underlying safeguards for the non-highly compensated employees.

Some have criticized H.R. 10 for not repealing the top-heavy rules because these rules are obsolete, discriminatory and serve as a real road block for small businesses to enter the qualified retirement plan system. Others have criticized H.R. 10 as the first step towards repeal of the top-heavy rules -- this is the camel's nose under the tent theory -- if you try to remove any burdens, it's just a matter of time before all the rules are repealed. Interestingly, H.R. 10 by stripping away some of the absurd burdens in the top heavy rules (for instance, requiring companies to look back only 1 year instead of 5 to determine who is a key employee to reduce extensive record keeping) while keeping what is perceived by some to be the two meaningful provisions of the top-heavy rules - extra contributions required and accelerated vesting has tried to reach a middle ground on this difficult issue.

Costs would be reduced by eliminating user fees. A welcome change for future legislation would be to provide a credit for small business to establish a retirement plan. This credit would go a long way towards reducing the initial costs of establishing a plan.

**The second reason why small business stays away from the retirement system is that the benefits that can be obtained by the owners and the key employees are perceived as too low. It is no secret that small business owners believe that the retirement plan system discriminates against them.** Short vesting periods and quick eligibility have provided more benefits for the transient employees at the expense of the loyal employees. Cutbacks in contribution levels hurt key employees and owners (of course they hurt the non-highly compensated also, but it took a long time to understand there was a very real correlation between what the small business owners could put away for themselves and their key employees and what would be put in for the non-highly compensated employees).

**H.R. 10 solves this problem also. This legislation understands there are two pieces to the puzzle - a reduction in complexity and costs is essential but is not sufficient by itself. A second piece is required. Increasing the contribution limits (in reality, partially restoring the limits) to where they stood in 1982 is equally important.<sup>3</sup>**

---

<sup>3</sup> The Department of Labor's ERISA Advisory Council on Employee Welfare and Benefit Plans released its Report of the Working Group on Small Business: How to Enhance and Encourage The Establishment of Pension Plans dated November 13, 1998. This extremely well-reasoned report provides eight recommendations for solving the problems facing small businesses today in the retirement plan area and is still valid today. Interestingly, these recommendations mirror many of those that came out of the National Summit on Retirement Savings.

The Advisory Council report calls for a Repeal of Top-Heavy Rules, Elimination of IRS User Fees, an Increase in the Limits on Benefits and Contributions, an Increase in the Limits on Includable Compensation, the Development of a National Retirement Policy, Consider the development of Coalitions, Tax Incentives and the Development of a Simplified Defined Benefit. Many of these items are included in H.R. 10. The Report explains the legislative development of the top-heavy rules and then summarizes the layers of legislation that occurred subsequent to their passage which made them obsolete. The Report states, "The top-heavy rules under Internal Revenue Code Section 416 should be repealed....Their effect is largely duplicated by other rules enacted subsequently....They also create a perception within the small business community that pension laws target small businesses for potential abuses. This too discourages small business from establishing qualified retirement plans for their employees." The Advisory Council Report calls for increasing the limits on benefits and contributions:

"The defined benefit and defined contribution plan dollar limit were indexed by ERISA and were originally established in 1974 at \$75,000 and \$25,000 respectively. From 1976 to 1982, the indexing feature was allowed to operate as intended and the dollar amounts grew to \$136,425 and \$45,475. Under the Tax Equity and Fiscal



It is interesting to examine where these limits would be today if the law in 1982 had not been enacted. *The defined contribution limit which was \$45,475 in 1982 would be \$80,741 today. This is where 401(k) limit would have been also.* Only in 1987, was the amount an employee could save by 401(k) contributions on an annual basis limited to \$7,000 and the "ADP" tests could further limit the amount (below \$7,000) for the highly compensated employees. If the 401(k) limit had then been allowed to increase thereafter with the COLA, it would now be at \$46,891. *The defined benefit limit which was at \$136,425 in 1982 would be at \$242,224 today. Allowable compensation would be at \$279,770 instead of the \$170,000 limit today.*

Given how critical it is for people to start saving for their own retirement today, it seems most peculiar to have limits harsher than what they were 17 years ago. Some people say that these limits will not operate as an incentive to small businesses to sponsor the plan and will only be used by the so-called "rich". These people do not understand small business - not only will the increased limits serve as an incentive to small businesses to sponsor a retirement plan, but the higher limits will be enjoyed by employees who are not "rich". For instance, it is very common today for both spouses to be employed. Quite often, these couples decide that

---

Responsibility Act of 1982, the dollar limit on defined benefit plans was reduced to \$90,000 and the dollar limit on defined contribution plans was reduced to \$30,000. ...

"These reductions in the dollar amounts are widely believed to have been revenue driven. These reductions had the net effect of adjusting downward the maximum amount of benefits and contributions that highly-paid employees can receive in relationship to the contributions and benefits of rank and file employees. ...

"In order to give key employees the incentive needed to establish qualified retirement plans and expand coverage, we recommend that the \$30,000 dollar limit on defined contribution plans be increased to \$50,000 which will help partially restore the dollar amount to the level it would have grown to had the indexing continued without alteration since the dollar limit was first established in 1974.

"Second, we recommend that the \$90,000 dollar limit on defined benefit plans be increased to \$200,000 which will restore the dollar amounts lost through alterations in the dollar amount since 1974, while maintaining the 1:4 ratio established in 1982 as part of TEFRA.

"Third, we recommend, that in the future, indexing occur in \$1,000, not \$5,000 increments which has had the effect of retarding recognition of the effect of inflation."

And finally the report concludes, "we recommend, that actuarial reductions of the defined benefit plans dollar limit should be required only for benefits commencing prior to age 62. This was the rule originally enacted in 1974 as part of ERISA." The Report also calls for a corresponding increase in the limit on includable compensation for similar reasons. "Under ERISA, there was no dollar limit on the amount of annual compensation taken into account for purposes of determining plan benefits and contributions. However, as part of the Tax Reform Act of 1986, a qualified retirement plan was required to limit the annual compensation taken into account to \$200,000 indexed. The \$200,000 limit was adjusted upward through indexing to \$235,843 for 1993. As part of the Omnibus Budget Reconciliation Act of 1993, the limit on includable compensation was further reduced down to \$150,000 for years after 1994. Although indexed, adjustments are now made in increments of \$10,000, adjusted downward. In 1998, the indexed amount is \$160,000." "We recommend that the limit on includable compensation be restored to its 1988 level of \$235,000 be indexed in \$1,000 increments in the future."

one of the spouse's income will be used as much as possible to make contributions to a 401(k) plan (and most often only one spouse works for a company which sponsors a 401(k) plan). Today, the most that couple can save is \$10,500 in a 401(k) plan (and if the participant spouse made more than \$85,000 last year or made less but is a 5% owner of a small business, then the couple might not even be able to put in \$10,500). Often, the couple would have been willing to save more. These couples might make \$40,000, \$50,000, \$60,000 or more, but they are not "rich". Decent income levels are achieved only because both spouses are working. Our retirement policy should provide the means by which they can save in a tax advantaged fashion *while they can*. If both spouses worked for companies which sponsored 401(k) plans, then each could put in \$10,500. The problem discussed above becomes most acute when only one spouse has a 401(k) plan. Since we know that most small businesses do not sponsor retirement plans and most new employment has been in the small business sector, it is highly probable that this is the most common fact pattern for couples today. Of course, the worst situation is where neither spouse is covered by a 401(k) plan - in this case the couple can only save a reduced amount through IRAs.

This same principle applies particularly to women who enter and leave the work force intermittently as the second family wage earner. They and their families stand to benefit the most from increased retirement plan limits because the increased limits will provide the flexibility that families require as their earnings vary over time and demands such as child rearing, housing costs and education affect their ability to save for retirement.

The relative few critics of this legislation raise the concern that some of the provisions in the comprehensive legislation might work to reduce contributions for non-highly compensated employees in small plans. Once again, these groups are not concerned with increasing formation of plans in the small business area so they dismiss the need for incentives to bring additional companies into the voluntary retirement plan system. Instead, they focus on a extremely small group of plans which *might* reduce their contributions to the non-highly compensated employees. This argument is specious for the vast majority of small businesses who sponsor retirement plans inasmuch as small businesses do not reduce employee contributions because of the obvious adverse affect on employee morale and the need to provide benefits to attract good labor because of the labor shortage.

Many mid-size and large employers rely less on their existing defined benefit plan to provide benefits for their key employees and more on non-qualified deferred compensation plans. This is a direct result of the reduction in the defined benefit plan limit. In 1974, the maximum defined benefit pension at age 65 was \$75,000 a year. Today the maximum benefit is \$140,000, even though average wages have more than quadrupled since 1974. Thus, pensions replace much less pre-retirement income now than they did in the past. In order for these ratios to return to prior levels, the maximum would have to be over \$300,000 now. The lower limits have caused a dramatic increase in non-qualified pension plans, which provide benefits over the limits. They help only the top-paid employees. This has caused a lack of interest in the defined benefit plan by the key employees since there is no incentive to increase benefits since the increases cannot benefit the highly compensated employees or key employees. This is unfortunate since increases affect all participants. The importance of bringing these limits back to the 1982 levels cannot be underestimated. They are crucial if small business is to be persuaded to join the system.

Prior to mid 1990's where Congress has worked hard to improve the retirement plan system, the thrust of the laws was how to prevent any conceivable abuse and how to limit what the upper middle income and upper income employees could receive from a retirement plan. Interestingly, it is often obvious for a member of Congress to understand that if the upper two to three quintiles of income earners are removed from the social

security system that it could prove the death knell for the system because the top earners would be disenfranchised and would no longer have any interest in the system. Interestingly, this is exactly what has happened during the mid-70's through the early 90's in the retirement plan system, but even though the same concept applied, it was not apparent. By now it should be apparent to all that we have disenfranchised large numbers of key employees from the qualified retirement system and that this has also contributed to its stagnation and decline.

Rumors have been circulating to the effect that 20% of all retirement plan benefits generated by both the private retirement plan system and the governmental retirement system go to the top 1% of taxpayers, 75% go to the top 20% of taxpayers and less than 10% go to the bottom 60% of taxpayers. These rumors appear to be attributable to a talking points sheet entitled "Distribution of Pensions Benefits under Current Law" prepared by the Office of Tax Analysis, Department of the Treasury, 1/29/99. Even though it is entitled "Distribution of Pension Benefits", it seems clear that all of the statistics are based on how projected tax expenditures for pension contributions and earnings are "received". Half of the total projected "tax expenditure" is allocated to government plans. Even taking into account that 30% of the taxpayers pay no tax (so would receive no tax expenditure), the numbers still appear to be out of line. It appears that couples where both spouses work have been treated as one individual and income has been imputed to the couple from a variety of sources. The concept of "tax expenditure" itself is controversial. The theory is based on the premise that all sources of money should be taxed and "belong" to the government. When the government foregoes its collection of this money it becomes a "tax expenditure". This is in contrast to the theory which states that the government is only entitled to tax certain enumerated items and no others. However, these rumors have started, they are not based on fact and they do a real disservice to the people who are trying to revitalize the retirement plan system at a time when it is critical to do so.

In fact, it is a shame that H.R. 10 is characterized as a tax bill at all. Yes, passage of the bill would, if the law operated as intended, increase retirement savings which would cause a short term drop in the collection of tax dollars. However, retirement policy should be placed above the short term collection of tax dollars and shoring up the qualified retirement system by passage of H.R. 10 should be given the same priority as shoring up the Social Security System. In truth, we all know that unless all three legs of the famous retirement stool - Social Security, Qualified Retirement Plan System and individual savings are all bearing the weight, the stool will collapse.

Interestingly, the American Council of Life Insurance has concluded a research project authored by Janemarie Mulvey, Ph.D, Director of Economic Research, May 19, 1999. This study defines pension benefits as benefits coming from employer-sponsored plans, federal, state and local and military, but does not include lump sum payments. This study shows that the system provides meaningful benefits for many individuals who are in the low to middle income ranges. For example, the report found that:

Among Married Couples Receiving Pensions:

1/3 had incomes below \$30,000 (median income);  
 57% had incomes below \$40,000 (average income)  
 Nearly 70% of those receiving pensions had income below \$50,000

These types of statistics are based on real data and show that meaningful benefits are being received by employees who have average income. This is the only data which gives us a true picture of the success of the retirement plan system. Utilizing a tax expenditure concept, when roughly one-third of the pension system

recipients do not receive a tax expenditure because they pay no taxes, renders any results arising out of this type of analysis to be absurd.

Another major “fix up” in this bill deals with Section 404. This section limits a company’s deductible contribution to a profit sharing plan to 15% of all participant’s compensation. This limit presently includes employee 401(k) contributions. This means that if an employer chose to make a 15% contribution to a profit sharing plan, then no employee would be allowed to make a 401(k) contribution. Realizing the absurdity of this rule, H.R. 10 would no longer count employee contributions (401(k)) towards the 15% overall deduction level.

Even more importantly, the 15% level would be raised to 25%. This change would allow small businesses to sponsor one plan in place of two plans that are now required to accommodate a contribution greater than 15%. This would generate real savings to the small business since only one plan document, one summary plan description, one annual 5500, etc. would be required instead of two. In short, this small change would cause a significant reduction in administrative expenses.

It is becoming increasingly apparent that the public needs to be educated on the importance of saving for retirement, particularly when still relatively young. The use of public service spots on television, radio and in the printed media to educate the public and raise the awareness of the need to prepare and save for retirement will need to be increased. One of the direct benefits to come out of the National Retirement Summit is the educational spots being put on the air by ASEC and EBRI. It is critical for the public to become educated about the need to start saving for their retirement and the benefits of starting early.

The graying of America, and the burden that it will place on future generations, should not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by 49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our nation’s programs designed to serve the aged.

While we must shore up Social Security and Medicare, it is clear that the private retirement system and private sources for retiree health care will have to play a more significant role for tomorrow’s retirees. The savings that will accumulate for meeting this need will contribute to the pool of capital for investments that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. The policy direction reflected by H.R. 10 will ensure that sufficient savings will flow into the retirement plan system so as to provide a secure retirement for as many Americans as possible.

The last two bills passed by Congress to enhance the retirement system and retirement savings began the process of simplifying the technical compliance burdens so that small businesses are able to sponsor qualified retirement plans. *H.R. 10 represents another huge step forward.* Indeed, if this legislation becomes the law, then relatively few changes remain to be implemented before the system is fully restored to its former health prior to the onslaught of negative and complex changes of the 1980’s while retaining the needed reforms introduced during that period.

**SBCA, ASPA and SBLC strongly support the following items in H.R. 10 which will greatly assist businesses, and particularly small businesses, in sponsoring retirement plans:**

**Top Heavy Rules**

These rules are now largely duplicative of many other qualification requirements which have become law subsequent to the passage of the top-heavy rules. They often operate as a "trap for the unwary" particularly for mid-size businesses which never check for top-heavy status and for micro small businesses which often do not have sophisticated pension advisors to help them. These rules have always been an unfair burden singling out only small to mid-size businesses. *The changes made in H.R. 10 will simplify the retirement system with little to no detriment to any policy adopted by Congress during the last decade.* The top-heavy rules have required extensive record keeping by small businesses on an ongoing 5 year basis. They also represent a significant hassle factor for small business - constant interpretative questions are raised on a number of top-heavy issues and additional work is required to be done by a pension administrator when dealing with a top-heavy plan, particularly a top-heavy 401(k) plan. Make no mistake that many of the burdens of the top-heavy rules will survive H.R. 10 and will need to be further examined in the years ahead to see if their administrative burdens can be justified in light of the questionable benefits that are gained.

SBCA, SBLC and ASPA strongly support the repeal of the family attribution for key employees in a top-heavy plan. These rules require a husband and wife and children under the age of 19 who work in a family or small business together to be treated as one person for certain plan purposes. They discriminate unfairly against spouses and children employed in the same family or small business.

We also support the simplified definition of a key employee as well as only requiring the company to keep data for running top heavy tests for the current year rather than having to keep it for the past four years in addition to the current year.

We strongly support the change which would allow a small business to keep a defined benefit plan in frozen status without incurring additional charges for the non-key employees. The current rule in this area promotes the termination of defined benefit plans to the detriment of all small business employees.

#### 401(k) Changes

**The 401(k) Plan is a tremendous success story.** The excitement generated by this plan is amazing. Prospective employees ask potential employers if they have a 401(k) plan and if so, what the investment options are and how much does the employer contribute. Employees meet with investment advisors to be guided as to which investments to select, employees have 800 numbers to call to see how their investments are doing and to determine whether they want to change investments. Employees discuss among themselves which investment vehicles they like and how much they are putting into the plan and how large their account balances have grown.

The forced savings feature of the 401(k) plan cannot be underestimated and must be safeguarded. When a person participates in a 401(k) plan, he or she cannot remove the money on a whim. Savings can be removed by written plan loan which cannot exceed 50% of the account balance or \$50,000 whichever is less. Savings can be removed by a hardship distribution, but this is a tough standard to meet. The distribution must be used to assist with a statutorily defined hardship such as keeping a house or dealing with a medical emergency. This is in contrast to funds inside an IRA or a SIMPLE (which is an employer sponsored IRA program) where the funds can be accessed at any time for any reason. True, funds removed will be subject to a 10% penalty (which is also the case for a hardship distribution from a 401(k) plan), but preliminary and totally unofficial data suggests that individuals freely access IRAs and SEPs (also an employer sponsored IRA program) and that the 10% penalty does not seem to represent a significant barrier. In fact, this is why the SIMPLE IRA starts off with a 25% penalty for the first two years an individual participates in SIMPLE in hopes that if a participant

can accumulate a little bit he or she will be tempted to leave it alone and watch it grow. Nevertheless, there is a distinct difference between asking the employer for a loan or a hardship distribution and having to jump through some statutorily and well placed hoops versus simply removing money at whim from your own IRA.

\* Increasing 401(k) contributions from \$10,000 to \$15,000 is a significant, beneficial change which will assist many employees, particularly those who are getting closer to retirement age.

\* Opening up the second 401(k) Safe Harbor, the "Match Safe Harbor" to small businesses by exempting it from the Top-Heavy Rules is a valuable change which places small businesses on a level playing field with larger entities. Lately, there has been some discussion that this change will hurt small business non-highly compensated employees. Again and most unfortunately, this type of argument is often advanced by people with little technical knowledge of how the top heavy rules operate nor do they understand small business. They also are not particularly concerned about expanding small business coverage. This type of change is critical if we are to promote the match safe harbor plan. Without this change, this plan is basically dead on arrival. Why? Because a small business would be required to make a top heavy contribution AND the prescribed safe harbor match. Under the alternative 3% 401(k) safe harbor, the same contribution satisfies the top-heavy rule and the 401(k) safe harbor rule. This is an area where it is critical for Congress to ask the folks in the trenches what impact the change will have rather than relying on those with no practical experience.

\* We believe that the voluntary safe harbors will prove to be the easiest and most cost effective way to make the 401(k) plan user friendly for small businesses. If a small business makes a 3% contribution for all non-highly compensated employees, or makes the required matching contributions, then the company no longer has to pay for the complex 401(k) nondiscrimination testing (nor does it have to keep the records necessary in order to do the testing). We recognize that many companies will choose to stay outside the safe harbor because the 3% employer contribution or required match "cost of admission" is too high and because it is more cost-effective to stay with their current system (including software and written communication material to employees). *Many believed that small business would embrace the voluntary safe harbors that do away with costly complex testing.* It is hoped that the remaining road blocks with respect to the safe harbors can be removed. It is important to applaud Treasury and IRS for their work done last year to try to make these safe harbors more workable for small business. First, the notice requirement for the 3% safe harbor should be removed. It is a statutory requirement and even though Treasury and IRS have worked around it as best as they are able, they are not capable of removing it. The notice requirement plays no function at all with respect to the 3% safe harbor and operates only as a nuisance and a trap for the unwary. As we know, there are two safe harbors - one is a prescribed company match to employee 401(k) contributions, the other is a non-elective 3% contribution. A non-elective 3% contribution means that every eligible employee receives this contribution whether or not he or she makes 401(k) contributions. The rationale for notice in the context of the match safe harbor is self evident. An employee may very well change his or her behavior and contribute more 401(k) contributions knowing that a match is going to be made. As mentioned above, there appears to be no rationale for notice in the context of the non-elective 3% contribution - no employee is going to change any behavior on knowing that a contribution will be made for them at the end of the year. The problem of course is compounded when dealing in the small business world. Unless an outside advisor has informed a small business that it must give a fairly extensive written notice by a certain date and the company complies, it will not be able to take advantage of the safe harbor for the entire year.

IRS also has stated that the 3% non-elective contribution must be paid to every non-highly compensated employee regardless of whether they have completed 1,000 hours and whether he or she is employed on the last day of the plan year. This is more restrictive than either the rule for normal plan contributions or the rule for

the top-heavy minimum contributions. This rule should be changed so that either the safe harbor has to made for all participants who have 1,000 hours of service in the year OR are employed on the last day of the plan year.

*SBCA, SBLC and ASPA suggest that there be no notice requirement for the 3% non-elective contribution safe harbor. We also suggest that the 3% non-elective contribution or the match safe harbor contribution be made to either all non-highly compensated employees who have worked 1,000 hours or to those employees who are employed on the last day of the plan year, but not both.*

\* **Increasing the IRC Section 404 15% deduction limit to 25% is a major change which will appreciably assist small businesses.** Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. Because of this rule, today many companies, including small businesses, sponsor two plans because the 15% limit is too low for the contributions they are putting in for their employees. Most often a money purchase pension plan is coupled with a profit sharing plan to allow the company to get up to a 25% deduction level. By requiring companies to sponsor two plans where one would do, administration expenses and user fees are doubled. Each year the company is required to file two IRS 5500 forms instead of one. The company is required to have two summary plan descriptions instead of one. This change would truly simplify and reduce administration expenses and exemplifies the outside of the box thinking found in H.R. 10. In fact, it is interesting to contemplate whether Section 404 serves any meaningful function today.

\* **The Qualified Plus Contribution is an exciting concept which may prove to be sought after by employees contributing 401(k) contributions.**

\* **Excluding 401(k) contributions made by the employees from the IRC Section 404 15% deduction limit will make these plans better for all employees.** Today, employee 401(k) contributions are included in the Section 404 limit. Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. This limit covers both employer and employee 401(k) contributions. This limitation now operates against public policy; either employer contributions are cut back which works to the detriment of the employees' retirement security or employee pre-tax salary deferred contributions must be returned to the employee. Thus, employees lose an opportunity to save for their retirement in a tax-free environment. This is particularly inappropriate since the employee has taken the initiative to save for his or her retirement, exactly the behavior Congress wants to encourage, not discourage.

\* **Congress will need to enact a law which will allow an employee-pay all 401(k) plans for small business.** Today, a key employee who makes a contribution to a 401(k) plan sponsored by a small business will trigger the top-heavy rules so that the small business will be required to make a 3% contribution for all non-key employees. Not only is this a trap for the unwary since many small businesses, including their advisors, are unaware of this strange rule, but it is also unfair since a larger company would be able to sponsor an employee-pay-all 401(k) plan and not have to make any employer contributions to the plan. The regular 401(k) anti-discrimination tests are more than sufficient to ensure that the non-highly compensated employees are treated fairly vis a vis the highly compensated employees.

\* **The so-called "Catch-Up Contributions" for people approaching retirement may be helpful for small business employees, particularly those who were not able to save while they were younger.**

Changes to Plan Contribution Limits

Perhaps the most important change in the retirement legislation is increasing the dollar limits on retirement plan contributions, removing the 25% of compensation limitation and increasing the compensation limitation.

\* Increasing the \$150,000 compensation limit to \$200,000 is an important change which will at least partially bring the plan contributions back into line with 1982 dollars. This cutback was perceived by owners and other key employees of small businesses as reverse discrimination and as a disincentive in establishing a retirement plan.

\* Increasing the defined contribution limit from \$35,000 to \$40,000 and the defined benefit limit from \$140,000 to \$160,000 are good changes which will increase retirement security for many Americans. These numbers, however, are way below actual inflation and should be increased.

SIMPLE Plans

It is exciting to see that the SIMPLE is attracting so many small businesses. We believe, though, that the SIMPLE plan should be viewed as a starter plan and that all businesses, including the very small, should be given incentives to enter the qualified retirement plan system as quickly as possible. The SIMPLE is an IRA program, as is the old SEP plan and in the long run true retirement security for employees is better served by strengthening qualified retirement plans rather than SIMPLEs and SEPs. This is simply because employees have a far greater opportunity to remove the money from IRAs and SEPs and spend it - the forced savings feature of a qualified retirement plan is not present. While we appreciate that for start-up companies or micro businesses, a SIMPLE is the best first step into the retirement plan system, the company should be encouraged to enter the qualified retirement system as soon as possible. By making the SIMPLE rules "better" than the qualified retirement system, the reverse is achieved. Thus, we hope that the "gap" between the 401(k) limit (\$15,000) and the SIMPLE limit (\$10,000) is carefully preserved so that the system does not tilt in the wrong direction.

We do not believe that any other new plans than those set forth in H.R. 10 are needed. We now have a very good mix of plans - from those which provide flexibility and choice to very simple plans for the companies who do not want administration costs.

Required Minimum Distribution Rules

We support exempting a minimum amount from the required minimum distribution rules. We would encourage the Committee to also consider whether the rule which delays receiving distributions for all employees, other than 5% owners, until actual retirement, if later, should be extended to 5% owners. There seems to be no policy rationale for forcing 5% owners to receive retirement distributions while they are still working.

We also respectfully suggest the following:

1. **Allow direct lineal descendants of the participant, in addition to a spouse, to be able to roll-over a plan contribution to an IRA.** Today, if a participant dies and names the spouse as beneficiary, the spouse can "roll-over" the retirement plan assets into an IRA, rather than receiving payments from the retirement plan. On the other hand, if a participant dies and names his or her children as the beneficiaries, the children



cannot roll over the assets into an IRA and will in most cases be forced to take the distribution in one lump sum. This triggers the problem set forth in 2 below.

2. **Provide an exemption of retirement plan benefits from estate taxes.** As mentioned above, if the children are forced to take a lump sum distribution (and assuming they have no surviving parent), the entire retirement plan contribution is brought into the estate of their parent who was a plan participant and is subject to immediate income tax. This is the fact pattern where the plan distribution is reduced by up to 85% due to taxes - federal and state income taxes and federal and state estate taxes. This is why people often say they don't want to save in a retirement plan because if they die the government takes it all and the children and grandchildren receive way too little.

#### Plan Loans for Sub-S Owners, Partners and Sole Proprietors

This is a long overdue change to place all small business entities on a level playing field. We support this change.

#### Repeal of 150% of Current Liability Funding Limit

This is a very technical issue, but basically defined benefit plans are not allowed to fund in a level fashion. Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less than the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. *This provision is particularly detrimental to small businesses who simply cannot adopt a plan which does not allow funding to be made in a level fashion.* The changes made to this law by H.R. 10 are critical for small businesses to be able to sponsor defined benefit plans. However, there is an unfair provision in H.R. 10 which is that funding up to unfunded termination liability would be available to ALL plans except those sponsored by a professional service employer with fewer than 25 employees. This type of blatant discrimination towards professional service companies deserves no place in our tax laws.

A small business will go through a cost-benefit analysis to determine whether to sponsor a qualified retirement plan. A number of factors are analyzed including the profitability and stability of the business, the cost of sponsoring the plan both administratively as well as required company contributions, whether the benefit will be appreciated by staff and by key employees and whether the benefits to the key employees and owners are significant enough to offset the additional costs and burdens. **The legislation being contemplated by this Committee will dramatically improve the qualified retirement plan system.** By making the system more user friendly and increasing benefits, more small businesses will sponsor retirement plans. Easing administrative burdens will reduce the costs of maintaining retirement plans. The changes would revitalize the retirement plan system for small business as it is perceived by small businesses as more fair to them. Finally, the positive changes made by Congress in the 1980's would be retained and the time tested ERISA system would stay in place. Ultimately, it is essential for this country to do everything possible to encourage retirement plan savings so that individuals are not dependent upon the government for their retirement well-being.

STATEMENT OF MICHAEL P. KELSO  
PRESIDENT AND CEO, ELS

HOUSE COMMITTEE ON SMALL BUSINESS

SMALL BUSINESS IMPLICATIONS OF HR 10  
MARCH 28, 2001

Mr. Chairman and members of the committee, I am Michael Kelso, President of ELS, located in Arlington, Virginia. We are a 40 person employee-owned business providing engineering and consulting services to the federal government and commercial customers. We were founded in 1976 and in 1987 used an Employee Stock Ownership Plan (ESOP) to purchase the company from the retiring owner. Today we are 100 percent employee owned.

As this Committee is aware, small business has a difficult time competing with larger firms for scarce employees. One tool used by small business is an attractive profit sharing and 401(k) plan. The Profit Sharing/401(k) Council of America's latest study reports that firms employing less than 50 workers contribute 19.8 percent of net profits to these plans, more than any larger business and several times more than firms employing 1,000 or more workers. HR 10 will improve the ability of small business to retain this important advantage.

ELS is strongly committed to offering a meaningful retirement plan to all our employees. We are extremely proud of our plan and I want to take a minute to describe it to you. ELS contributes to the plan in three ways. First, we provide an Employee Stock Ownership Plan which averages 6 percent of pay. Second, we match one-to-one the first four percent of pay that an employee contributes to his or her 401(k) plan or \$2,000, whichever is greater. That means that employees with annual earnings earning less than \$50,000 get a higher percentage contribution than other employees. Any participant earning more than \$50,000 receives a maximum 4 percent matching contribution while a participant earning \$40,000 gets 5 percent and one earning \$30,000 gets 6.7 percent. Finally, participants receive an allocation to their plan accounts of non-vested assets from the accounts of employees who leave ELS before fully vesting in the employer contributions credited to their accounts. This year, these forfeiture allocations will amount to around 7.6 percent of salary. When you add up all these contributions to our employees, they total 17.6 percent for people making \$50,000 and 18.6 percent at the \$40,000 level. The lower the salary, the higher the percentage the company contributes.

ELS pays a price for its generosity. Last year, and for many earlier years, we paid an excise tax because we contributed more than 15 percent of payroll, the annual employer deduction limit, to the retirement plan. This is especially onerous since the 15 percent calculation has to include elective deferrals by our employees. HR 10 contains provisions that would provide ELS relief from the tax by eliminating the requirement to include employee contributions in the calculation and raising the limit to 20 percent of compensation.

Our lower paid employees, all of whom participate in our 401(k) plan, are also negatively affected by existing pension law. For the past several years I have had to require many of these employees to cease their contributions to the 401(k) plan because they were about to violate the 25 percent of compensation limit on combined employer and employee contributions to their plan account. Last year, three-quarters of my non-highly paid employees were told that they had to stop contributing to their 401(k) because of the 25 percent limit. They were capped at around 7 percent of their pay. HR 10 would eliminate the 25 percent of compensation limit and allow these non-highly paid employees the opportunity to accumulate more in their retirement accounts.

Maria Pingree is a typical example. She is a data management specialist at ELS, earning \$36,000 a year and a single mother of two grown children. As someone who entered the workforce later in life, Maria is anxious to save as much as she can for retirement. Through careful budgeting, Maria can afford to defer 10 percent of her salary, or \$3,600, into her 401(k) plan account, far short of the \$10,500 statutory limit currently in effect for 2001. I had to require Maria to stop deferring last year when she reached 7 percent of salary, around \$2,500. This year is even worse. Because of the increased allocation of forfeitures, Maria will be limited to a 6 percent deferral, approximately \$2,100, because of the 25 percent rule. This rule inordinately affects our lower-paid employees. Under the limit imposed last year, an employee earning \$80,000 could still contribute \$5,600, more than twice as much as Maria could. This makes no sense.

HR 10 will eliminate the 25 percent rule retroactively to the beginning of this year. It also has a provision for people over age 50, like Maria, who are trying to catch up for years spent outside the workforce, to save an additional \$5,000 over the normal plan limit for their upcoming retirement. I hope that HR 10 is enacted before Maria has to stop making her contributions this year.

**PREPARED TESTIMONY OF JOHN W. BACHMANN,  
MANAGING PARTNER, EDWARD JONES INVESTMENTS, BEFORE  
THE HOUSE SMALL BUSINESS COMMITTEE, MARCH 28, 2001**

Mr. Chairman and members of the Committee, thank you for inviting me to speak with you today on the important subject of small business retirement plans. I am John W. Bachmann, Managing Partner of Edward Jones Investments, a full-service investment firm with more than 6,600 branch offices in the United States, Canada, and the United Kingdom. I am very pleased to come before this Committee today to express our enthusiastic support for the Portman/Cardin bill, H.R. 10. Edward Jones believes that the Portman/Cardin bill would provide much-needed incentives to small businesses to establish new retirement plans for their workers and to enhance existing plans. We applaud Congressman Rob Portman and Congressman Ben Cardin for their excellent work in proposing this important legislation and for their years of leadership in encouraging retirement savings. We also applaud Congressman Roy Blunt and Congressman Ken Bentsen for their leadership in introducing H.R. 738, which contains critical reforms for small business retirement plans. These reforms have been incorporated into the Portman-Cardin bill.

Edward Jones serves more than 4.6 million investors, of whom approximately 650,000 are small business owners. Our small business owners are, in many cases the smallest of the small – those with 10 or fewer employees and \$1 million to \$2 million in annual sales revenue. While these small business owners are often overlooked by the financial services industry, our experience is that this group of companies is the fastest growing among the general universe of businesses with 100 or fewer employees.

Planning for retirement income is a growing concern across America. Demographics show us that our nation is growing older and living longer. As American workers retire, their income sources are primarily personal savings (including IRAs), Social Security, and employer-provided retirement plans. Much recent discussion has focused on encouraging Americans to increase their personal savings, and on reforming Social Security. I am here today to discuss ways to encourage small business owners to establish and maintain retirement plans for their employees.

**Barriers to small business retirement plans**

We at Edward Jones are concerned about the low number of small businesses that provide a retirement plan for their employees. Today, approximately 22% of the American workforce is employed at a business with 25 or fewer employees. However, only 18% of these workers are covered by a retirement plan, leaving over 23 million employees of small

businesses uncovered.<sup>1</sup> This clearly jeopardizes the retirement security of a very large portion of the workforce.

In June of 1998, I served as a delegate to the National Summit on Retirement Savings, held here in Washington. One of the objectives of the summit was to identify barriers to retirement savings. In looking at employer-provided retirement plans, we discussed two key factors that prevent small businesses from establishing employee retirement plans: the high cost involved in setting up and maintaining tax-qualified retirement plans, and the complexity involved in administering these plans.

The Portman/Cardin bill would very effectively address these obstacles to small business retirement plan coverage. In particular, the bill would:

- Dramatically simplify the annual filing requirements for small business retirement plans. By reducing this administrative burden, the cost of maintaining a qualified plan would be reduced for small businesses.
- Simplify the rules for small business owners who want to provide their employees with enhanced retirement benefits to catch up for the years when the owner could not afford to maintain a plan.
- Increase the contribution limits for plans so as to provide greater incentives for savings and plan establishment. These increases would reverse years of revenue-driven decreases and frozen contribution limits that have severely hindered retirement plan growth.
- Eliminate or simplify burdensome restrictions applicable to small business retirement plans.

The Portman/Cardin bill would also provide a needed boost to our economy by stimulating retirement savings and thus providing a critical source of capital for businesses. In short, this is a bill for both individuals and for businesses. It benefits individuals who need a secure retirement; at the same time, it benefits businesses by making needed capital available. It is truly win-win legislation that should be enacted this year.

#### The Portman/Cardin Bill Would Address The Complexity and Burdens of Current Law

Reducing reporting burdens. Retirement plans are generally required to file a Form 5500 with the government each year. This multi-page reporting obligation can be quite burdensome for a small business. The Portman-Cardin bill would simplify this burdensome requirement in two very significant respects.

---

<sup>1</sup> *Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage* (GAO/HEHS-00-131, August 2000) (based on data in 1998).

First, where a small business does not have any employees other than the owners, the Portman/Cardin bill would generally exempt a retirement plan maintained by that business from the Form 5500 requirement if the plan has less than \$250,000 in assets (increased from \$100,000 under current law). This proposal would dramatically expand the group of small businesses that can focus their resources on retirement savings, rather than on reporting, thus encouraging the adoption of new plans.

Second, the Portman/Cardin bill would make the Form 5500-EZ -- a vastly simpler form available under current law only to owner-only plans with more than \$100,000 in assets -- applicable to all plans that cover fewer than 25 employees, as long as they satisfy certain requirements (such as coverage of a nondiscriminatory group of employees). This proposal would simplify the reporting obligation for a tremendous number of small businesses and would do so in a way that has already been recognized as providing sufficient information.

Eliminating obstacles to plan formation. Many small businesses cannot afford to establish a plan during the business' early years. When the business starts becoming profitable in later years, the owner realizes that none of the business' employees has any material retirement savings. Often, the owner wants to remedy this problem not only for himself or herself, but also for the business' loyal employees, some of who may be nearing retirement. This type of business owner should be encouraged to provide generous catch-up contributions for the business' workforce but instead the law contains significant obstacles.

Small businesses that wish to provide a 401(k) arrangement and provide total retirement benefits in excess of 15% of participants' compensation must generally establish two plans: a profit-sharing plan and a money purchase pension plan. Under current law, this type of two-plan arrangement enables many small employers to make total deductible contributions for a participant up to 25% of that participant's compensation. Having two plans, however, adds significant burdens that would not apply in the case of a single plan, such as two determination letter requests to the IRS, two Forms 5500, separate recordkeeping, and separate application of numerous rules (including certain rules that apply differently to the two types of plans).

These burdens are unnecessary; there is no policy reason to require small businesses to have a complicated two-plan arrangement in order to provide enhanced contributions for their employees. The Portman/Cardin bill would solve this problem, and thus encourage small business plan formation, by establishing a simple rule -- a 20%-of-compensation deduction limit with respect to profit-sharing plans -- that minimizes the need for two plans.

Increased limits. The Portman/Cardin bill would increase many of the limits applicable to retirement plans. For example, the limit on 401(k) contributions would be increased from \$10,500 to \$15,000. The similar limit applicable to SIMPLE plans would be increased from \$6,500 to \$10,000. In addition, employees who have attained age 50 would be entitled to make additional catch-up contributions of up to \$5,000. These increases are sorely needed as an incentive for increased savings and for the adoption of retirement plans by small businesses.

Similarly, the overall limit on employer and employee contributions to a defined contribution plan would be increased by the bill from \$35,000 to \$40,000. This is clearly appropriate in historical context; the same limit was \$45,475 in 1982.

The Portman/Cardin bill also increases a limit that under current law applies most harshly to low and middle-income employees. Under current law, the total of employer and employee contributions to a defined contribution plan cannot exceed 25% of compensation. The Portman/Cardin bill would raise that limit to 100%, so that, for example, the older employee who earns \$50,000 and wants to contribute a full \$15,000 to his or her 401(k) plan would not be precluded from doing so.

These limit increases will clearly encourage greater savings and the adoption of more small business plans. Moreover, they send a clear message that the government values retirement savings and will strive to increase such savings. Small business owners who have witnessed years of complexity and revenue-driven limit cutbacks will hear this new message and respond to it.

Eliminating or simplifying burdensome restrictions. The Portman/Cardin bill eliminates or simplifies many burdensome restrictions that inhibit the adoption and growth of small business retirement plans. I will provide two examples here.

First, small businesses that adopt or amend a retirement plan must pay a user fee to the IRS in order to request the IRS to approve the plan. This fee, which generally ranges from \$125 to \$1,250, is an additional cost that is clearly inappropriate in light of the severe need to encourage small businesses to have plans. Accordingly, the Portman/Cardin bill generally provides that a small business retirement plan is not to be charged a user fee with respect to the first five years of its existence.

Second, under current law, businesses cannot deduct contributions to a profit-sharing plan in excess of 15% of participants' compensation. (As noted above, the bill would increase that limit to 20%.) However, this limit has a very odd and harsh aspect that has a disproportionate effect on small businesses. Under present law, employees' 401(k) contributions are counted against the employer's 15% deduction limit. This has forced many small employers to limit their own contributions and/or their employees' 401(k) contributions. The Portman/Cardin bill would eliminate this anomaly by providing that employees' 401(k) contributions do not count against the employer's 20% deduction limit.

#### **Small business support**

We at Edward Jones are confident that the reforms contained in the Portman/Cardin bill will be embraced by our small business owner clients. We believe these reforms will encourage more small business owners to establish and fund retirement plans for their employees. As a matter of fact, during the 1997-1998 winter, more than 10,000 of our small business owner clients signed petitions in support of these types of changes.

Mr. Chairman, changes are needed as soon as possible. The retirement income crisis facing America is real. Americans need to save more for their retirement. However, the generations of Americans working for small businesses today clearly will have a more secure retirement if they participate in an employer-provided retirement plan. We believe the Portman/Cardin bill meets the needs of small business and will provide retirement security for their employees. Mr. Chairman, we urge you and your colleagues to enact the Portman/Cardin bill.

Thank you, Mr. Chairman. I would be pleased to answer any questions you or other members of the Committee may have.



**TESTIMONY OF THE HONORABLE ROB PORTMAN****House Committee on Small Business**

March 28, 2001

Thank you, Chairman Manzullo and Ranking Member Velazquez, for allowing us to testify here today. I want to commend you and your subcommittee for your strong interest in improving our pension system and making sure that small businesses can offer retirement security to their workers.

Congress and the Administration have appropriately made strengthening Social Security a top priority, and both Ben Cardin and I are strongly supportive of these efforts. But we also believe this Congress needs to explore expanding retirement security in other ways. Specifically, we believe we must take steps to significantly increase the availability of secure retirement savings – by strengthening our private, employer-based pension system. This is a critical issue for all Americans – especially the 76 million Baby Boomers who are nearing retirement age.

That's why – over the past four years, along with my Ways and Means colleague from Maryland, Mr. Cardin, and Members of this Committee -- we have been working on comprehensive improvements to our pension system. This year, we have introduced H.R. 10 -- the Comprehensive Retirement Security and Pension Reform Act. It builds on pension expansion and simplification measures Congress has taken the lead on in the past few years, and, if enacted, would constitute the most sweeping reforms to our pension system in a generation.

H.R. 10 is nearly identical to H.R. 1102, the pension legislation that passed the House last year -- twice with 401 votes. H.R. 1102 actually passed the House on five separate occasions. Clearly, pension reform is an idea whose time has come. And I am delighted to say that, as of today, H.R. 10 has more than 285 cosponsors -- including more than 160 Republicans and more than 120 Democrats.

H.R. 10 increases retirement security for millions of Americans by strengthening that "third leg" of retirement security -- our pension system -- including traditional defined benefit plans as well as defined contribution plans like 401(k), 403(b) and 457 arrangements.

Clearly, pensions are a critical component of America's retirement safety net. But not all is well with our pension system, particularly when it comes to small businesses. Right now, only half of all private sector workers have a pension plan. And, far fewer than half of employees who work for small businesses have access to a pension plan. Today, only 20% of small businesses with less than 25 employees offer any kind of pension plan.

And, not enough workers have pension coverage at the same time that overall savings is dangerously low. In fact, the personal saving rate in this country – the amount of money people save for retirement and other needs – is at historically low levels. You may have seen a recent report from the Commerce Department that, in the month of February, the nation had a savings rate of minus 1.3 percent. For economists, this is the most troubling statistic out there.

And this is one aspect of pension reform that is often overlooked – the economic argument. The current slowdown of the economy has helped spur interest in tax relief. Many economists point to tax relief as an effective way to spur consumption and provide working Americans with the resources to pay down debts. But in addition to encouraging Americans to consume and to reduce debt, tax relief should also encourage Americans to save. Savings not only strengthens the long-term financial security of individuals and families but also produces a number of positive effects for the U.S. economy as a whole.

Retirement savings provides our economy with a ready source of investment capital. Assets in employer-sponsored retirement plans and IRAs total more than \$5 trillion and pension plan assets account for 26.2% of all equity holdings and 12.3% of all taxable bond holdings in the U.S. Increasing retirement savings will increase the pool of capital which permits greater production of goods and services. Increased capital accumulation also generates additional corporate tax revenue for the federal government.

While some might argue that the federal tax expenditure for pensions and retirements savings is significant, evidence demonstrates that this expenditure is a highly efficient use of federal dollars. Data from the Department of Commerce's Bureau of Economic Analysis shows that the benefits paid by employer-sponsored pensions are 4.6 times as large as the foregone federal tax collections attributed to them. The investments in the employer-sponsored pensions system contained in Portman-Cardin would clearly be a sound federal expenditure that will translate into meaningful retirement benefits for American workers.

Pension reform is particularly important because it benefits everyone. Pensions provide a needed backstop to our Social Security system for lower and middle income workers. A pension makes the difference between retirement subsistence and real retirement security for millions of retirees.

And, 77% of current pension participants are middle and lower income workers. By taking action to expand pension availability this year, we will help those workers who are most in need of secure retirement savings.

The Portman-Cardin legislation is designed to directly address the deficiencies in our current pension system. Simply put, it lets workers save more for retirement. It makes it less costly and burdensome for employers -- particularly smaller businesses -- to establish new pension plans or improve existing ones. And, we modernize pension laws to address the needs of a changing, 21<sup>st</sup> Century workforce.

Let me highlight a few of the key provisions.

**First - Increased Contribution Limits:** Over the last 20 years, Congress has lowered the annual dollar limits on contributions workers can make and benefits they can accrue. These restrictions have been an obstacle to adequate private pension savings. Portman-Cardin partially restores the limits for all types of plans.

**Catch-up Contributions:** Portman-Cardin increases the limits on employee contributions to employer-sponsored savings plans by an additional \$5,000 for workers 50 and older so that they can "catch-up" for years when they weren't employed, didn't contribute to their plan or otherwise weren't able to save. Americans are quickly becoming aware of the

importance of retirement savings. Since 1994, the percentage of workers who have attempted to calculate their income needs in retirement has risen from 34% to 56%. And we know from research that many Baby Boomers who are now approaching retirement age have only saved about 40% of what they will need for retirement. In particular, this catch-up provision will benefit women who have returned to the workforce after taking time away to raise families.

**Increased Portability:** We're told that the average worker will hold nine jobs by the age of 32, and workers typically do not stay in any job for more than five years until age 40. H.R. 10 includes "portability" provisions to allow workers who are changing jobs to roll over retirement savings between 401(k)s, 403(b)s and 457s. To accommodate the needs of an increasingly mobile workforce, we also lower the vesting requirement for employer matching contributions from 5 to 3 years.

**Cutting Pension Red Tape:** The increasing complexity of the laws governing pensions – both in the private sector and in the non-profit and government sectors – has discouraged the growth of pension plans. For many small businesses in particular, the costs and liabilities associated with pensions have made it too expensive for many companies to offer plans. Portman-Cardin takes steps to cut the unnecessary red tape that has put a stranglehold on our pension system.

And, let me specifically summarize some of the small business issues that will be of particular interest to this Committee.

**SMALL BUSINESS INCENTIVES:**

We provide a number of incentives to encourage small businesses to sponsor pension plans.

**Loans for Small Business Owners:** Under current law, many small business owners are not permitted to take loans from retirement plans even when all other employees can do so. H.R. 10 would lift this discriminatory restriction, thereby treating business owners like all other plan participants. This will encourage small business owners to establish plans and, for those who currently maintain plans, to include a loan feature, which is a significant incentive for employees, especially lower income individuals, to contribute to the plan.

**Reduced PBGC Premiums for Small Businesses and Other Plans:** Studies repeatedly show that one of the chief reasons small employers do not establish defined benefit plans is the significant administrative costs incurred in maintaining the plan. PBGC premiums are cited as one of these cost barriers. H.R. 10 would address this concern by reducing PBGC premiums in the early, formative years of a plan's existence. Small employers would enjoy the largest premium discount. This will not only encourage small employers to establish defined benefit plans, but will help those plans flourish, since scarce benefit dollars can be contributed towards employee benefits rather than administrative costs.

**Pension Insurance for Small Business Owners:** Under current law, many business owners do not receive the same PBGC guaranteed benefits upon a plan termination that non-owners receive. Together with significant administrative costs, this lack of comparable pension insurance has acted as a strong disincentive to defined benefit plan creation and maintenance by small employers. H.R. 10 would eliminate this discriminatory treatment for many business owners. Together with the reduced PBGC premiums discussed previously, this

pension insurance reform will encourage small employers to offer defined benefit plans to their employees.

**Streamlined Top-Heavy Rules:** The tax rules that prevent disproportionate benefits flowing to highly paid workers serve an important purpose in our employer-sponsored pension system, but the specific rules known as "top-heavy" are duplicative and overly burdensome. Indeed, the Clinton Administration's ERISA Advisory Council recommended outright repeal of these rules. The pension reform bill takes a more modest step, making common-sense simplifications to the top-heavy rules that will provide relief to small company plans and thus encourage new plan formation.

**Simplified Reporting:** Many small business owners complain of the administrative headaches associated with maintaining a retirement plan. A significant portion of this administrative burden is attributable to the complex reporting form (Form 5500) that pension plans must submit to the government each year. The pension reform bill would provide relief from these burdens by streamlining the reporting requirements imposed on small businesses and directing the Secretary of the Treasury to develop a new simplified reporting form for companies with 25 or fewer employees.

Let me conclude by pointing out that, in addition to more than 285 cosponsors on a bipartisan basis, we also have more than 105 endorsing organizations from across the ideological spectrum -- from the U.S. Chamber of Commerce and the NFIB to labor organizations like AFSCME and the Building and Construction Trades Department of the AFL-CIO. This coalition has been together for four years to reach this point.

Again, this is a chance to help all Americans save more for their retirement. Imagine the impact we would have on our national savings rate and overall retirement security if we could give every American worker access to a 401(k), a defined benefit plan or another kind of pension.

This is a tremendous opportunity that I hope this Congress will seize this year. Thank you.

STATEMENT FOR THE RECORD  
HOUSE COMMITTEE ON SMALL BUSINESSHEARING ON THE SMALL BUSINESS IMPLICATIONS OF THE COMPREHENSIVE RETIREMENT  
SECURITY AND PENSION REFORM ACT OF 2001 (H.R. 10)  
MARCH 28, 2001Kevin J. Brenman  
President  
JMI Software Consultants, Inc.  
Spring House, Pennsylvania

As president of a small software development company in Spring House, Pennsylvania, I would like to share with the Committee our experience as the sponsor of a retirement plan and how H.R. 10, the Comprehensive Retirement Security and Pension Reform Act of 2001, would affect that experience.

We are proud to sponsor a 401(k) profit sharing plan for our 22 employees, and we view the plan as a flagship benefit as well as a competitive recruiting tool. However, the plan benefits and our recruiting advantage have been all but eliminated by a law that singles out small businesses.

In addition to all the laws and regulations that apply to employer-provided retirement plans of all sizes, only small plans are affected by the top-heavy rules. A defined contribution (e.g., a 401(k)) plan is considered top-heavy if more than 60 percent of the plan's assets are held in the accounts of "key employees" (officers, owners, and high-paid employees). If a 401(k) plan is top-heavy it must comply with a mandatory vesting schedule which may require a more rapid vesting than under the existing plan and the sponsoring employer generally must contribute at least three percent of each non-key employee's compensation into the plan, in addition to whatever matching contributions have been made, and whether or not the employee elects to contribute to the plan.

Our 401(k) plan is top-heavy due not to discrimination in our benefits schedule, but because of the definition of a "key employee" that includes "top ten owners." We have 16 stockholders, six of which are current employees. The average tenure of those six employees greatly exceeds that of the 16 other employees in the plan. Our "key employees" therefore have simply been participating for a longer period of time, resulting in a greater proportion of plan assets in their plan accounts. We believe that unless the top-heavy regulations are changed many small companies like ours may have similar problems due to the fact that less-tenured employees with relatively smaller plan account balances tend to change jobs more often (usually taking their 401(k) assets with them). In fact, one could say that the top-heavy regulations may unfairly punish small business workers who *don't* change jobs often.

When it became available in 1999, we amended our plan to provide a safe harbor design to avoid future problems with regulatory compliance. Despite its name, a safe harbor plan doesn't relieve us of conducting the top-heavy tests; it merely guarantees that we are providing the top-heavy required benefits. Our plan now provides a three percent contribution to all employees regardless of their own contributions to the plan. The incentive to maximize deferrals, a direct benefit to employees, has been eliminated.

Another ongoing problem we experience is that of the Internal Revenue Code (IRC) Section 404 limit on an employer's deductible contribution to a plan. A contribution in excess of 15 percent of "covered compensation" is subject to an excise tax. We are a small group with 100 percent participation and an average elective deferral of almost 12 percent of covered compensation. The employee's elective deferral is deemed an employer contribution for purposes of this limitation in addition to the three percent top-heavy

contribution. These elective deferral contributions are not, however, counted as covered compensation for purposes of the same test, thereby inflating the employees 12 percent contribution in the context of this test. This results in requiring that the average deferral must be less than 10.5 percent in order to meet the Section 404 limit on the maximum allowable employer contribution to a plan.

Adding insult to injury, the IRC Section 404 excess deduction must be carried forward. Unless we limit employee deferrals or accelerate the compensation for employees who hit the Section 402(g) limit on what an employee can contribute to the plan - \$10,500 in 2001 - we will always have a Section 404 excess deduction. In fact, with the carry-forward, the Section 404 excess deduction can snowball indefinitely. In order to receive an immediate deduction for amounts we contribute to the plan, our solution has been to ask participants to voluntarily limit their deferrals to eight percent for the remainder of the plan year - certainly not attractive to a group that would otherwise average an elective deferral of almost 12 percent.

If H.R. 10 were in effect, almost all of the problems I described above would not have occurred. The provisions in H.R. 10 would have had the following effects for our plan:

- The definition of "key employee" would not be as broad and the "look back" period to examine who is a key employee would be shorter. This would help many small businesses such as ours avoid top-heavy status.
- Employer matching contributions would be counted towards the three percent top-heavy contribution requirement.
- The 401(k) safe harbor plan adoption would exempt the plan from the top-heavy rules.
- Employee contributions would not be included in calculating the employer deduction limit for contributions into the plan, thereby eliminating the excise tax and excess carryover problem.
- Employee contributions would not have to be reduced because they would no longer affect the employer's 15 percent deductibility limit.
- Employee contributions would be included in compensation for purposes of calculating the IRC Section 404 employer excess deduction limit.
- The employer deductibility limit, in addition to the changes above, would be raised to 20 percent.
- The higher deductibility limit would allow the company to again provide an employer matching contribution in addition to the fixed non-elective safe harbor contribution. This is an incentive for all employees to maximize their deferral, since the employer match is a percentage of the employee's elective deferral.

While I understand and support the principle of insuring that tax-qualified retirement plans provide equitable benefits to all employees, it seems clear that small business 401(k) plans can suffer disproportionate hardships under the top-heavy regulations due to simple mathematics rather than discriminatory practices. Accordingly, we wholeheartedly support H.R. 10 and the additional retirement security it can provide for all small business employees and the reduced administrative complexity which will be afforded sponsoring employers.

Thank you for the Committee's attention and support. If you have any questions or if I can be of any further assistance, please contact me.



**Securities Industry Association**

1401 Eye Street, NW • Washington, DC 20005-2225 • (202) 296-9410, Fax (202) 296-9775  
www.sia.com, info@sia.com

STATEMENT FOR THE RECORD

H.R. 10, THE COMPREHENSIVE RETIREMENT SECURITY  
& PENSION REFORM ACT

SECURITIES INDUSTRY ASSOCIATION<sup>1</sup>

BEFORE THE HOUSE SMALL BUSINESS COMMITTEE

MARCH 28, 2001

---

<sup>1</sup> The Securities Industry Association brings together the interests of nearly 750 securities firms, employing more than 400,000 individuals, to accomplish common goals. SIA members – including investment banks, broker-dealers, and mutual fund companies – are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans and accounts for more than \$300 billion of revenues in the U.S. economy.

Mr. Chairman and Members of the Committee:

The Securities Industry Association is pleased that the House Small Business Committee has convened a hearing on H.R. 10, the Comprehensive Retirement Savings and Pension Reform legislation introduced by Representatives Rob Portman (R-OH) and Ben Cardin (D-MD). The SIA strongly supports the legislation and is encouraging the House to pass H.R. 10 at the earliest opportunity.

Congress should take the opportunity now to improve existing incentives for saving and increase the number of employer-sponsored pension plans. The demographic threat to Social Security and lower rates of saving by Baby Boomers mean that today's workers could come up short on income once they retire. While there are different measurements of desired income in retirement, data from the Health and Retirement Survey found that a median household head would have to increase their saving by 16 percent of annual gross income in order to retire at their pre-retirement standard of living.

Elected officials also should not disregard the importance of H.R. 10 to improving the lackluster personal savings rate. Since the 1970s the U.S. personal savings rate has declined steadily -- recently hitting its lowest level since the Great Depression of the 1930s. This low rate of savings combined with high consumer indebtedness will continue to threaten economic productivity. By boosting retirement savings, corporations and small businesses will have access to additional sources of capital. This capital is what our economy needs to raise productivity and maintain healthy economic growth.

Federal policy makers have begun to confront the challenge to improve savings incentives by approving new vehicles that reward workers for saving. One recent enhancement, the Roth Individual Retirement Account (Roth IRA) has been very successful. IRA custodians have seen strong increases in the number of new IRA accounts since the Roth IRA first became available. Currently, ten percent of U.S. households own Roth IRAs; nearly one in three of these accounts were opened as a first IRA account.

But most other savings incentives could work better. Employer-sponsored retirement plans reach a high percentage of workers in large businesses. But in small businesses, only about 35 percent of workers employed by firms with less than 100 workers participate in a retirement plan. In larger businesses, participation is almost 75 percent.

Most of our member companies actively market retirement plans to employers of all sizes. Many of our members also provide record-keeping services for retirement plans or have relationships with third-party record-keepers who have expertise in retirement plans. Our firms believe that small business owners are at a major disadvantage when trying to start a pension plan. An option like the SIMPLE IRA -- authorized by Congress in 1996 -- has met some of the needs of small employers but many other small employers find that the SIMPLE is inadequate. Under the SIMPLE, an employer can defer up to \$6,000 of income into the plan. For many small employers, that benefit is too small given the SIMPLE's inflexibility and cost.



The federal budget surplus provides an avenue to increase personal savings, help individuals secure a better retirement, and take some of the pressure off of our federal entitlement programs. Further, the support for this legislation is overwhelming. In the 106<sup>th</sup> Congress, the legislation under discussion was passed by the House of Representatives two times with more than 400 votes.

The most needed reform is to correct a mistake that occurred in the 1980s when pension plan contribution and benefit limits were reduced. These lower limits indirectly impact the willingness of business owners to offer pension plans to their workers. Increasing the 402(g) limit from \$10,500 to \$15,000 (the limit that impacts how much a worker can contribute to a 401(k) plan) and increasing the combined employer-employee contribution limit to \$45,000 will help ensure that these limits keep pace with inflation.

Congress should also provide small businesses relief from the top heavy rules. These rules result in disparate treatment for small businesses and discourage many businesses – particularly those that are family-owned – from offering a pension plan. The ERISA Advisory Council recommended outright repeal of the top heavy rules in 1998. H.R. 10 takes a more cautious approach of reform that should still result in new plan formation by small businesses.

The House of Representatives has a window of opportunity to tie up loose ends from the 106<sup>th</sup> Congress. The SIA urges you to multiply the positive impact of any economic stimulus tax cut proposal by enacting comprehensive retirement savings legislation this year.

**STATEMENT BY THE PRINCIPAL FINANCIAL GROUP**  
**TO THE**  
**COMMITTEE ON SMALL BUSINESS**  
**U.S. HOUSE OF REPRESENTATIVES**  
**ON**  
**COMPREHENSIVE RETIREMENT SECURITY AND PENSION REFORM ACT**  
**(H.R. 10)**  
**April 6, 2001**

This statement is submitted by the Principal Financial Group, a family of insurance and financial services with over \$117 billion in assets under management. Its largest member company, Principal Life Insurance Company, is the ninth largest U.S. insurance company based on 1999 statutory assets. The Principal Financial Group serves more than 13 million customers worldwide. We provide retirement plan investment and administrative services to more than 44,000 employers, the majority of whom employ fewer than 100 employees.

The Principal appreciates the opportunity to comment on retirement security and pension reform. We congratulate the committee, in particular, for holding this hearing on H.R. 10, the Comprehensive Retirement Security and Pension Reform Act of 2001. In recent years, Congress has strengthened the employer-sponsored retirement system and improved the retirement security of many American workers. In particular, the pension simplification provisions enacted by the Small Business Job Protection Act of 1996 (Public Law 104-18) and the Taxpayer Relief Act of 1997 (Public Law 105-34) have helped ease plan administration and helped more small employers establish retirement plans for their employees. Nevertheless, the Principal believes more can, and should, be done to encourage small- and medium-size employers to establish and maintain retirement plans. H.R. 10, Representatives Rob Portman and Benjamin Cardin and 280 of their colleagues, will help achieve these goals.

**Inspired Linkage**

Currently, less than 30 percent of our nation's smaller employers (those with less than 100 employees) sponsor a retirement plan<sup>1</sup>. Why is this number so small? We believe that much of the problem is because Congress has lost sight of the "inspired linkage." Under this concept, the government tells employers "we will allow you certain tax advantages and adequate retirement benefits to your key employees. However, you must cover your rank and file employees in your pension plan."

This concept worked well for many years. To remain competitive, employers generally provide their key employees with good retirement benefits. As long as the employer was able to provide comparable benefits for all employees under the same plan, everyone benefited. Unfortunately, Congress repeatedly reduced these limits over the past 17 years in order to raise revenue for non-pension related items. This led to the erosion of the

<sup>1</sup> Employee Benefit Research Institute, The 2000 Small Employer Retirement Survey, Washington, D.C.

“inspired linkage.” Employers were no longer able to provide comparable retirement benefits for all their employees under a single retirement plan.

### **Small Businesses**

Why is the concept of comparable benefits so important to employers in general, and to small employers in particular? Small employers have worked hard to make their businesses profitable and to ensure they, as well as their employees, are provided for in retirement. Social Security provides a higher percentage of pre-retirement income for lower-income workers than for middle- and higher-income workers. It provides 70 percent of pre-retirement earnings for workers earning \$15,000, compared to 42 percent for workers earning \$40,000 and 24 percent for workers earning \$70,000. As a result, middle- and higher-income workers need other sources of income to provide the 80 percent of pre-retirement income experts say is needed in retirement. Many small employers hope to provide this additional income through their retirement plans.

Unfortunately, a small business owner often finds that the amount of benefit she/he can provide for herself/himself and highly paid employees, is substantially limited by the various nondiscrimination tests and the dollar limits on contributions and compensation. Currently, the Internal Revenue Code sets limits on how much money can be contributed to a plan, the percent of an employee’s pay that can be contributed to a plan, and the amount of pay that can be taken into account for determining benefits under a plans. Often, a small business owner establishes a plan only to discover that the plan provides a much smaller benefit (as a percent of pay) for the key employees than it does for the rank and file employees. The compensation limit, in particular, has a huge impact on a highly compensated employee’s ability to accumulate an adequate benefit for retirement.

The Comprehensive Retirement Security and Pension Reform Act of 2001 (H.R. 10) goes a long way toward recreating the spirit of “inspired linkage.” By increasing the various dollar limits under the plan, the bill aims to increase the number of employer sponsored retirement plans by making them more attractive to business owners.

We offer the following additional comments on the provisions in H.R. 10:

### **Retirement Plan Limits**

The Principal Financial Group supports the proposed increases in the dollar limits that cap the amount that employees can save or accrue in employer sponsored plans. Increases in the dollar limits will encourage employers to establish plans by allowing them to accumulate benefits in an amount comparable to the amounts accumulated by lower paid employees. Existing nondiscrimination rules-such as the 401(k)/(m) nondiscrimination tests and the 415 maximum benefit limits-will ensure that plans do not discriminate in favor of the highly compensated employees.

We also support repealing the 25 percent of pay limit on annual additions under a defined contribution plan. This limit has little effect on the most highly paid employees while adversely affecting lower paid employees who choose to contribute generously to their 401(k) plans. Repealing the percentage of pay limit would allow lower paid employees to increase their retirement savings.

#### **Administrative Costs**

We are pleased H.R. 10 includes provisions to reduce administrative costs and burdens, which have a disproportionate impact on small employers. Specifically, allowing matching contributions to be counted toward satisfying the top-heavy minimum required contribution and modifying the definition of key employee will help small employers comply with these rules. Elimination of the multiple use test for 401(k)/(m) plans will also simplify the nondiscrimination test and reduce the administration burden on plan sponsors. We also strongly support the provisions that promote good faith compliance and correction of plan errors rather than plan disqualification and IRS sanctions. This feature will encourage self-correction without penalizing inadvertent violations of the qualified plans rules.

#### **Portability**

We are pleased with the liberalization of the transfer and rollover rules and the modification of the "same desk rule" for 401(k) plans. Corporate acquisitions, mergers, dispositions and voluntary job changes are increasingly frequent today; these incidents can have a huge impact on an employee's retirement savings. As employees change jobs, keeping track of their retirement accounts from several different plans is often difficult and time consuming. The best way to do this is to make it easier for employees to transfer these distributions to qualified plans or roll them over to an IRA. The provisions in H.R. 10 will preserve plan assets by making it easier to transfer benefits between 401(a), 403(b), and 457 plans. The bill also eliminates the "same desk rule" that prevents employees in 401(k) plans from receiving a distribution in certain corporate take-over situations.

#### **Participant Security**

The Principal supports requiring faster vesting of employer matching contributions and allowing members age 50 or older to make additional contributions of up to \$5,000 per year to 401(k), 403(b), 457, and SIMPLE plans. We also support provisions that would require defined contribution plans members to receive annual benefit statements and defined benefit plan participants to receive benefit statements every three years.

#### **Summary**

We believe that more small employers will establish retirement plans if we can make those plans more attractive for the employer and his/her key employees. We believe the

pension reform provisions included in H.R. 10 will accomplish much of this and urge Congress to enact these reforms this year.

**For More Information**

*Inquiries from legislators and regulators should be directed to:*

Stuart Brahs

Vice President-Federal Government Relations

(202) 682-1280

[brahs.stuart@principal.com](mailto:brahs.stuart@principal.com)