# Congress of the United States
## U.S. House of Representatives
## Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515–6315

**MEMORANDUM**

| | |
|---|---|
| TO: | Small Business Committee Members |
| FROM: | Nydia M. Velázquez, Chairwoman |
| DATE: | March 27, 2019 |
| RE: | Full Committee hearing entitled, "Unlocking Small Business Retirement Security." The hearing is scheduled to begin at 11:30 A.M. on Wednesday, March 27, 2019 in Room 2360 of the Rayburn House Office Building. |

The Committee on Small Business will meet for a hearing titled, "Unlocking Small Business Retirement." The hearing is scheduled to begin at 11:30 A.M. on Wednesday, March 27, 2019 in Room 2360 of the Rayburn House Office Building. Retirement security is one of the most important issues facing Americans today. Retirement benefits not only provide future financial security for business owners and employees, but also allow entrepreneurs the ability to attract and retain talented individuals as their businesses grow. However, many retirement plans are complicated and expensive to start and maintain. These challenges lead many small business owners to forgo such a plan, leaving the employers and the employees without adequate retirement savings. The hearing will examine the options for small employers, the benefits and barriers they face in offering plans, and options for expanding coverage.

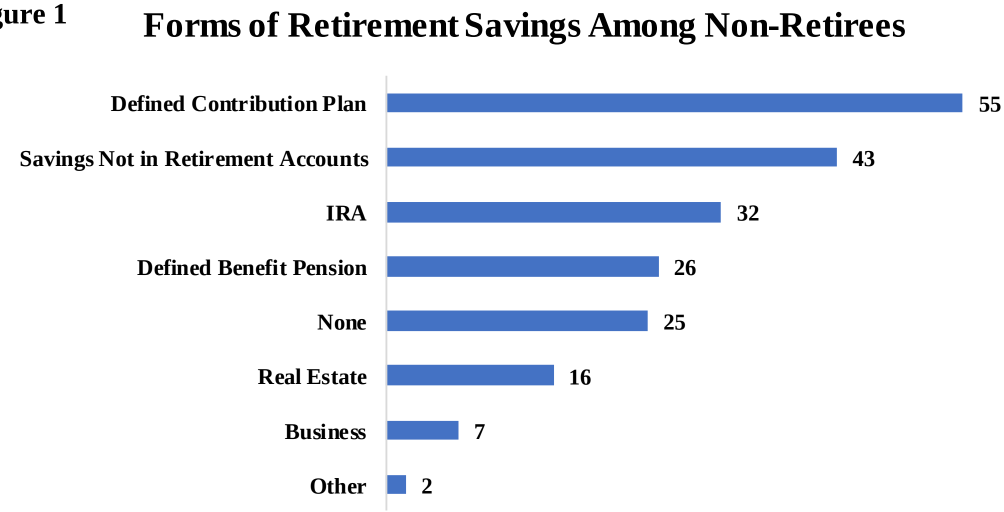
**Witnesses include**:

- Mr. Paul F. Davidson, Director of Product Management, Paychex, Rochester, NY
- Ms. Martella A. Turner-Joseph, Founding Partner, Joseph & Turner Consulting Actuaries, LLC, Harlem, NY, Testifying on behalf of the American Retirement Association
- Mr. Greg Gorgone, Chief Financial Officer, Citizant, Inc, Chantilly, VA, Testifying on behalf of the U.S. Women's Chamber of Commerce
- Mr. Keith Hall, President and CEO, National Association for the Self-Employed, Washington, D.C.

## Background

The primary manner in which Americans secure retirement income beyond Social Security is through their employer. Retirement security not only insures against life's uncertain events, but it also adds to our nation's economic stability by helping secure the income and welfare of American families. Perhaps no other issue is more important to the nation's future than whether people will be adequately prepared for retirement. The nation is faced with a number of challenges that cast doubt on whether the current population of working Americans will have sufficient resources to

**Figure 1**




Source: Federal Reserve - Report on the Economic Well-Being of U.S. Households in 2017 - May 2018.
Note: Datapoints are from respondents that have not retired. Figures do not add up to 100 because respondents are allowed to select multiple answers.

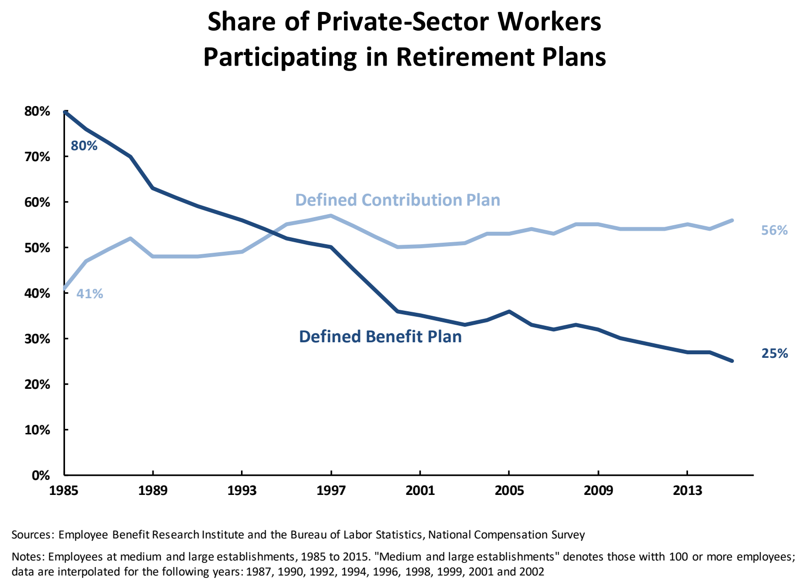
fund their expected retirement. In fact, 25 percent of non-retirees indicate have no retirement pension or savings accounts according to the Federal Reserve.[1] Of those that do have retirement savings, defined contribution plans (DC), such as 401(k)s, are most common (see Figure 1).

As the population starts reaching retirement age, more and more are either choosing to or are forced to continue working into older age. In fact, the labor force participation rate among those 65 years and over with no disability has remains elevated, reaching 25.2 percent.[2] Complicating retirement plans is the fact that since 1975, the rate of personal savings in the United States has followed a steady downward trend, only temporarily increasing following the 2008 financial crisis.[3] While account balances have made steady gains since 2009, the recession left many workers with deflated savings. Half of all-American families near retirement have $12,000 or less in formal retirement savings.[4] Deflated savings may also be as a result of stagnant wages over the last several years that have left little to stash away.[5]

What became clear in recent years is the importance of retirement security for millions of Americans. In a recent Retirement Confidence Survey, 48 percent of workers expect to retirement

[1] REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2017 - MAY 2018 BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-retirement.htm (last visited Mar 18, 2019).
[2] CIVILIAN LABOR FORCE PARTICIPATION RATE: WITH NO DISABILITY, 65 YEARS AND OVER FRED, https://fred.stlouisfed.org/series/LNU01375379 (last visited Mar 15, 2019).
[3] PERSONAL SAVING RATE FRED, https://fred.stlouisfed.org/series/PSAVERT (last visited Mar 19, 2019).
[4] THE RETIREMENT SAVINGS CRISIS: IS IT WORSE THAN WE THINK? NATIONAL INSTITUTE ON RETIREMENT SECURITY, https://www.nirsonline.org/reports/the-retirement-savings-crisis-is-it-worse-than-we-think/ (last visited Mar 18, 2019).
[5] THE STATE OF AMERICAN RETIREMENT: HOW 401(K)S HAVE FAILED MOST AMERICAN WORKERS ECONOMIC POLICY INSTITUTE, https://www.epi.org/publication/retirement-in-america/ (last visited Mar 19, 2019).

**Figure 2**




at age 66 or beyond, with a significant portion expecting to retirement at 70 or older.[6] Among the top reason for workers planning to delay retirement is their inability to afford to retire.[7] These factors have led many to suggest that current retirement saving by individuals will be inadequate to meet the needs for post-retirement income. This failure to save cannot be blamed entirely on the recent recessions because at the core of the issue is a deficiency of retirement plan participation by small business owners and their employees.

A recent study reveals that 53 percent of small business owners do not have a formal retirement savings program.[8] The costs and complexity in administering a retirement plan, potential increased liability due to the fiduciary obligations associated with running a plan, mandatory contribution requirements, have all been cited as barriers to offering retirement benefits to their employees.[9] Under these circumstances, it will be vital for the small business community to play a leading role in any effort to address the retirement concern.

**Small Business Retirement Plan Options**

There are three broad types of retirement plans that small businesses may offer their workers – 1) defined benefit plans (DB); 2) defined contribution (DC) plans; and 3) individual retirement accounts (IRA) based plans (see Table 1 for examples). Of these three, DC and IRA plans are most common among large and small firms (see Figure 2). What follows is a brief description of the most common retirement plans that small businesses offer their employees.

[6] 2018 RCS FACT SHEET #2 EXPECTATIONS ABOUT RETIREMENT, https://www.ebri.org/docs/default-source/rcs/6_rcs_18-fs-2_expect.pdf?sfvrsn=e1e9302f_2 (last visited Mar 19, 2019).
[7] *Id.*
[8] EMPLOYER ADVANTAGES OF 401(K) PLANS PAYCHEX, https://www.paychex.com/articles/employee-benefits/employer-advantages-of-401k-plans (last visited Mar 15, 2019).
[9] *Id.*

**Table 1**

| Examples of Plans | |
|---|---|
| IRA - Based Plans | |
| | Savings Incentive Match Plans for Employees of Small Employers (SIMPLE) |
| | Simplified Employee Pensions (SEPs) |
| | Payroll Deduction IRAs |
| Defined Contribution-Based Plans | |
| | Profit Sharing |
| | Traditional 401(k) |
| | Self-Employed 401(k) |
| | Safe Harbor 401(k) |
| | Automatic Enrollment 401(k) |

*Defined Contribution-Based Plans*

Defined contribution plans are employer-established plans that do not promise a specific amount of benefit at retirement. Instead, employees or their employer (or both) contribute to employees' individual accounts under the plan, sometimes at a set rate (such as 5 percent of salary annually).

Employee salary reductions, if provided under the plan, may be pretax or after-tax, in some cases. At retirement, an employee receives the accumulated contributions plus earnings (or minus losses) on the invested contributions. Generally, DC plans tend to be more heavily weighted in stocks, either through individual holdings or as a result of mutual funds. As with employer-sponsored IRA plans, employees participating in DC plans bear the full risk of investment and will realize any returns on those investments. Defined contribution plans tend to have higher limits for employee contributions but also more rules and reporting requirements than employer-sponsored IRA plans. Like IRA-based plans, there are several options available to employers based on their specific needs.

*IRA-Based Plans*

People tend to think of an IRA as something that individuals establish on their own, but an employer can help its employees set up and fund their IRAs. With an IRA, the amount that an individual receives at retirement depends on the funding of the IRA and the earnings or losses on those funds. Employer-sponsored IRA plans allow employers and, in some cases, employees to make contributions for deposit in separate IRA accounts for each participating employee. These plans generally have fewer administration and reporting requirements than other types of plans. Participating employees bear the full investment risk of their account assets. Current total contributions can be no more than $6,000 annually, or $7,000 for those aged 50 or older.

**Small Business Participation in Retirement Savings Products**

While Social Security is a system financed through mandatory payments by employers and employees, the private retirement system is voluntary. Though it is critical to give employers the choice about whether or not to provide a retirement plan, it is even more important to ensure that both business owners and their workers are prepared for retirement. With an aging population, a weak savings rate, and the decline of traditional defined benefit plans, employer-sponsored plans have become the focus of proposals to encourage saving. Yet, less than half of private sector workers participate in an employer-sponsored retirement plans plan.[10] While much of the problem can be attributed to a lack of employer offerings, nearly 20 million workers actively choose not to participate in plans offered by their employers.[11] The probability of working for an employer that offered a retirement plan is substantially higher for workers at firms with 100 or more employees compared to those who work for smaller firms; and for full-time employees compared to part-time employees.[12] Access to employer-sponsored retirement plans is especially low for the 40 million workers at small firms.[13]

Current proposals to address enrollment and access challenges focus on providing auto enrollment credit for small employers. Some current auto enrollment proposals would increase the tax credit for small employer pension plan startup costs and would allow a tax credit for small employers that establish retirement plans that include automatic enrollment.[14] Other proposals seek to build off tax credits and ease small businesses' concerns by adopting grace periods to correct, without penalty, reasonable errors in administering these automatic enrollment and automatic escalation features.[15]

As employee size grows so does the likelihood of a company sponsored retirement plan. For example, small firms with 26 to 100 employees had the highest sponsorship rate at 31 percent, while small employers with 1 to 4 employees had the lowest rate at 5 percent.[16] The same can be said for wages paid by small companies, a higher average annual wage increased the probability of an employer-sponsored retirement plan. Despite having a smaller overall population, small employers with average annual wages of $50,000 to $99,999 sponsor almost three times as many retirement plans compared to small employers paying average wages of under $10,000.[17]

Saving for retirement often takes a backseat to building a company for many owners. Generally, owners do not want to spare money that could be used for research and development, new hires, or purchases of equipment or property. Young owners are even less likely to be saving for retirement, though this is more likely due to financial constraints of student loan debt. Recent

---

[10] RETIREMENT PLAN ACCESS AND PARTICIPATION ACROSS GENERATIONS THE PEW CHARITABLE TRUSTS, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/02/retirement-plan-access-and-participation-across-generations (last visited Mar. 15, 2019).
[11] SMALL BUSINESS RETIREMENT PLAN AVAILABILITY AND WORKER PARTICIPATION SMALL BUSINESS ADMINISTRATION, https://www.sba.gov/content/small-business-retirement-plan-availability-and-worker-participation (last visited Mar. 19, 2019).
[12] PENSION SPONSORSHIP AND PARTICIPATION: TRENDS AND POLICY ISSUES PENSION SPONSORSHIP AND PARTICIPATION: TRENDS AND POLICY ISSUES, https://www.ssa.gov/policy/docs/ssb/v64n2/v64n2p92.pdf (last visited Mar 15, 2019).
[13] SMALL BUSINESS RETIREMENT PLAN AVAILABILITY, *supra* note 11.
[14] RETIREMENT ENHANCEMENT AND SAVINGS ACT OF 2018, https://www.finance.senate.gov/imo/media/doc/3.8 RESA Section-by-Section.pdf (last visited Mar 20, 2019).
[15] NEAL INTRODUCES TWO BILLS TO INCREASE AMERICANS' RETIREMENT SECURITY WAYS AND MEANS COMMITTEE - DEMOCRATS, hhttps://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/RPSEA Summary 12.1.17.pdf (last visited Mar. 20, 2019).
[16] U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-326, PRIVATE PENSIONS: BETTER AGENCY COORDINATION COULD HELP SMALL EMPLOYERS ADDRESS CHALLENGES TO PLAN SPONSORSHIP (2019).
[17] *Id.*

Federal Reserve data found that 41 percent of those aged 18 to 29 have no retirement savings, compared to 13 percent of those over 60.[18]

Small companies face many challenges when determining whether to start and maintain a retirement vehicle for themselves and their employees. Besides the financial and administrative complexities, certain characteristics of small firms may contribute to the challenges of starting and maintaining a plan. When compared with large employers, small employers are more likely to encounter higher rates of employee turnover and higher costs per employee to comply with federal regulations. Further, small employers, especially start-ups, rely heavily on owner investment and bank credit, and operating revenue can be uncertain from year to year. This leads to many problems if the employer can no longer make contributions to the plan as was experienced during the recession.

**Challenges Facing Small Businesses**

A retirement plan should be considered in the context of the entire business since there are numerous factors that could affect the type and operation of the plan. There are a variety of challenges facing business owners causing them to not offer a plan or terminate an existing one. These challenges include the overwhelming amount of choices available, administrative duties, fiduciary responsibilities, financial and personnel resources, fees, and the specific qualities of the business, such as wages and demand. Many times, a small business owner wish to offer some kind of retirement support for their workers but claim there are too many obstacles to overcome.

*Selection and Administration*

Small employers are often overwhelmed at the sheer number of plan options and the administration requirements that they entail. The administrative duties are frequently complex and burdensome, thereby discouraging some owners from sponsoring a plan. For example, some small employers are dissuaded because it is difficult to compare and choose plans due to the details associated with each option. Owners are also responsible for selecting investment options for employees, which brings its own risks because often the owner does not understand how plans work, which plan to use, how much they cost, or the benefits and disadvantages of a plan or investment portfolio.

Additionally, the administrative burden of plan paperwork, such as reviewing complicated quarterly investment reports or complying with federal reporting requirements are particularly burdensome for companies with few resources and personnel to dedicate to plan administration. These regulations and compliance requirements are complex and can be timely to perform. Proposals, such as the Receiving Electronic Statements to Improve Retiree Earning (RETIRE) Act, seek to lower administrative cost to employers by establishing e-delivery as the default distribution method for Employee Retirement Income Security Act required documents. The proposal would permit retirement plan sponsors to automatically enroll participants in electronic delivery for plan communications, while providing an opt-out option for employees who prefer to continue receiving paper documents.[19]

---

[18] REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS, *supra* note 1.

[19] E-DELIVERY BILL'S INTRODUCTION IN THE SENATE SETS THE STAGE FOR 2019 ACTION NATIONAL ASSOCIATION OF PLAN ADVISORS, https://www.napa-net.org/news-info/daily-news/e-delivery-bill's-introduction-senate-sets-stage-2019-action (last visited Mar. 20, 2019).

*Fiduciary duties*

Fiduciary responsibilities of the plan sponsor tend to deter many small businesses from offering a retirement plan. Plan sponsors are generally tasked with reviewing, and monitoring investment options held by the plan and must exercise sound judgment in its administration. Fiduciaries have a number of responsibilities, such as the duty to act prudently, in the sole interest of the participants and beneficiaries, and to diversify the investments of the plan. Some small employer sponsors find the selection of investment fund options for their plans particularly challenging. Choosing investment options is difficult, particularly when a small firm has a more transient workforce and less access to cash flow because they could be exposing themselves to considerable risks just by the nature of their business and the complex rules.

A number of small business advocates and retirement experts suggest that small employers have an inadequate understanding of their fiduciary duties and are not always aware of all their responsibilities under the law. For example, some small employers mistakenly believe that all fiduciary responsibilities and liabilities are transferred to a service provider when they are hired, while other owners have an exaggerated sense of the liabilities that being a fiduciary carries, causing them fear of being sued by their employees. Studies have demonstrated that small businesses are hesitant to take on these fiduciary responsibilities out of concern about their potential liability if the plan is not administered properly or an investment option performs poorly.

*Financial Resources and Fees*

Small employers, especially those with lower profit margins or an unstable cash flow, are generally less willing or able to sponsor a retirement plan because of the costs to start a plan and the ongoing maintenance costs. These costs can result from start-up activities, complying with reporting and testing requirements, and fees paid to an outside party for administration tasks. Additionally, any requirement for small employers to match employee contributions or to make mandatory contributions to an employee’s account can increase costs. Further, small employers still face general economic uncertainty. This uncertainty makes small business owners reluctant to commit to such long-term expenses before reaching a comfortable level of profitability.

To make financial considerations more difficult is the fact that small employers generally lack bargaining power to lower fees. Participants in small plans often pay twice as much for recordkeeping and investment management fees than workers in larger plans, and also pay significantly more for consulting and advisory services to help the employer with their plan responsibilities.[20] Large firms are more able to absorb these costs and also have the personnel and resources to hire an in-house administrator. Such inequities make it difficult for small employers to offering retirement plans even though it may be in the best interest of the employees.

*Business Characteristics*

The smallest businesses are the least likely to offer retirement benefits due to the small number of employees. In some cases, it is not feasible for a very small entity to offer retirement benefits, because they do not have enough employees to make it worthwhile. Other instances of not sponsoring a plan arise because wages are low and employee demand is nonexistent. Much of the time low-wage workers opt to take home extra money in their paycheck rather than participating in a company-sponsored retirement plan. Finally, employers have realized that health care is

[20] GAO-12-326, *supra* note 16.

generally more important to their employees and can be more attractive to potential hires. In that case, most business owners would rather allocate their limited employee benefit dollars to offering or improving health benefits. While there are numerous challenges facing business owners when deciding whether to offer or maintain a retirement plan, it is critical that small firms take that first step because they are the key to ensuring workers are adequately prepared for the future. For that reason, policymakers should make it easier to choose, fund, and maintain these critical savings vehicles for retirees.

*Emerging Trends*

As is well known, many of today's young people are saddled with astonishing amounts of student debt. The latest figures from the Federal Reserve of New York shows that outstanding student loan debt increased to $1.46 trillion in the fourth quarter of 2018, a rise of $79 billion in total for 2018 and greater than credit card debt.[21] It is glowingly evident that this growing debt is having an impact on all aspects of these individuals' lives, particularly for those looking at how to make retirement work. In fact, two-thirds of working millennials have nothing saved for retirement according to recent reports by the National Institute on Retirement Security.[22] These figures are even more stark for millennial from communities of color and women.[23]

As the population ages, the ability to adequate save for retirement and continuously paying off high student loan debt into older age are going to meet in conflict. Proposals like the Retirement Parity for Student Loans Act helps workers who cannot afford to both pay off their student loan debt and save for retirement. Under the proposal, workers would continue to make their student loan payments, but they would also receive employer matching contributions into their retirement plan as if those student loan payments were salary reduction contributions made to the plans.[24]

Over the last decades, platform-based and gig commerce has grown from a small corner of internet to an integral aspect of our modern society. Whether it is using digital platforms to make online purchases or hailing transportation to the next destination, digital and technological innovations have opened the door to new market and economic opportunities. At the same time, these innovations have led to the rise of a new category of workers: the gig economy workers. Individuals working within the gig economy can be small business owners, independent contractors, or freelancers. While the existence of single project-based employment is far from new, the gig economy is specifically characterized by the use of technology as a means of connecting workers to employers. However, unlike traditional forms of work, most of these gig workers are not classified as traditional workers, creating a host of other retirement challenges and opportunities.

## Conclusion

---

[21] CENTER FOR MICROECONOMIC DATA FEDERAL RESERVE BANK OF NEW YORK - FEDERAL RESERVE BANK OF NEW YORK, https://www.newyorkfed.org/microeconomics/topics/student-debt (last visited Mar. 19, 2019).

[22] MILLENNIALS AND RETIREMENT: ALREADY FALLING SHORT NATIONAL INSTITUTE ON RETIREMENT SECURITY, https://www.nirsonline.org/reports/millennials-and-retirement-already-falling-short/ (last visited Mar. 20, 2019).

[23] *Id.*

[24] RETIREMENT PARTITY FOR STUDENT LOANS ACT SECTION-BY-SECTION 2018, https://www.finance.senate.gov/imo/media/doc/Retirement%20Partiy%20for%20Student%20Loans%20Act%20one%20pager%20and%20section%20by%20section.pdf (last visited Mar. 20, 2019).

For workers at small employers, building an adequate level of income for retirement is becoming increasingly challenging. Particularly for small employers, the low level of plan sponsorship means that many of their workers may enter retirement with little or no income outside of Social Security. Small employers also face some greater challenges to sponsorship than larger employers and they often have less time, fewer resources and personnel to handle them. Given that small businesses employ nearly half of all private sector employees, it is imperative that small business owners and their employees are provided some sort of relief in this economic downturn.