Testimony of
Daniel W. Hall
Regional Pension Manager
Standard Insurance Company

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Mr. Chairman, members of the committee, my name is Dan Hall. I am a regional pension manager for Standard Insurance Company. The Standard is a financial services company headquartered in Portland, Oregon, and provides employee benefits, investment advice, annuities and retirement plan products and services to more than seven million customers nationwide.

We are committed to helping people achieve financial security. The Standard has been in the retirement plans business since 1939 and we introduced our first 401(k) product in 1982. Our particular expertise is micro and small plans. We are consistently rated as a top provider of such plans by our customers and independent third parties. Micro plans serve businesses with up to 100 employees and small plans serve employers with 100 – 500 employees. I have been in the retirement planning business for 23 years.

Thank you for the opportunity to share my perspective on the barriers to small business pension coverage. I would also like to take this opportunity to address some issues that inhibit employee participation in pension plans.

The existence of employer–provided retirement plans when used by a large number of employees helps alleviate pressure on state and federal social welfare programs, creating significant taxpayer savings. Employer-provided plans also provide a critical safety net to individuals. It is imperative for the financial health of our citizens and our nation that employers and government continue to work together to provide improved pension coverage and encourage individual participation.

In my daily discussions with employers about implementing pension plans, I encounter two types of barriers:

1. Barriers due to perceptions that small business owners hold about pension plans.
2. Barriers created by the realities of implementing a pension plan.

Prior to the advent of the 401(k), many employers provided retirement income through defined benefit pension plans. Originally, 401(k) plans were intended to supplement Social Security and the company pension rather than becoming the primary retirement income vehicle. Many small business owners today grew up in households with parents whose retirement income was provided by the company's pension plan. My experience is that the current generation of business owners and employees has not adjusted savings habits to reflect the movement from company-provided pensions to 401(k) plans, which require employees to exercise discretion and take responsibility for their own retirement security.

Another perception creating barriers to small business employers providing pension plans is that many view their business as their retirement. Consequently, when choices are made between investing in infrastructure to improve the business and investing money for a retirement plan for themselves and their employees, infrastructure usually takes priority.

Small business owners also have a general perception that retirement plans are complicated, over-regulated and expensive. They often fear that they do not have the skills or resources to manage the compliance issues and mandatory plan testing. The question becomes, “If I do this, what part of my business suffers?” or “Will I need to hire staff just to administer this plan?”

Although these perceptions present barriers to small businesses providing pension coverage, they can typically be overcome with education and information. Beyond perception issues, however, are some real barriers for small businesses seeking to provide pension coverage for their employees.

Competing priorities regarding employee benefits are a constant reality for small business owners: medical, dental, life and vision insurance, disability coverage, long term care, childcare assistance – the list goes on. The most pressing needs require more immediate attention and take precedence in a small business. Health care is a basic, immediate need and both the employer and the employee can see tangible results from medical coverage. Retirement planning for many is abstract until retirement approaches. By the time retirement planning becomes a priority it is often too late.

One method to promote the provision of retirement plans by small business is to offer a tax credit to help offset either the employer contribution or the expense of implementing plans. Typically, small employers are required to pay an annual administrative fee to cover some of the costs of servicing a plan. The fee can be several thousand dollars. A tax credit on employer contributions or an annual tax credit equal to all or part of the annual administrative fee would encourage the formation of these plans.

A second barrier is compliance testing. Although well intended, it works against the small business owner. Top-heavy and non-discriminatory compliance testing ensures that a plan does not discriminate in favor of highly compensated employees.

However, non-discriminatory compliance testing eliminates top-heavy issues, making the top-heavy rule outdated and redundant. Eliminating the top-heavy rule would allow providers to lower fees, reducing the costs of pension plans.

Most experts agree that the majority of employees are not saving enough in their retirement accounts. In addition, many eligible participants have not made the decision to participate in their employers' plan. So it is important to increase employee participation and the level of their contribution to the employer plan.

Two ways to increase employee participation are through automatic enrollment features and promotion of automatic deferral increases.

Automatic enrollment, requiring employees to opt out of the plan rather than in, would help increase participation. Implementing federal regulations that make automatic enrollment rules consistent nationally would encourage plan providers to offer automatic enrollment and multi-state employers to implement it.

Although plan sponsors are able to implement automatic deferral increases, this tool is underutilized. Automatic deferral increase options allow participants to set up a schedule of future increases to their salary deferral rates at enrollment. Typically, these increases are timed to coincide with salary increases so an employee's take-home pay is not reduced. Educating and encouraging small business owners to implement automatic deferral increases will increase participation and help ensure that employees, including the small business owner, are participating at the appropriate level.

The third barrier for small businesses is the federal law requiring employee benefit plans with 100 or more eligible participants to have an audit performed by a third party. Audits can cost several thousand dollars annually. My clients' experience has been that audits rarely uncover anything. Often rapidly growing companies are surprised by the 100-employee audit rule. Raising the audit minimum – perhaps to 200 employees – would reduce the scope of this issue.

"Safe harbor" regulations introduced in 2006 have addressed many of the above issues. However, a serious barrier remains for small businesses. Payroll, equipment outlays, advertising, sales costs and the rising costs of health care place immediate demands on the capital of a small business. It is often difficult for businesses to provide matching funds and their plans are, therefore, not eligible for "safe harbor" treatment.

In summary, the two barriers to increasing pension coverage for small business employees are:

Perceptional

1. The 401(k) requires new investment habits for baby boomers.
2. Small business owners view their business as their nest egg and have little financial incentive to offer a plan for employees that unduly caps the participation of the owner.
3. Retirement plans are complicated, highly regulated and expensive, three traits a small business is not eager to tackle.

Actual

1. Competing benefit priorities – health care, dental and other employee benefits may provide more immediate returns versus a retirement plan.
2. Compliance testing to ensure that pension plans do not discriminate in favor of highly compensated employees.
3. The 100-employee audit rule.

On a daily basis, my staff and I have the opportunity to correct misperceptions that small business owners have about pension plans. However, the actual barriers created by the reality of running a small business and the administration required for pension plans are more difficult to overcome.

Some solutions with incentives for both parties to the transaction – the employer and the employee – should be considered to help small businesses provide pension coverage:

1. Offering a tax credit, rather than a deduction, to small business employers who implement plans.

2. Implementing federal regulations that make automatic enrollment rules consistent nationally for multi-state employers and plan providers.

3. Eliminating top-heavy rules to allow plan providers to lower fees. Non-discriminatory testing already addresses top-heavy issues.

4. Raising the 100-employee audit rule to 200.

Participation is often low even when voluntary retirement plans are offered. In addition to the benefit to employees, increased employee participation provides more benefit to the small business owner as it raises the allowable participation by the owner in the plan.

Some solutions that may help increase employee participation:

1. Automatic enrollment whereby employees opt out of plan participation rather than in. Even the simple act of enrollment is an impediment for many employees.

2. Automatic deferral increases.

Some additional solutions that have not previously been discussed, but may help participation rates are:

3. Encourage plan providers to offer unbiased and revenue neutral advice. A significant barrier to individual participation is the lack of knowledge about investment options and strategies.

4. Revisit the age 50 catch-up provision – lower the age or allow catch-up based on a percentage of income. Currently, catch-up contributions are exempt from non-discriminatory testing. This would allow small business owners more time to realize benefit from a group pension plan.

5. Consider limiting the available loan amount to $5,000 and tighten the rules to allow loans for hardship only. 401(k) loans are often abused. We currently have a plan with 120 participants with 70 loans on the plan.

6. Revise rollover rules so that it is more beneficial and easier to rollover a 401(k) than to cash out. In today's work environment individuals change companies frequently. Providing incentives to keep money invested during job changes may decrease the number of cash outs.

7. Allow favorable tax treatment on benefits that are annuitized. Currently, annuitized benefits are taxed at normal income tax rates at the time of distribution.

The keys to increasing both employer and employee participation in pension plans are simplicity, education, decreasing the administrative burden and offering incentives for business owners to provide plans and employees to participate.

The private sector can then handle the educational component. Financial knowledge and expertise is often a barrier to small businesses providing plans and it is almost always a barrier to employees participating. The more we can educate and provide financial advice and direction the more we will increase participation.