STATEMENT BY DAVID WRAY, PRESIDENT
ON BEHALF OF THE PROFIT SHARING/401k COUNCIL OF AMERICA BEFORE THE ERISA ADVISORY COUNCIL
APPROACHES FOR RETIREMENT SECURITY IN THE UNITED STATES

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Mr. Chairman: Thank you for this opportunity to speak about the approaches for retirement security in the United States. My name is David Wray. I am here presenting the views of the Profit Sharing/401k Council of America (PSCA), a 60 year old non-profit association representing companies that sponsor profit sharing and 401(k) plans. PSCA speaks for over 1200 companies who employ approximately 5 million plan participants throughout the United States. PSCA's members range in size from very small firms to conglomerates with hundreds of thousands of employees. All regard their profit sharing or 401(k) plans as vital factors in their business success.

Before I answer the questions you have posed, I would like to lay some groundwork.

Social Security and DC Plan Saving

In the future, the retirement benefits of non-governmental workers in the United States will be provided by a combination of Social Security and personally accumulated wealth. This approach makes sense. Social Security is a universal, mandatory program that provides a progressively structured joint and survivor lifetime annuity that is indexed for inflation. Social Security provides a strong foundation of retirement income for America's workers. Social Security payments in the future will ensure that Americans of normal retirement age, soon to be 67, will continue to have the lowest poverty rates of any segment of American society.

In addition to their Social Security benefits, future American nongovernmental retirees will consume wealth they accumulated from deferred consumption of income while they were working. All Americans are eligible to save in a government promoted retirement program. They can save in an employer sponsored defined contribution plan like a 401(k) or they can save in a SEP or IRA. Some can save in both. The employer-sponsored defined contribution was greatly augmented with the passage of the Pension Protection Act of 2006. With this action, Congress put in place a regulatory infrastructure that will encourage the continued growth in the usage of employer-sponsored defined contribution plans.

Workers also accumulate assets that can be consumed in retirement on an after-tax basis. A few will continue to benefit from employer-sponsored defined benefit plans, though the plans will probably be less generous than in the past. However, even for those relying entirely on defined contribution accumulation, the outcome from this approach can provide adequate retirement income.

2008 Median Wage Retiree DC Saver

According to Aon Consulting's "2008 Replacement Ratio Study" individuals who retired in 2008 earning $50,000 needed $40,500 (81% replacement ratio) in income after retirement to maintain their pre-retirement standard of living. Social Security replaced 37 percent. This means 44 percent ($22,000) needed to come from other sources. Currently it takes $268,000 to buy an immediate income annuity paying $22,000.

The following chart illustrates how a defined contribution plan can deliver income equal to 44 percent of final pay. It also includes age-specific accumulation targets and highlights the importance of saving over the long term. It assumes annual 3 percent salary increases and an 8 percent investment rate of return. The accumulation target was determined using the instant annuity quote calculator at www.immediateannuities.com on July 8, 2009. This person made $15,300 at age 25 using a 3 percent wage inflation assumption. Numbers have been rounded for presentation purposes.

Age	Pre-retirement Income	Retirement Income Needed	Accumulation Target	Target in Multiples of Current Income
65	$50,000	$22,000	$268,000	5.4 Times Pay
55	$37,200		$112,100	3.0 Times Pay
45	$27,700		$ 41,900	1.5 Times Pay
35	$20,600		$ 12,000	.6 Times Pay
25	$15,300		0	0

Accumulation Period	Required Savings Rate to Achieve Target
40 Years	4.5%
30 Years	8.0%
20 Years	16.0%
10 Years	41.0%

While some workers have enjoyed a full working career with access to an employer sponsored defined contribution plan such a as profit sharing plan, most have participated in them for a much shorter period of time. The typical participant today has participated in their plan for approximately 10 years. Policymakers must be wary of statistics citing average 401(k) balances and balances of those approaching retirement because they have not saved over their full working career in their current plan and some balances belong to new participants. Further, over time more and more individuals and households will have multiple 401(k)-type accounts or assets rolled over into an IRA. For example, in 2006 the private employer sponsored defined contribution system held over 12 million accounts of terminated vested employees.

Employers Make It Happen

While there are many ways for workers to save and invest for retirement, one proven way stands out - employer-provided defined contribution plans, of which 401(k) is the predominant type. Workers will save in an employer provided defined contribution plan when otherwise they might not save at all. A study by the Employee Benefits Research Organization (EBRI) found that 77.7% of those making between $30,000 and $50,000 save in an employer defined contribution plan where one is offered. Compare that to only 5.0% of those making between $30,000 and $50,000 saving in an IRA when no employer defined contribution plan is offered.

This is not surprising. Employers who sponsor DC plan plans do a lot. They encourage their employees to save by providing incentives for saving and simplify the saving process. Employers and their service providers have committed millions of dollars and millions of work hours to communicating to their employees how important it is to save for retirement. Based on our conversations with providers, every day over 80,000 people across the country help plan participants through call centers, in live or online education meetings, and by administering the 401(k) and other employer-sponsored savings programs. In addition, these dedicated individuals assist participants in making transactions, getting account balances, as well as help people with loans and distributions.

80% of employer-sponsored defined contribution plan sponsors reward participant savings by matching their contributions with contributions from the company. For plan sponsors that do not provide a matching contribution, an employer contribution in the form of a profit sharing contribution or a defined benefit plan is often provided.

With a click on the internet or brief telephone conversation, plan participants put into motion a process that deducts savings from their paycheck and allocates it to their investment portfolio. Employees can initially choose and later change the amount of money they wish to save. Even the smallest savers have accessibility to employer sponsored DC plan plans. There are no minimum starting balances, small contribution dollar amounts are allowed, and there are no required investment fund minimums. For example, a participant earning $24,000 per year is able to invest 1% of pay or $20 per month in the employer sponsored DC plan. This would be difficult, if not impossible, for them on their own. Those participating in an employer sponsored DC plan currently save approximately seven percent of their pay, not including any employer contributions, an amount that far exceeds what is saved by those without access to such programs.

In addition, some employers make the process even easier. They may automatically enroll employees in the employer sponsored DC plan and automatically increase contribution amounts over time. Of course, the employee has the opportunity to opt out of these automatic employer sponsored DC plan features, but employers spend time and money telling them why should not.

Employers offer employer sponsored DC plan participants a carefully selected and limited range of diversified, high quality investment choices. As a result, participants are spared the intimidating process of choosing from among the thousands of available investment options. Having a limited list of employer screened investments from which to choose simplifies the participant’s investment decision and greatly improves the likelihood of financial success.

By encouraging employer sponsored DC plan participants to begin saving early and by automatically investing those savings every time money is deposited into participants' accounts, plan sponsors also engage participants in dollar cost averaging, a proven method of reducing investment risk by spreading purchases over time.

Some plan sponsors make investing even easier. They may arrange to have employer sponsored DC plan assets managed for the participating employee in managed accounts or they may provide investment options like target date or life cycle funds where the employee can choose to have their assets managed and rebalanced based on their expected retirement date or their age.

Importantly, investment returns in employer sponsored DC plan plans are enhanced because fees charged in plans, such as account maintenance costs and investment management expenses, are typically lower than fees paid when investing outside a plan. This is particularly true for small accounts that are frequently held by lower income workers. In addition, some employers pay some or all of the plan related fees.

Employees are in need of financial education – a subject that is inadequately provided in the U.S. education system. Employers recognize that they, along with financial advisors and planners, are a key source of financial education for their employees. Employers provide investment education by using enrollment kits, fund performance sheets, newsletters, and internet seminars to assist participants with their investment allocation choices. Advice may be offered through one-on-one counseling, internet providers or telephone hotlines.

Savings in an employer sponsored defined contribution plan is safe. A plan has plan trustees, administrators and service providers who have specific obligations under federal law to carefully manage the assets in their defined contribution plans. Under the law, the assets in a plan belong to participants and beneficiaries and must be managed solely for their benefit. Plan assets must be where they are supposed to be when they are supposed to be there and cannot be commingled with company assets. Importantly, company decision-makers have a personal interest in the safety of plan assets since they often have the largest amounts in the plan.

Those with responsibility for defined contribution plan assets, called fiduciaries, must follow rules set by law. They are personally liable to the plan for all losses suffered as a result of their action or inaction. In other words, if fiduciaries mishandle plan assets they must make restitution out of their own pockets. Bernie Madoff was not managing 401(k) assets.

The greatest benefit of an employer sponsored defined contribution program is the oversight the employer provides, not payroll deduction. It is important to understand that employers invest the time and effort necessary to make their defined contribution program successful because it is in their interest to align the interests of the company and its employees. The current regulatory framework permits employers to design a program that works best for both their employees and the company. Replacing plan design flexibility with a generic approach designed by the government will drastically reduce employer commitment and the system will regress to the government imposed mean and savings will decrease.

The Employer Sponsored Defined Contribution System Is Amazingly Stable

The recent drop in employer sponsored defined contribution plan account balances was not caused by a defect in the retirement plan system or ignorant workers. It was caused by a catastrophic failure in the operation of capital markets. It is hardly surprising that 401(k) plans did not escape a collapse that has stricken almost every financial system or arrangement in the world.

It is reassuring that, unlike many other investors, employer sponsored defined contribution plan participants did not act out of panic and stop saving or reallocate their investments to government securities, money market funds or their mattress. According to reports by Fidelity, Hewitt, Vanguard, and others, some participants have reduced their savings in their employer-sponsored defined contribution plan, some significantly so. However, even more have increased their contribution so that the average deferral in plans remains about the same. Hardship withdrawals are up but still only about 2 percent of participants take them. New plan loan originations are within normal range. While allocation to equities from new contributions was adjusted downward from 70 percent at its peak, 56 percent of new contributions are still going into equities.

Before I move to the questions let me summarize:

- Social Security and defined contribution accumulation approaches are successfully complementary programs.
- Every American worker currently has access to a government incentivized defined contribution program.
- Employer sponsored defined contribution programs work well, not because of payroll deduction, but because of the effort of employers to make them so.
- Employers commit the money and resources necessary to make their defined contribution plan successful because their plan’s success translates into company success.
- An enormous infrastructure has been built to support defined contribution plan participants.
- The employer-sponsored defined contribution has been stable even in the most extreme of situations.

Employer provided defined contribution plans, of which 401(k)-like plans are the predominant type, are a proven way for employees to build retirement wealth. By offering these plans, employers provide a secure structure for saving and investing for employees that has resulted in trillions of dollars of retirement savings - savings well beyond what working Americans would have accumulated without them. Combined with Social Security, employer sponsored defined contribution plans are a path to retirement security for America’s workers. We do not need to redesign the system of employer sponsored retirement plans. We need to build on it. We need to give the changes in Pension Protection Act of 2006 time to work.

The Questions:

1. Does the current voluntary U.S. retirement system need to be redesigned or completely restructured?

The U.S. Bureau of Labor Statistics (BLS), in their March 2009 "Program Perspectives on Retirement Benefits: Issue 3," reports in Table 3 that in March 2008 67 percent of *all* (emphasis added) private industry workers had access to either a defined contribution plan or a defined benefit plan. Sixty-two percent had access to a defined contribution plan. The numbers for full-time workers are even higher. According to other BLS reports, 71 percent of full-time workers had access to an employer-provided retirement plan.

The system is working well for millions of American workers. We should be cautious about making fundamental changes. Further, The Pension Protection Act of 2006 put in place changes necessary to bring the employer sponsored defined contribution plan system to its full potential. Specifically, the regulatory structure established in the 2001 Tax Act (EGTRRA) was made permanent, and the Saver's Credit was renewed, made permanent, and indexed. The barriers to automatic enrollment were removed. This legislation will foster a voluntary redesign of employer-sponsored 401(k) and other defined contribution plans if we give it time. Major change at this time to the employer-sponsored defined contribution system will be counterproductive.

The employer provided defined contribution system has demonstrated that it can provide asset accumulation adequate for a secure retirement for participants at all income levels. The participation rate when a plan is offered is encouraging, but can be improved. There are two areas in which to concentrate our efforts - lower-paid workers and small business plan coverage. We also need to increase participation by African-Americans and some ethnic groups, as revealed by some recent studies. Small business owners need simplicity and meaningful benefits for themselves to compensate for the costs of providing a plan to their workers.

For example, in order to increase the amount of small company plan formation, the top heavy test must be eliminated. According to an EBRI study, 30 percent of small employers say they would be much more likely to offer a retirement plan if they were not required to make contributions. This is understandable as many small companies have uncertain cash flows, and a required contribution to a retirement program could jeopardize a company's survival. Unfortunately, ERISA requires that small companies do just that.

The rules for employer-sponsored defined contribution plans may look the same for large and small companies, but, in practice, the results are very different. Large companies can exclude from their plans up to 30 percent of their workforce and limit company contributions to those who make voluntary contributions or even make no company contribution at all. In contrast, small companies must contribute 3 percent of pay for every full-time employee over the age of 21 with one year of service. This outcome stems from the top-heavy rules, one of the many government-imposed limitations and rules designed to ensure that company managers do not disproportionately benefit from defined contribution

In addition, the top heavy rules are among the most complex regulations in ERISA. For example, the top heavy test is more complex than the 401(k) anti-discrimination test. Also, the definition of those considered to be in the top-paid group different and broader then for the 401(k) discrimination test. This makes top-heavy testing considerably more onerous.

In practice, nearly all companies with fewer than 50 employees will eventually fail the top heavy test, even if they are not top-heavy initially. For companies with fewer than 25 employees, it is a virtual certainty. This is because small companies are owner-managed, so there is virtually no turnover in the company's HCEs. In contrast, turnover within the rest of a small company's workforce is usually very high — typically higher than turnover among similar employees at large companies' plans.

If a plan is top heavy and does not comply with the required remedies, there are severe penalties: immediate disqualification of the plan, serious tax fines, and the possibility that the company may be liable for substantial make-up contributions and legal fees. For small businesses, the resources to cover these fines and reparations — especially those with 50 or fewer employees — may put the entire company at risk.

The following chart (based upon a company with 20 NHCEs and 4 HCEs) demonstrates how small plans become top-heavy over a four-year period. The chart assumes that four NHCEs quit and are replaced annually and that there is a one-year eligibility period. The turnover and eligibility assumptions are important because it is turnover among NHCEs that is a major cause of top-heavy test failure.

	First Year Assets	**Second Year Assets**	**Third Year Assets**	**Fourth Year Assets**
HCEs	$42,400	$89,040	$140,344	$196,778
NHCEs	$48,000	$90,900	$108,300	$125,361
Total Plan	$90,400	$179,940	$248,644	$322,139
Top Heavy %	46.90%	49.48%	56.44%	**61.08%***

*A plan is top-heavy when 60 percent of its assets are in the accounts of HCEs.

One company with 22 employees installed a 401(k) plan that matched 50 percent on the first 15 percent of pay — a generous program by any measure. Unfortunately, the plan sponsor discovered the top heavy test only after it had been failed. The company had to pay $17,000 in legal fees to deal with the IRS in addition to a $28,000 corrective contribution to the plan on behalf of NHCEs. Fortunately they could afford to do so.

Many small companies who are suspending their contributions to their defined contribution plans to stay in business are going to be unpleasantly surprised when they learn after the fact that they must make the 3 percent contribution anyway.

2. Can DC plans be redesigned to generate better retirement security outcomes?

Federal law governing employer-sponsored retirement plans provides for substantial flexibility except in one area. To the extent a guaranteed type of solution like an annuity is a distribution option, it must fit within the annuity regime proscribed by law. The rejection by participants of the government-mandated joint and survivor annuity solution could not be any clearer. This annuity is this default distribution option of pension plans. Pension plan beneficiaries who want to take a lump sum, when a lump sum is available, have to go through some effort to override the default. Overwhelmingly, they choose the lump sum, often in the face of significant educational efforts to discourage them from doing so. To illustrate, one significant defined contribution plan has an annuity as the default option. At this company, less than ten individuals out of the thousands of retirees over the last decade have chosen the plan's annuity option.

The approach to annuitization is changing. Providers are designing new alternatives and plan sponsors are interested in new solutions. However, until the laws governing plan-delivered annuities are changed, they will not be part of the new retirement security innovation. Participants interested in annuitization will roll their money over into IRAs. Further, efforts to force mandatory annuitization using the current approach will be met by fierce opposition from participants. The law mandating the current joint and survivor annuity approach must be repealed before there can be serious conversation about how to deliver income solutions from defined contribution plans.

3 Can DB plans be redesigned to be more attractive to employers, and ultimately result in broader coverage, as well better retirement security for participants?

Defined benefit plans are not within the purview of PSCA's mission.

4. Would the adoption of plan designs in use outside of the U.S. contribute or detract from retirement security in the US?

It is always useful to study other systems and approaches. However, I would point out that the United States has more money set aside for retirement in total, and per capita, than any other country in the world. Future retirement income security will depend on pre-funded solutions. To date, no other country of any size has done this better than the United States.

5. Has the consolidation of the financial services industry impacted participant retirement security?

The financial services industry has been in a continuous state of consolidation since the 1990s. While it is critical that there be sufficient providers so that there is serious competition, the consolidation to date has resulted in significant economies of scale that have allowed the delivery of increasingly sophisticated employer-sponsored defined contribution plans and services at continually decreasing costs. This is especially true for smaller employers, even though the costs for some smaller employers still remain high.

6. Should plan providers be able to market retail products to plan participants because of their relationships?

Plan sponsors are wary of the implied employer endorsement that occurs when providers are able to market retail products to plan participants. Most would say no. Certainly this should happen only where there has been careful consideration by all parties and everyone understands what is happening.

7. Should DC plans be amended to permit sponsors to invest funds contributed by participants to better ensure financial security and can such sponsors receive fiduciary protection?

Please see my answer to question 2.

8. Can the Government provide some form of guaranty or insurance for DC plans to protect retirement security?

Defined contribution plans by their nature deliver an accumulation of contributions and the earnings on those contributions. Defined contribution investors are like other investors. They invest in assets where the value of the principal can fluctuate. As we have just witnessed, these asset values can be highly volatile in the short term. There are guaranteed investments, but they have relatively low returns, for example money market and stable value funds. In short, it is possible to guarantee specific kinds of investments in defined contribution plans in exchange for a lower return, but not for the system overall.

Thank new for this opportunity to comment. I look forward to your questions.