THE SPARK Institute, Inc.

# Statement of The SPARK Institute to the U.S. House of Representatives Committee on Ways and Means and Working Group on Pensions and Retirement

## April 2013

Chairman Camp, Ranking Member Levin, Working Group Chair Tiberi, and Working Group Vice-Chair Kind, The SPARK Institute appreciates this opportunity to share its insights and concerns about certain retirement plan related provisions in the President's fiscal year 2014 budget proposal. The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms and benefits consultants. Our member companies include nearly all of the largest retirement plan record keepers. Collectively, they serve approximately 70 million participants in 401(k) and other defined contribution plans. They are the companies that employers turn to and rely on for help in operating their retirement plans and complying with new laws. Their collective expertise and vantage point as service providers to retirement plans give them a unique perspective on these matters.

Employer sponsored retirement plans have enabled tens of millions of American workers to accumulate more than 19 trillion dollars in retirement savings.[1] The importance of the current system and tax incentives that encourage employers to voluntarily offer plans to their employees and make voluntary matching and profit sharing contributions cannot be overstated.

The budget provisions discussed below are complex, they create the potential for significant unintended consequences, and will be costly to employers and individual savers. At a minimum, the proposals will increase the costs ultimately borne by <u>all</u> American workers trying to save for retirement, not just the higher-income workers whom the provisions target. At worst the proposals will adversely impact the availability of plans and the amounts contributed by employers, particularly among small businesses. We urge you to consider proposals that will encourage voluntary plan formation and

[1] *See* Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2012" (March 2013) available at www.ici.org/info/ret_12_q4_data.xls.

contributions by employers instead of complex and costly provisions that will have the opposite effect.

**Limitation on Retirement Plan Accruals**

The proposed budget includes a limit on the total amount of savings any individual can accumulate in tax-favored retirement plans, including 401(k)s, IRAs, 403(b)s, 457(b)s, and pension plans. We share the concerns raised by others about the potential adverse and chilling impact this would have on plan adoption, retention, and contributions, particularly among small employers where the owners and key decision makers could be denied the ability to continue to save for retirement on a tax deferred basis. Our members have shared information with us from small business owners who are concerned about the proposal. Some business owners have indicated that they would consider slowing or stopping voluntary contributions to their plans or terminating them as they approached or reached the cap. Under such circumstances, an employer's entire workforce would be adversely impacted by the cap.

Further, we are very concerned about the complexity that the cap adds to the administration and operation of all retirement plans. Many employers identify the complexity of operating a plan as one of the main reasons that they are unwilling to offer one. Many of the existing rules already subject plan participants, particularly higher-income workers, to significant limits on the amounts they can contribute to a plan on an annual basis. The current rules are confusing for employers and plan participants, and substantially increase the costs of operating a plan. For example, participants cannot defer more than $17,500 ($23,000 for workers age 50 and over) per year in a 401(k) plan, and the total limitation on additions to defined contribution plans for any individual is $51,000. Deferrals by highly compensated employees are limited further under certain compliance tests that must be performed annually by employers. These tests limit the amounts highly compensated employees can defer based on the amounts deferred by other employees, limit the amount of matching contributions that can be allocated to highly compensated employees based on amounts allocated to other employees, and limit the aggregate amounts that can be accumulated among highly compensated employees in a plan relative to the amounts accumulated by others. Additionally, excess contributions and accumulations must be distributed annually under current laws, which also require special tax reporting.

The proposed cap would layer yet another, even more complicated requirement on top of those already in place. From what we know so far, it is extremely complex, will be difficult to administer, will involve substantial reporting by employers and service providers, and impose substantial burdens on savers, including those who have not reached the cap. The cap amount will fluctuate constantly because it is tied to the calculated cost of buying a particular annuity, which is based on many variables. Factors such as interest rates and inflation will impact the cap and will likely cause the cap to decline substantially when interest rates return to historically normal levels. The cap will have to be calculated annually, and reported to every individual who has any retirement savings and to the IRS by each employer and account trustee. Although the proposed cap on its face may appear to only impact higher-income individuals, it will have implications for everyone who saves for retirement, and will be expensive to comply with, monitor and enforce. Compliance and enforcement will also have unintended consequences. For example, excess distributions will have to be coordinated and verified among unrelated employers and plan trustees to ensure that individuals do not improperly withdraw money from their retirement accounts and jeopardize the tax-favored status of a plan. The mechanisms for this type of verification do not exist and is just one example of the potential unintended consequences and costs of the proposed cap.

The administrative, compliance and reporting costs resulting from the cap will ultimately be borne by all individuals trying to save for retirement, not just the higher-income workers whom the provision targets. We urge policymakers to consider and study the costs and benefits of the proposed cap before giving any serious consideration towards adopting it, given the complexity it adds and burdens it imposes on employers and all individuals trying to save for retirement. Further consideration should be given to possible unintended consequences that are likely to result from this broad and far reaching proposal.

**Limitation on the Value on Retirement Plan Deferrals**

Additionally, we are concerned about the implications for retirement plans of the President's proposal that will limit the value of deductions and exclusions. We are also concerned about the additional administrative complexity and burdens the limit will create for employers and savers. The limit would apply to employee deferrals in 401(k) plans. However, deferrals, unlike deductions, are subject to ordinary income tax (as are the earnings on such amounts) when they are distributed. The most recent iteration of this proposal included provisions intended to address criticisms about an earlier version that would have resulted in double taxation of deferrals that exceeded the limitation. The proposed correction (i.e., assign and track individual taxpayer basis on the disallowed amounts) adds further complexity for employers who already struggle with administering complex plan rules. As stated above, the administrative, compliance and reporting costs resulting from the proposal will ultimately be borne by all individuals trying to save for retirement, not just the higher-income workers whom the provision targets.

We recognize the critical need to resolve our budget and deficit problems. However, we urge you not to do so by adding complexity and costs to the voluntary employer sponsored retirement plan system that is already burdened by regulatory complexity. We also urge caution with broad and sweeping proposals that are likely to have significant unintended adverse consequences on how Americans save for retirement.

We believe that Congress should be encouraging voluntary plan formation and contributions to retirement plans by employers instead of adding complex and costly provisions that will have the opposite effect.

* * * * *

The SPARK Institute appreciates your consideration of our views and concerns. Please do not hesitate to contact us if you would like additional information or if we can be of further assistance regarding these matters.

Larry Goldbrum, General Counsel
The SPARK Institute
larry@sparkinstitute.org
704-987-0533