

Written Testimony of

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**“Retirement Plan Options for Small Businesses”**

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## Introduction

Thank you Chairman Enzi and Ranking Member Sanders and members of the Committee for the opportunity to participate in today's discussion of how we can expand retirement savings opportunities for the millions of Americans employed by small businesses in this country.

I am Jamie Kalamarides, Head of Institutional Investment Solutions, Prudential Retirement. Prudential is the second largest life insurer and a top ten global asset manager with over \$1.2 trillion in assets under management. Prudential provides workplace based retirement solutions to all sizes of corporations, governments, unions and consumer groups.

Prudential has long been concerned about what is often referred to as the "retirement coverage gap," that is, the absence of retirement savings opportunities for employees in far too many of today's small businesses. It is well established that employer-sponsored retirement savings plans have become a critical component of the private retirement system in the U.S., and a proven tool for helping working Americans prepare for life after work. According to calculations by the nonprofit Employee Benefit Research Institute, workers earning between \$30,000 and \$50,000 per year are 16.4 times more likely to save for retirement if they have access to a workplace plan.

Unfortunately, tens of millions of working Americans don't have access to a plan on the job, leaving many ill-prepared to meet their financial needs after they stop working. With 10,000 individuals reaching retirement age each day, this is a large and growing problem. We know that a comprehensive retirement plan requires a stable three-legged stool - Social Security, personal savings, and pensions. While Social Security is a critical program, for median income earners, it replaces only 47% of pre-retirement income, leaving those without a workplace retirement plan with a potentially significant income gap in retirement.

The workplace retirement system works very well for employees of medium and large companies. Employees of small companies, however, are far less likely to have access to savings opportunities. According to data from the Bureau of Labor Statistics, only 50% of workers in firms with fewer than 100 employees have access to retirement plans at work. This compares to 89% for workers at larger firms.

This retirement coverage gap is especially problematic given that small employers provide jobs for a large and diverse section of the American population. Small businesses in the private sector provide over 30 million jobs for women. Small businesses employ over 12 million Latino Americans, 6 million African Americans, and 4 million Asian Americans - and yet, only 50% of employees of small businesses have access to a workplace retirement plan.

The retirement coverage gap can and should be narrowed. While a variety of solutions are possible, there is a growing consensus among financial institutions, consumer groups and some Members of Congress<sup>1</sup> that one of the broadest and most expedient ways to close the gap is to expand access to multiple employer plans, or MEPs, for small employers and their employees. MEPs – single plans utilized by two or more employers – have been utilized successfully for years by trade associations and professional employee organizations. Unfortunately, tax laws and regulations discourage or prevent most small employers from taking advantage of them.

Addressing the constraints on multiple employer plans has bipartisan support in both the U.S. Senate and U.S. House of Representatives, as well as support from the U.S. Chamber of Commerce, AARP, many affinity groups, and the financial services industry. Most recently, the Senate Finance Committee’s Savings & Investment Bipartisan Tax Working Group issued a report in which it indicated that “[t]o enable small employers to sponsor high quality, low cost plans, the working group recommends that the Committee consider proposals that allow employers to join open multiple employer plans.”<sup>2</sup>

For the small employer market, multiple employer plans would enable small businesses to participate in a single, professionally administered plan that affords them economies of scale and minimal fiduciary responsibility. The plans would provide employees of those organizations the same opportunities to invest for retirement that employees of large companies already enjoy on a near universal basis via 401(k)s and similar defined contribution plans.

### **Small Business Retirement Survey by Prudential**

In an effort to better understand why small businesses do not offer retirement plans, Prudential Retirement conducted a survey of more than 850 small employers during the months of March and April, 2015. All the survey participants were business owners who do not offer retirement plans today, and who have the responsibility for making decisions on employee benefits. Included in the survey were small businesses of between 3 and 500 employees.

When asked un-prompted why they don’t offer retirement plans for their employees, almost 50 percent cited cost as the concern. When prompted with a list of reasons, the top reasons why they do not sponsor plans include cost, administrative burden and

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<sup>1</sup> Legislation relating to addressing MEP issues has been introduced in the 114<sup>th</sup> Congress by Representative Richard Neal (D-MA) – H.R. 506; Senator Sheldon Whitehouse (D-RI) – S. 245; Senators Susan Collins (R-MA), Bill Nelson (D-FL) and Claire McCaskill (D-MO) – S. 266; and Representatives Vern Buchanan (R-FL) and Ron Kind (D-WI) – H.R. 557).

<sup>2</sup> The Savings & Retirement Bipartisan Work Group Report, July 2015, at page 6.

hassle, and fiduciary concerns. Importantly 29 percent indicated a lack of understanding as to how retirement plans work.

Reflecting these concerns, baseline interest in offering a retirement plan is low. Only 14 percent of small business respondents are likely to consider offering a plan over the next five years. However, if provided an opportunity to offer a plan with little or no cost, most responsibility assumed by an independent trustee, and minimal retained responsibility beyond forwarding contributions, the rate of interest increases by more than 250 percent. Also, almost half indicated support for legislation that would make it easier for small businesses to provide retirement plans to their employees, with only 17 percent saying legislation is not needed.

Finally, the survey measured employers' attitudes towards offering retirement plans. Attitudes varied widely, highlighting the differing mindsets of small employers. We found that about 1/3 of employers had the most positive attitudes: That saving for retirement is very important; that programs to make it easier are very important; and, that they have a key role in the process. For the 1/3 of employers with the most positive attitudes, almost 70 percent were likely to consider offering a plan with little or no cost and minimal responsibility.

Given small businesses employ over 55 million workers, capitalizing on employer interest by offering plans which have little or no cost to employers, and minimal employer responsibility, could be an important step towards reducing the retirement coverage gap. At Prudential, we believe multiple employer plans can be part of the solution, but there are challenges – challenges to expanding MEP sponsorship and challenges to expanding MEP participation.

### **Challenges to Expanding MEP Sponsorship and Participation**

Expanding access to multiple employer plans for small businesses and their employees will require federal legislative and/or regulatory action. The challenges, in our view, are concentrated in four areas:

Tax Law – Section 413(c) of the Internal Revenue Code already recognizes plans maintained by more than one unrelated employer. However, it imposes a number of requirements on these plans as a condition of maintaining their tax-qualified status. As currently interpreted, some of these requirements, such as nondiscrimination rules, are applied on an employer-by-employer basis rather than a plan basis. This means that just one non-compliant employer can jeopardize the tax status of the entire plan, putting all employers at risk. This barrier is often referred to as the “one bad apple” rule.

ERISA – For purposes of ERISA, the Department of Labor treats as a single retirement plan only those multiple employer plans that are sponsored by a “cognizable, bona fide group or association of employers” acting in the interest of its members. It also requires that this group of employers have a “commonality of interest,” such as operating in the same industry, and exercise either direct or indirect control over the plan. Taken together these conditions significantly limit the ability of other organizations, such as a local Chamber of Commerce, to sponsor a MEP for a diverse population of small employers.

Fiduciary Liability – Some employers – particularly small employers – shy away from offering a plan because they are concerned about the responsibilities and liabilities they might assume under ERISA as plan fiduciaries. The uptick in retirement plan litigation relating to plan fees and other factors has only exacerbated their concerns.

Enforcement – The Labor Department has expressed concern that expanding the number of “open” multiple employer plans – those sponsored by any entity other than a “bona fide group or association of employer” – could allow promoters of such plans to take advantage of small employers and their employees under the guise of offering a low cost, no liability plan.<sup>3</sup>

### **Facilitating Sponsorship of and Participation in MEPs**

To make multiple employer plans more accessible to small businesses, lawmakers and regulators will need to take action on several fronts.

#### Tax Law

First, Treasury and IRS or Congress needs to clarify tax law so that any adverse consequences of not complying with the applicable tax qualification requirements for MEPs will be limited to the noncompliant employer, rather the entire plan and rest of its participating employers.

#### ERISA

Second, the Department of Labor or Congress needs to modify the ERISA requirements to allow a broader array of entities, organizations or associations to sponsor MEPs, subject to conditions that will ensure plans comply with ERISA’s fiduciary requirements and minimize risk to plan sponsors and their employees. These conditions might include the following:

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<sup>3</sup> Letter from Phyllis Borzi to Charles Jezeck, reprinted in “Private Sector Pensions, Federal Agencies Should Collect Data and Coordinate Oversight of Multiple Employer Plans,” a GAO report to Chairman, Committee on Health, Education, Labor, and Pensions, U.S. Senate, September 2012, at page 44.

- The sponsor must exist for bona fide purposes unrelated to the sponsoring of a retirement plan.
- The documents of the plan must identify the person(s) who will serve as the named fiduciary of the plan. That person(s) must acknowledge in writing joint and several liability for controlling and managing the operation and administration of the plan.
- The documents of the plan must identify the trustee(s) of the plan responsible for the management and control of the plan's assets and for the prudent collection of contributions to the plan.
- The documents of the plan must identify the person(s) who will act as the administrator of the plan, responsible for satisfying reporting, disclosure, and other statutory obligations.
- The plan and plan officials must maintain a fidelity bond in accordance with ERISA section 412.
- The documents of the plan must ensure that participating employers will not be subject to unreasonable restrictions, penalties, or fees upon ceasing participation in the plan.
- Inasmuch as the retirement coverage gap is most acute among smaller employers, participation in these new MEPs should be limited to those employers with no more than 500 employees. While it is likely that MEPs will appeal principally to employers with 100 or fewer employees, establishing the ceiling at 500 employees will give smaller employers ample time to grow without having to worry about identifying a new retirement savings vehicle for their employees.

### Fiduciary Responsibility

Congress and regulators, in our view, should consider limiting the fiduciary responsibility of employers participating in an MEP to the prudent selection of the MEP sponsor and remitting timely contributions. Similar to the selection of an investment manager under ERISA, such a limitation is not intended to eliminate or reduce fiduciary responsibility with respect to the management and operation of the plan, but rather appropriately allocates those responsibilities to professionals best positioned to protect the interest of plan participants and beneficiaries.

## Enforcement

Importantly, lawmakers and regulators can help ensure the integrity of MEPs in the marketplace by strengthening the protections afforded plan sponsors and their employees. We believe they can do this by establishing accountability for, and meaningful oversight of, MEPs. Appropriate measure could include:

- A requirement that MEP sponsors file a registration statement with the Department of Labor in advance of offering a retirement plan to employers. The statement could include, among other things, the name of the sponsor; the scope of its intended offering in terms of its geographic area; representations that all applicable conditions – such as those enumerated above – have been satisfied; and copies of the plan documents.
- A requirement that the MEP file an annual report, in addition to any other information required in its Form 5500 annual return/report, an audit and a listing of participating employers.
- An amendment to ERISA giving the Department of Labor authority to issue ex parte cease and desist orders, as well as summary seizure orders, similar to the authority it already enjoys in overseeing multiple employer welfare arrangements (MEWAs).

## A Safe Harbor MEP

To facilitate participation in MEPs and reduce compliance risks for small employers, the Department of the Treasury and the Internal Revenue Service, in coordination with the Department of Labor, should develop a safe-harbor model plan that minimizes the administrative complexities and costs of MEPs, is not subject to complex tax-qualification testing requirements, and enhances the ability of MEPs to generate positive retirement outcomes for plan participants.

A template we would recommend for such a model would include the following characteristics:

- A single plan, with a centrally administered trust, serving all participating

employers.

- Plan participation would be limited to employers with no more than 500 employees.
- Specifically identified persons to serve as the named fiduciary, trustee(s), and administrator.
- Funded by employee contributions, with employer contributions permitted, but not required.
- Automatic enrollment of employees at a rate equal to 6 percent of pay, with employees eligible to opt out or select an alternative contribution rate.
- Automatic escalation of employee contributions to 10 percent of pay, in annual 1 percent increments, with employee opportunity to opt out.
- Hardship withdrawals in accordance with IRS rules, but no participant loans.
- A broad range of diversified investment options.
- In the absence of investment direction, contributions would be defaulted in to a preservation of principal investment option for the first four years and, thereafter, into a qualified default investment alternative (QDIA) in accordance with Labor Department standards.
- At least one investment or distribution option that includes a lifetime income product.

We believe that use of a model plan, similar to the above, should avoid the need for complex and costly nondiscrimination testing and, through reduced administrative costs, increase retirement savings for plan participants.

### **MEPs - a “Win Win”**

We – at Prudential - see MEPs as a “win” for both employees and employers.

*MEPs will afford employees the opportunity for better retirement outcomes. A properly designed MEP will promote savings by employees through the use of automatic enrollment and automatic escalation of their contributions. MEPs may further encourage appropriate investment behavior by providing investment options selected by investment professionals, better ensuring that plan participants will be able to tailor their portfolio to their investment goals and tolerance for risk.*

Unlike IRAs, MEPs offer employees the potential for an employer match and the opportunity to save for retirement at levels more appropriate for meaningful



retirement savings (\$18,000 per year, as compared to \$5,500 per year for 2015 and 2016), as well as access to institutionally priced investments. MEP participants would further benefit from having their plan's fiduciary and administrative responsibilities discharged by plan and investment professionals, thereby enhancing the fiduciary and other protections afforded by federal law - the Employee Retirement Income Security Act (ERISA).

*Small businesses will be better positioned to compete for talent.* For employers, MEPs represent an opportunity to offer employees a meaningful opportunity to save for retirement in a tax-advantaged plan, without the administrative costs and fiduciary risks attendant to maintaining a stand-alone retirement plan. Moreover, surveys consistently show that workers consider retirement savings plans a valued employee benefit. The offering of a retirement plan, therefore, can increase an employer's ability to attract and retain a high quality workforce and, thereby, be more competitive.

## **Conclusion**

While multiple employer plans may not be the only solution to closing the retirement coverage gap, we believe it is an important one and one that should be available to substantially more employers than is the case today. For a more comprehensive discussion of MEPs and our proposals, we have attached a copy of our recent white paper, *Multiple Employer Plans – Expanding Retirement Savings Opportunities*, for your consideration. (Also available through our website at: [http://research.prudential.com/documents/rp/mep\\_paper\\_final\\_2015.pdf](http://research.prudential.com/documents/rp/mep_paper_final_2015.pdf)).

With the support from benefits professionals, consumer groups and Members of Congress, we believe the climate is right for expanding both the sponsorship of and participation in multiple employer plans and, with 10,000 individuals reaching retirement age everyday in this country, the time for action is now.

We thank Chairman Enzi, Ranking Member Sanders and members of the Committee for their focus on the challenges facing small businesses in offering retirement savings opportunities to their employees. We look forward to working with members of this Committee and other interested persons in expanding retirement savings opportunities through MEPs.