April 10, 2015

United States Senate Committee on Finance, Tax Reform Working Group 3, Savings & Investment

Re: Comments of Empower Retirement to the United States Senate Committee on Finance, Savings & Investment Working Group

Dear Sir or Madam:

As the second-largest retirement services provider in the U.S., with more than 7 million people in the plans we serve, Empower Retirement deeply appreciates the opportunity to share our thoughts, comments and information regarding tax and pension reform. We applaud the bipartisan efforts of the Senate Finance Committee, and we share Chairman Orrin Hatch's and Ranking Member Ron Wyden's goals of a simpler, fairer and more efficient tax system.

Because we serve every segment of the retirement market — from emerging companies to global mega-corporations to state and local governments — we have deep experience in helping retirement plan sponsors and their participants meet the challenge of saving enough to reliably replace their working income for life. We know what works well in our current systems. We also believe these systems can be significantly improved.

First, however, we want to suggest to the working group that the linkages between tax policy, retirement savings, investment and growth are powerful. Rather than being seen only as a matter of providing income to retirees, the policies that support and incent savings should be viewed in the broad context of national economic policy and through an accurate long-term budget lens.

As you weigh the role of savings incentives in any future tax reform, we urge the working group to assess the following key issues:

- The value of retirement savings in not only providing a secure future for American workers, but in also providing flows of investment that can spur investment and higher future growth.
- The need for a more accurate way of accounting for the costs and benefits of retirement-related tax expenditures — far beyond the 10-year *window* used today.
- The need to distinguish — categorically — between once-and-gone tax expenditures and savings deferrals, which mature over decades and are taxed as ordinary income on withdrawal.
- The benefits that accrue to the Treasury Department precisely because retirees who have substantial savings do not — indeed, cannot — draw on means-tested programs, such as Medicaid.

- The savings of the American people, in short, serve as a buffer against dependency on government aid and the cost reductions that these savings bring to the Treasury can — and should — be part of any budget estimation process.
- Common-sense pension reforms that:
    - Increase the access to retirement savings.
    - Encourage behaviors that help participants succeed.
    - Provide participants with the means of making their savings last a lifetime.
    - Create a regulatory and tax-certainty environment that encourages companies and organizations to sponsor retirement plans.
- Lastly, we would like to share some thoughts on a tax incentive — either compatible with the current or a reformed code — that could encourage job creation and wage gains.

Value of retirement savings

Today's retirement savings programs were given the advantage of deferring federal income taxes precisely because they could deliver results that are clearly in the public interest. Whether they take the form of defined benefit or defined contribution plans, these systems create a regular, steady flow of investment funds to America's capital markets, helping to make them the most dynamic in the world. At the same time, savings accumulated in these systems enable retirees to continue to consume more than they possibly can without such savings.

The dynamic and stabilizing benefits retirement savings provide to the economy are not captured in current budgetary calculations. We believe they should be. Personal solvency and national solvency reinforce each other. They should never be pitted against each other as they have been in multiple recent proposals for tax and fiscal reform.

Proposals to curb, or cap, retirement incentives risk lowering America's already low savings rates, discouraging companies from establishing retirement savings plans, lowering future growth — by undercutting capital market investment — and, quite possibly, *raising* future deficits because fewer retirees will be able to support themselves.

The tax deferrals for savings in current law do, in fact, work. They offer a powerful incentive for workers to save and have contributed greatly to the success of workplace savings plans, such as the 401(k), 403(b) and 457. Today, 67% of American families have tax-advantaged retirement savings. Assets held in employer-sponsored retirement plans, IRAs and annuities totaled $23 trillion at year-end 2013.[1]

This is a huge American success story. We hope the working group will build on and extend it — and reject any effort to pare away at savings incentives or use them as a source to *pay for* unrelated budgetary items.

Tax incentives are not only vitally important to workers saving for retirement, but they also enjoy overwhelming popular support. A recent survey by the Investment Company

1 Investment Company Institute, "2014 Investment Company Fact Book"

Institute found that 88% of households supported maintaining tax incentives for retirement savings, and that number rose to 93% among households with defined contribution accounts or IRAs.[2]

Limiting or eliminating these incentives would quickly erode workers' ability to save enough to retire well — and also reduce the propensity of employers to offer workplace plans at all. Recent analysis by the Employee Benefit Research Institute (EBRI) shows that "modifying the federal tax treatment for 401(k) contributions would result in an average percentage reduction in 401(k) balances of between 6% and 22% at Social Security normal retirement age for workers currently ages 26-35." The study also found that "smaller employers were more likely to respond negatively to the proposed changes than larger employers."

EBRI cited other recent surveys that reported that small companies may "have less desire" to offer a 401(k) plan to their employees if the tax-incentive structure changed.[3]

In addition to potential damage to future retirees, proposals to curb or cut retirement savings incentives fail to consider the impact on the larger national economy. Basic economics — and our own national experience — shows us that retirement savings channeled through robust capital markets have played a key role in spurring faster overall economic growth.

To illustrate that often overlooked fact, Empower's sister company, Putnam Investments, partnered last year with Oxford Economics on a study called "Another Penny Saved," which analyzed the economic impact of higher household savings in America.

Co-sponsors on the study included a broad, nonpartisan group of retirement associations, financial service firms and civic groups, representing more than 80 million Americans. They included AARP, the American Society of Pension Professionals & Actuaries, the Aspen Institute, Bank of America Merrill Lynch, the Financial Services Roundtable, John Hancock Financial, LPL Financial, Natixis Global Asset Management, the New England Council, and the U.S. Chamber of Commerce.

The study's findings were crystal clear: Current American savings rates are too low to ensure dignified retirement for millions of workers. But raising U.S. household savings could add a net of $7 trillion to America's gross domestic product over the next 25 years.[4] In short, any legislative action that promises to increase Americans' savings rate would be strongly positive. But any policy shift that undermines incentives or lowers personal savings would be negative — damaging future economic growth. The full report's detailed findings are available online at AnotherPennySaved.com.

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2 ICI, "American Views on Defined Contribution Plan Savings," January 2015

3 EBRI, "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," 2012

4 Oxford Economics, "Another Penny Saved – The Economic Benefits of Higher US Household Saving," 2014

Fair and accurate accounting of retirement tax expenditures

Our current way of accounting for, and *scoring,* savings tax deferrals is deeply flawed. It seriously overstates the *costs* of these incentives to the Treasury and understates their benefits to working Americans and the nation's economy.

Three elements of current budget scoring for retirement costs are especially egregious and should be questioned — and changed — before the next round of pension or tax reform legislation goes forward. We simply must base the next round of retirement tax policy on accurate arithmetic and reasonable estimates of these policies' economic impact.

How can we possibly justify making policy that could affect millions of workers' security on the basis of outdated conventions that we all know are wrong?

First, and most important, savings deferrals should be treated for budgetary purposes as distinctly different from such true tax expenditures as deductions for mortgage interest and charitable giving. Savings deferrals are categorically different.

Unlike true once-and-gone tax expenditures, deferred savings appreciate for many years in vehicles such as 401(k) plans, IRAs and variable annuities, and then they flow back into the federal revenue system on withdrawal. At withdrawal, the capital gains and dividends such accounts hold are taxed as ordinary income. This process unfolds over decades and lifetimes, in fact — and is distinctly different from true once-and-gone tax expenditures. To accurately assess the long-term budget impact of savings incentives, we need to first draw that basic distinction.

Secondly, and almost equally important, the 10-year window is a totally inappropriate metric to apply to cash flows that evolve over a half-century or more. It routinely overstates true revenue costs of savings deferrals to the Treasury and takes no account of the economic — and human — damage that could be done if savings incentives are cut or curtailed. We need to adopt a full life cycle, holistic time frame to measure net costs.

Thirdly, in estimating the long-term budgetary cost of savings deferrals, Congress should also include a reasonable estimate for the future savings to the Treasury that stem from the fact that these same savings help citizens rely on their own resources — *before* needing to draw on means-tested federal benefits, such as Medicaid.

The retirement savings of the American people do, in reality, provide a buffer that shields the Treasury against the need to fund those citizens' daily necessities in retirement.

Recognizing the economic benefit of raising household savings and assessing the true cost of our existing savings incentives can lay a solid foundation for action to strengthen both the public and private elements of America's *hybrid* retirement system.

We believe that Congress should amend the Budget Act of 1974 to differentiate retirement savings deferrals from tax expenditures, such as the mortgage interest deduction. Any tax law that affects savings deferrals also should be required to look beyond the current 10-year window to assess the full life cycle costs and benefits of savings deferrals, and then express that cost to the Treasury in net present value terms.

Pension reforms

While our current defined contribution is an effective tool for helping many millions of American workers reach a secure retirement, there are changes that could promote better outcomes — by spreading proven best practices across all plans.

The 401(k) plan is less than 40 years old. During that time, we have seen constant, and significant, enhancements improve the system. But public policy should encourage further innovation that draws upon our latest learning and newest technologies. Any potential change to the current tax code should also encourage a range of common-sense pension reforms, including:

- Providing greater access to retirement savings (closing the access gap).
- Ensuring that workers and participants save enough to reach retirement readiness — by supporting fully automatic plan designs, raising deferral rates, and offering plan sponsors stronger legal safe harbors for adopting such proven best practices.
- Helping retirees manage the drawdown process so their savings last a lifetime.

Access – The primary vehicles for Americans' retirement savings are now employer-sponsored defined contribution plans, such as the 401(k) plan. Bureau of Labor Statistics data from 2014 shows that 74% of full-time workers have access to some form of a workplace savings plan, but fewer than 50% of workers in small businesses (fewer than 100 employees) enjoy such access.[5] A 2012 Government Accountability Office report suggested several reasons why small businesses are less likely to sponsor a plan, including:

- Plans are complex and can be burdensome to administer.
- Lack of financial resources.
- Insufficient financial or tax incentives to start up a plan.[6]

These employer concerns result in a yawning coverage gap that leaves tens of millions of workers with no access to any job-based savings plan at all. Closing that gap should be a priority in the next round of pension and tax reform — and there have been multiple efforts to do so.

For example, the Secure Annuities for Employee Retirement (SAFE) Act of 2013 would have provided for a *starter 401(k)* plan for small businesses that would have helped address many of the administrative challenges faced by small employers. We strongly support many of the elements contained in the SAFE Act and urge the committee to ensure any tax reform it favors would also support such plans.

5 Bureau of Labor Statistics news release, March 2013

6 "PRIVATE PENSIONS: Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship," GAO – 12-326, March 5, 2012

Additionally, current law provides modest tax credits for employers who adopt a retirement plan. At Empower, we believe these credits should be substantially increased, and they should be made refundable.

Many small businesses make no money in their early years, so they can't benefit from nonrefundable credits. Yet society benefits whenever any business offers savings plans to their workers. Increasing the size of the credit and making it refundable would be a major step toward closing the access, or coverage, gap that leaves tens of millions of workers with no on-the-job savings plans today.

Finally, third-party advisors, consultants and other intermediaries provide the primary distribution channel for small employers seeking to adopt a retirement plan. Despite this, our current regulatory structure continues to evolve in a manner that discourages these providers from servicing the small-business market.

The regulators' goal of protecting the small plan sponsor and its participants is admirable. But the unintended consequence has been erecting barriers that limit access to professional assistance. Full disclosure of fees is absolutely necessary, but an unneeded expansion of fiduciary liability would likely do more harm than good.

Adequacy of savings – Every year, the Empower Institute[7] works with Brightwork Partners to prepare a Lifetime Income Score (LIS) survey that estimates the percentage of work-life income that American households are on track to replace in retirement. The LIS survey is comprehensive; it includes a wide range of assets, including Social Security, workplace and personal savings, home equity, and even the value of businesses that people own.

The 2015 LIS survey confirms that access to a workplace plan is the single most important variable for retirement readiness. People who lack a plan at work are on track — at the median — to replace just 42% of their preretirement income — and that includes Social Security. People with access to a savings plan at work are on track — again, at the median — to replace 74%.

Most striking, those who participate in their 401(k) plan, and who also save more than 10%, are on track to replace more than 100% of their working income once they retire and begin collecting Social Security.[8] That is success by any measure.

The policy implications are crystal clear: We should encourage the adoption of full-auto plan designs and aim for 10%+ savings targets. That suggests:

- Requiring or incenting all 401(k) plans to adopt automatic enrollment and adopt automatic escalation of savings rates to levels of 10% or more.
- Lifting the initial default rate for initial automatic enrollment to 6% with automatic increases to 10%+ over four years or less.

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7 Empower Institute is the research and education arm of Empower Retirement's parent company, Great-West Lifeco U.S., Inc.

8 Empower Institute, "Lifetime Income Scores V; Optimism and opportunity," March 2015

- Encouraging small employers (fewer than 100 employees) to implement an autopilot program by providing generous, refundable tax credits and relief from discrimination testing.
- As part of full-autopilot design, plans should automatically re-enroll nonparticipating employees and participants deferring below the initial default rate every year (allowing them an opportunity to opt out, of course).

Managing distributions – Because defined contribution plans have now become America's primary retirement savings vehicle, workers are required to not only contribute and manage their investment choices but also find ways to reliably draw down — and not exhaust — their savings over what may be many years of retirement. This is a daunting challenge.

Far too few participants consider lifetime income options at the time of distribution. We can change this by adopting policies that encourage workplace savers and retirees to seriously consider guaranteed lifetime income solutions — either in the form of annuities or in guaranteed drawdown funds that can last a lifetime. Possible policies include:

- All participants should have the option of electing to receive their retirement benefits in the form of lifetime income distributions.
- The current qualified default investment alternative rules should be expanded to include lifetime income alternatives.
- Those participants that elect to receive any portion of their postretirement distribution in the form of lifetime income should have a portion of that distribution (e.g., the first $10,000 per year) exempted from income taxes.
- We should create a new fiduciary safe harbor for selecting lifetime income products, and, in order to effectively make these products available to small employers, the concern about an insurer's ability to meet its future obligations should be met by relying on the oversight currently provided through state insurance regulators.

Job creation

Of course, access to workplace retirement savings programs are dependent on employment itself. As we continue to look for innovative ways to encourage job growth and workforce participation, we would suggest consideration of an idea first proposed by our CEO, Robert Reynolds, in 2013: providing a generous, refundable tax credit to any private company or organization that can show that it has grown its payroll — measured by the Social Security taxes it pays — from one year to the next.

To claim the credit, companies would either have to hire more Americans or have to raise the pay of their American employees. Businesses could not qualify by hiring foreign

workers (who don't pay the Social Security tax) or by boosting the compensation of executives who earn more than the current OASDI tax cap ($118,500 in 2015).

Such a credit would counter both unemployment and stagnant wages. It would *lea*n against inequality and offshoring — and perhaps even encourage serious capital repatriation. Companies or organizations that can show they have increased their Social Security tax payments should be able to claim a credit worth, say, 25% of that increase — or bring home cash held offshore by a generous multiple of any FICA increase — at very low, or even zero, tax rates.

To make sure such a credit would benefit early-stage companies, many of which owe no taxes, the credit should be refundable. That would be a big help to young, not yet profitable firms that actually create most new American jobs. Because these entrepreneurs also drive most of America's productivity gains, we could score another benefit for the whole economy.

It is important to note that this proposal does not affect Social Security itself in any way. It simply uses FICA payroll taxes as the best, most accurate metric for an offsetting credit to companies or organizations that have done what all Americans want to see done: Hire more workers and/or give current workers higher wages.

In short, such a provision would help correct an unintended bias in our overall tax policy — one that actually penalizes firms for hiring or giving wage increases. This idea is compatible with any tax reform — or none — and would be highly cost-effective, with significant positive feedback in terms of lower social costs and higher-income tax revenue.

Conclusion

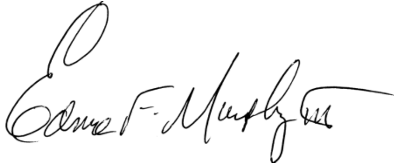
Solving America's retirement savings challenge is a difficult but eminently achievable goal. What's more, progress toward that goal would generate a great surge in public confidence in America's ability to shape its future; it would also spur the increased savings needed to get America's economy growing faster than its debts.

That is because changes that enhance retirement security and raise savings rates do more than help secure dignified retirements. They also provide the funds needed to fuel robust capital markets and finance investment and job creation. Over the next generation, economic growth itself offers the most effective, least painful solution for America's debt and deficit challenges.

Done well, retirement policy can, we believe, turn a potential crisis into an engine for renewed growth, hope and opportunity.

Once again, Empower appreciates the chance to share our thoughts. We would welcome any opportunity to meet with members of the Senate Finance Committee working groups to provide further detail.

Sincerely,



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cc:
United States Senate Committee on Finance, Tax Reform Working Group 1; Individual Income Tax

United States Senate Committee on Finance, Tax Reform Working Group 2; Business Income Tax