AMERICAN BENEFITS COUNCIL

TESTIMONY OF

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ON BEHALF OF THE
AMERICAN BENEFITS COUNCIL

BEFORE THE

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COMMITTEE ON EDUCATION AND THE WORKFORCE,
SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR,
AND PENSIONS

HEARING ON "ENHANCING RETIREMENT SECURITY: EXAMINING PROPOSALS TO SIMPLIFY AND MODERNIZE RETIREMENT PLAN ADMINISTRATION"

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Chairman Walberg, Ranking Member Sablan, and Members of the Subcommittee, thank you for the opportunity to speak with you today on the ways that we can work together to simplify and modernize retirement plan administration. The Subcommittee has before it a number of forwarding-thinking proposals that the American Benefits Committee is pleased to support.

My name is Krista D'Aloia, and I am testifying on behalf of the American Benefits Council (the "Council"). I am a vice president and associate general counsel at Fidelity Investments supporting its Workplace Retirement business. I have worked at Fidelity Investments for more than 20 years, and have also worked at the United States Department of Labor's Employee Benefits Security Administration and the New York State Attorney General's Office.

The Council and I appreciate the opportunity to participate in today's critical and timely hearing on retirement. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The views expressed in this testimony are those of the Council, although my testimony is informed by my extensive experience at Fidelity, the nation's largest provider of services to defined contribution (DC) plans. Fidelity provides recordkeeping, investment management, brokerage and custodial/trustee services to thousands of Code section 401(k), 403(b) and other retirement plans covering over 18 million individuals Fidelity also sponsors a plan for over 40,000 employees and shares many of the same concerns other plan sponsors have regarding the need to modernize plan administration.

My testimony today will focus on H.R. 4158, the Retirement Plan Modernization Act, which would increase the cash-out limit to reflect normal cost of living increases. The Council strongly supports this bipartisan, common-sense improvement. But I will also discuss our support for H.R. 4610, the RETIRE Act, which modernizes the rules regarding delivery of documents electronically, and H.R. 854, the Retirement Security for American Workers Act, which makes vital improvements to the rules governing multiple employer plans. The provisions of H.R. 854 are also contained in the Retirement Enhancement and Savings Act, or RESA, (H.R. 5282), which contains a variety of bipartisan improvements that the Council also supports.

INTRODUCTION

Employer-sponsored DC plans and defined benefit (DB) retirement plans are an indispensable building block of our Nation's retirement system. Retirement plans, like

those sponsored and administered by the Council's members, including by Fidelity, successfully assist tens of millions of families in accumulating retirement savings and will provide trillions of dollars in retirement income and a more financially secure retirement. Congress has adopted rules that encourage employers to voluntarily offer these plans, encourage employees' participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. Workplace-based retirement plans play a vital role in ensuring personal financial security and in generating savings to fuel the type of capital investment the economy needs to generate long-term growth.

With about 100 million active and retired workers (and their spouses) accumulating retirement savings under employment-based retirement plans and IRAs, it is critical that all key stakeholders – government, employers, individual investors, and service providers - continually look at ways to make the system better. The proposals that I will discuss today are improvements that can be made to simplify and modernize our system.

The need to build on, but not harm, our successful private system for delivery of retirement security alongside Social Security informed the Council's 2014 public policy strategic plan, **A 2020 Vision: Flexibility and the Future of Employee Benefits.** *A 2020 Vision* was adopted against the backdrop of 40th anniversary of the passage of the Employee Retirement Income Security Act of 1974 (ERISA). We recognized in that document the ongoing shift from a primarily defined benefit to a primarily defined contribution plan environment, which has focused greater attention on whether employees have what they need in terms of assets and financial education. Employers pursuing innovative strategies to help employees meet these needs are beset by complex compliance responsibilities and risks of increased fiduciary liability.

A 2020 Vision recommended adopting a number of improvements embodied in the legislation that is the subject of this hearing. The following recommendations come straight from *A 2020 Vision*:

- **Update rules to modernize communications with employees. Permit the use of common-sense approaches to deliver information among stakeholders while leveraging continually evolving technology and appropriately protecting privacy**. To protect employees and employers, clear guidance must be developed that sets forth the circumstances and methodology by which personal information about benefit plan participants may be shared electronically in a confidential manner that protects privacy.

- **Make common-sense changes to help small businesses through enhancing Open-MEPs Change the multiple employer plan rules to facilitate groupings of unrelated employers and limit collective liability for retirement plans. Helping small businesses join multiple employer plans (MEPs) so they can**

share administrative costs will expand employer-sponsored retirement coverage. Two changes would help make this possible: first, waiving the requirement for a "nexus" among unrelated businesses in order to join a MEP. Second, eliminating the rule that one employer's failure to meet the criteria necessary to maintain a tax-preferred retirement plan can result in potential disqualification of the plan and loss of tax benefits for the participants.

- **Increase the $5,000 threshold for employers to cash-out retirement plan accounts**. This will reduce administrative expenses associated with small accounts.

Thus, it is with great excitement that I am here on behalf of the Council to support bipartisan legislation that achieves these goals.

MODERNIZING THE CASH-OUT RULES TO REDUCE COSTS TO EMPLOYEES (H.R. 4158)

To understand the improvements made by Retirement Plan Modernization Act (H.R. 4158), we first need to provide some background. ERISA contains a rule – and a parallel rule appears in the Internal Revenue Code (Code) – that ensures that employees can wait until retirement age to receive benefits under a retirement plan. Specifically, section 203(e) of ERISA and section 411(a)(11) of the Code provide that a plan generally cannot distribute benefits without the consent of a participant. This rule protects participants from having their vested benefits distributed before they are ready to receive it in the form of retirement income. There are two important exceptions to this rule. First, a retirement plan can distribute a participant's benefit once the participant reaches the plan's normal retirement age (or age 62, if later). Second, if a participant terminates employment before retirement age, the plan can distribute the participant's benefit if the present value of the total accrued benefits is equal to or less than the "cash-out limit," which is currently $5,000. In that case, the plan can distribute benefits immediately at termination of employment in a lump sum.

Take a simple example. Assume I work for an employer for just a couple years, and accumulate a benefit under my employer's defined benefit plan. I then leave to join another company. Because I worked for a short time only, assume the present value of the annuity I earned, expressed in today's dollars, is less than $5,000. Rather than waiting to pay me an annuity at age 65, which would be an annual benefit of just a few hundred dollars a year, the employer can distribute that benefit immediately in a lump sum.

This can also occur in a 401(k) plan. Assume I work for a few years for an employer that automatically enrolled me in its 401(k) plan. Assume when I terminate employment to join another firm, I have accumulated only $2000 in the 401(k) plan. In that case, the plan can distribute that benefit to me immediately.

Why has this rule existed since the passage of ERISA? The cash-out rule reflects, like many parts of the law, an important balance. On one hand, we want employers to offer employees the right to delay distribution of benefits until retirement. But holding those benefits and accounts – in some cases for many decades – is costly. And these costs are often borne by the employees left behind, particularly in a 401(k) plan.

Records must be kept for any individual who still has a benefit or account under the plan. The plan must be able to track the contact information for many years for individuals who have terminated employment and otherwise may have no reason to stay in touch with their former employer. By distributing small benefits at termination of employment, the plan is able to reduce costs and ensure that the individual never loses track of their benefit.

It is critical to remember that the cash-out rules ***do not prevent individuals from preserving assets for retirement and avoiding taxable income****.* The law includes important protections to prevent these amounts from being used for something other than retirement income:

- A plan must offer the participant the right to have benefits of more than $200 paid in the form of a direct rollover to an IRA or another retirement plan, which avoids any taxable income.

- A plan must provide a notice – called a special tax notice – that describes this right to a direct rollover.

- If a participant does not affirmatively select another option (or simply does not respond), any distribution between $1,000 and $5,000 must be placed in an IRA opened in the participant's name and invested in a principal-protected investment. Again, this preserves assets in the retirement system and avoids taxable income.

The Retirement Plan Modernization Act, introduced by Chairman Walberg and Ranking Member Sablan (and cosponsored by Representative Roskam), would increase the existing $5,000 cash-out limit to $7,600 and then build in an inflation index going forward. This is part of a regular updating of the rules that Congress must do to prevent ERISA from becoming stale.

Notably, your bill would not *mandate* that an employer increase its cash-out threshold, or even have a cash-out rule at all. In fact, many employers do not have a cash-out rule, although we believe most do. Thus your bill preserves employer choice as to what plan features best serve the needs of their employees. In addition, your bill does not prevent a distribution (when allowed by the plan) if an employee chooses to do so. In fact, in many 401(k) plans, departing employees will often rollover their account of

any size to an IRA or another employer's plan. And your bill preserves the important protections for employees described above, including the right to a direct tax-free rollover to an IRA.

Congress has increased the cash-out limit twice previously, although has not addressed this issue in more than 20 years:

- In 1974, ERISA sections 203(e)(1) and 204(d)(1) set the automatic cash-out ceiling at $1,750.
    - $1,750 in September of 1974 is the equivalent of approximately ***$8,500 today***.[1]

- The Retirement Equity Act of 1984, Section 205(a) raised the automatic cash-out ceiling from $1,750 to $3,500.
    - $3,500 in August of 1984 is the equivalent of approximately ***$8,200 today***.

- The Taxpayer Relief Act of 1997, Section 1071(a)(1) raised the automatic cash-out ceiling from $3,500 to $5,000.
    - $5,000 in August of 1997 is the equivalent of approximately ***$7,600 today***.

As stated above, the Retirement Plan Modernization Act would also provide that, going forward, the cash-out limit would be increased at the same time and in the same manner as under section 415(d) of the Code (which sets limits on contribution and benefits) in multiples of $50. This is quintessential good governing. The cash-out threshold is one of the few dollar figures applicable to retirement plans that is not currently indexed for inflation. By indexing the cash-out limit automatically along with other dollar amounts, thresholds and limits, Congress would put this issue on auto pilot, so Congress would not need to act again every 10-20 years.

For these reasons, we commend your leadership in introducing this common sense legislation and are pleased to lend our strong support.

LEVERAGING TECHNOLOGY TO IMPROVE PARTICIPANT UNDERSTANDING (H.R. 4610)

The Department of Labor's (DOL) current rules governing the use of electronic media to provide reports, statements, notices and other documents required under ERISA severely restrict the circumstances in which email and other paperless means of communication can be utilized. The regulations contemplate the use of electronic media

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[1] The inflation adjusted figures above are based on the CPI Inflation Calculator made available through the Bureau of Labor Statistics website.

only if a participant either (i) uses an electronic network, *e.g.*, a computer or a smart phone, as an integral part of his or her duties as an employee, or (ii) affirmatively consents to receiving documents electronically in a manner that demonstrates the ability to access electronic disclosures. This standard restricts the use of email as a means of communication for many categories of employees and former employees, even in circumstances where the employer has email addresses and routinely uses email or other electronic disclosure for other forms of communication.

The Receiving Electronic Statements To Improve Retiree Earnings Act, or RETIRE Act, (H.R. 4610), which currently has 39 cosponsors of both parties, would amend both ERISA and the Code to provide that a document that is required by either statute to be furnished to a plan participant may be furnished in electronic form if certain requirements are met. The RETIRE Act would allow, but not require, an employer to use e-delivery as the default method to communicate with all participants in its retirement plan.

- ***Effective access:*** The system must be designed to result in effective access to the document through electronic means. The bill provides three methods that are considered to meet the effective access prong:
    - Direct delivery of the material to an electronic address;
    - The posting of material to a website to which access has been granted, "but only if proper notice of the posting has been provided (which may include notice furnished by other electronic means if the content of the notice conveys the need to take action to access the posted material)"; or
    - Any other electronic means reasonably calculated to ensure actual receipt.

- ***Consumer protections for participants:*** The participant must be able to: (1) select among the specific electronic means made available through which such a document is furnished; (2) modify that selection at any time; and (3) elect to receive paper documents at no additional direct cost to the individual. The system must protect the confidentiality of the participant's personal information.

- ***Establishes right to paper documents:*** Importantly, the participant must always have the right to opt out of electronic disclosure at any time and begin receiving notices and documents in paper.

- ***Annual paper reminder:*** Every participant must receive an individual annual paper notice describing: (1) the selection of the specific electronic means for receiving documents made by the participant that is in effect at the time that the notice is provided; (2) the right to modify the selection at any time or to elect at any time to receive paper versions of the documents at no direct cost, and how to make such an election; and (3) if applicable, any election made by the participant to receive paper.

- ***Electronic similar to paper*:** Any electronically furnished document must be prepared and furnished in a manner that is consistent with the style, format, and content requirements applicable to the particular document, and it must include a notice that apprises the individual of the significance of the document when it is not otherwise reasonably evident as transmitted.

- ***Preservation of current law and future options:*** The text provides that nothing in the bill shall be construed to prohibit any e-delivery permitted under current law, including regulations and other guidance, and it would clarify that DOL and the Treasury Department may prescribe additional means of furnishing documents, as they deem appropriate.

As with the Retirement Plan Modernization Act, the RETIRE Act ***preserves employer choice***. Some employers may find that paper disclosure best serve their participants, even as a default method of disclosure. Further, the bill preserves the ability of employees to completely elect out of paper disclosures when they choose to do so, or to elect into paper disclosure at no additional direct charge. We support passage of the RETIRE Act and encourage Congress to move this bill expeditiously.

INCREASING RETIREMENT COVERAGE THROUGH OPEN MEPS (H.R. 854)

Finally, I would like to address the Retirement Security for American Workers Act (H.R. 854). This bill would greatly expand opportunities for small employers to band together in a common "multiple employer plan" (MEP) and thereby achieve many of the economies of scale available to large employers. Additionally, it would help quell the growing coverage gap arising from the shifting workforce in a "gig" economy.

Many Americans lack access to a private retirement plan that can help deliver retirement security. This lack of coverage is most acute within the small business community because small businesses can only spread the fixed costs of retirement plans among a small number of employees. Thus, the per-employee cost of retirement plans is much higher for smaller employers. Expanding coverage among small businesses is important to all plan sponsors, even large employers currently sponsoring retirement plans, because it strengthens the overall voluntary system and helps ensure consistency of coverage through employees' working lives.

MEPs can address this problem very directly and very effectively. If a small employer joins a MEP with many other small employers, the fixed costs of the plan are spread among the employees of all the participating employers, thus dramatically reducing the per-employee costs.

Today, MEPs are hindered by two problems: (1) a prohibition on unrelated

employers joining together in a MEP, and (2) a penalty system that exposes all employers in a MEP to liability based on the failure of one employer to comply with the rules. H.R. 854 would solve both of these problems and in doing so, would make MEPs available to far more small businesses. We believe that the bill would enable countless small employers across the country that currently do not have a plan to join MEPs and provide retirement benefits to millions of employees who deserve access to retirement security.

We also view H.R. 854 as a critical component of addressing the problem of so-called "gig" workers. The gig economy has been growing rapidly. According to a study by the Federal Reserve Bank of Minneapolis, a "growing body of evidence finds that the prevalence of these alternative work arrangements has increased since 2005." Numbers on the size of the gig economy vary based on the various definitions of a gig worker, but there is clear agreement on the dramatic recent increase in the prevalence of gig workers.

This dramatic increase in the gig economy contrasts very starkly with the very low rate of coverage of gig workers under retirement plans. The U.S. Government Accountability Office ("GAO") issued a report that concluded that gig workers "are about two-thirds less likely than standard workers to have a work-provided retirement plan." GAO also found that gig workers are disproportionately low-income and Hispanic. Another study cites a growing presence of women in the gig economy.

As the gig economy has grown, and gig workers continue to be largely uncovered by retirement plans, the time has come for all of us to act. Today, businesses cannot cover gig workers under their retirement plans because gig workers are not employees, and the problem will get worse as estimates show that the gig economy will grow to 55 million workers by 2020. Open MEPs can be a critical part of the solution. Open MEP legislation would permit a business using gig worker to set up an open MEP for gig workers; the gig worker's sole proprietorship could very simply elect to join the open MEP. Accordingly, we support the passage of open MEP legislation.

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On behalf of the American Benefits Council and its members – and the millions of Americans whose benefits depend on continuing building on and improving the private retirement system – we thank you for holding this hearing to address common sense proposals to simplify and modernize retirement plan administration. I appreciate the opportunity to testify, and the Council looks forward to working with this Subcommittee, and all the members of the Education and the Workforce Committee, to advance these proposals.