

Testimony of

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on

“Drop in Retirement Savings: The Challenges Small Business Face  
Funding and Maintaining Retirement Plans in a Struggling Economy”

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Thank you, Chairwoman Velazquez, Ranking Member Graves, and other members of the Committee, for inviting me to talk to you about the challenges facing small businesses trying to provide retirement plans for their employees during these difficult economic times.

## **INTRODUCTION**

I am Andy Keeler, a CERTIFIED FINANCIAL PLANNER™ practitioner, and partner with Everhart Financial Group, Inc. in Dublin, Ohio. Our firm is a fee-based financial planning firm that practices in two areas-retirement plan design and implementation for small businesses, and comprehensive financial planning for executives and small business owners. I am honored to be here today on behalf of the Financial Planning Association to address your concerns about how the current economic environment is affecting employees of small businesses ability to save for retirement, and more importantly, how it is affecting their ability to achieve a positive financial outcome with respect to retirement.

Regrettably, only 15-20% of small businesses have retirement plans in a healthy economy. Perhaps this is a discussion for another day. So, I will focus my discussion on those small businesses that offer retirement plans to employees, and offer my insights and observations with respect to how business owners and plan participants are coping with the current economic crisis.

Day in and day out, our firm assists its corporate clients in establishing and maintaining customized retirement plan solutions. The most critical part of this process is face-to-face meetings where we learn more about participants as individuals and their needs and expectations. Part of this education process is also helping participants understand the importance of saving for retirement, and the determinants of wealth. As you might imagine, the largest determinant of wealth is the amount of money that is being saved by, or for, a retirement plan participant. Savings rates are the key factor, followed by market performance and security selection.

## **OVERVIEW**

As you are all well aware, this country has seen a major shift of responsibility for retirement planning from the employer to the employee. This transition from defined benefit “pension” plans to defined contribution plans like 401(k)’s have occurred over the past decade or so. In the process, we as a society have neglected to explain to America’s workers how this shift of roles and responsibilities affects their retirement income down the road. There is a great disconnect between the retirement income that an employee would have received under a traditional pension coupled with a solvent Social Security program as compared with where most Americans are heading today. Under the traditional defined benefit plan, retirees would receive around 60% of pre-retirement income until death. Social security would provide an additional 20%, giving retirees of generations past a retirement income replacement of 80%. On average, we find that most retirees need between 70 and 80% of pre-retirement income to make ends meet. Under defined benefit plans, employees were on track to receive 80% without saving a penny of their own money. Worries about the stock market were non-existent. Participants didn’t see a retirement plan balance or dollar value, nor were they beat over the head with negative financial news. All the participant had to do was simply count on a monthly income stream in retirement.

To finance this retirement liability, employers had to contribute roughly 25-30% of the employee's income into the defined benefit trust each and every year. As employers phased out the defined benefit plan and implemented the defined contribution plan, we failed to inform that employees that they would need to receive annual additions of between 25 and 30% of their income each year for the next 30 years. With the exception of discretionary employer matching funds or profit-sharing contributions, the responsibility of providing a solid retirement income rests almost entirely on the shoulders of those entering the workforce today. So, today, financial planners are finding that employees either choose to save nothing, or they contribute up to the employer match, which is often between 3 and 6% of pay. We find that the lower the match, the lower the contribution rate for employees. This presents a large unfunded liability for retirees, and high probability that retirement outcomes will not be successful.

Not only are participants not saving enough, but they must direct their own investments and make their own investment decisions. This is a responsibility that the average American is ill-prepared to do, or do well. Most people, once properly informed and educated, understand that over long periods of time the stock market has historically provided the greatest return. However, some have deep-rooted insecurities over the stock market, and these beliefs can often be traced back to their parents or grandparents that chose to invest in "safe" investments like banks or shoved under the proverbial mattress. After all, as I have just shown, years ago retirees didn't really need to save at all, since their retirement needs were fulfilled by their employer's generous pension plan and Social Security. Educating participants today that this model does not work for them can be very difficult, especially in manufacturing or other so-called "blue collar" industries.

Now, we are faced with the worst bear market since the Great Depression, and employees are losing faith in our securities markets, and questioning the fundamental premise for investing over the long-term. I often hear participants

say, “I can’t afford to lose everything”, or, “Should I stop contributing to the plan until the market goes back up?” or “Every penny I invest in the plan is being lost, so why bother?” While most lay people are initially willing to take risk over long periods, when they actually see losses in their statements, their risk tolerance will shift and they will look for more conservative options.

In addition, we have employers that are laying off their workforce. No paycheck means no savings. It also makes those who are still employed all the more conservative, and not so eager to save as much as they should given uncertainty of employment.

Obviously, at the heart of the recession are businesses, big and small, that are having a hard time staying in business. Financing has dried up, so they can no longer borrow to make payroll. Revenues are down, so after reducing their workforce, the next area to cut is the company match. If there are no profits there is no profit sharing. According to Watson Wyatt, 2% of large businesses have reduced or eliminated their match, and another 4% plan to reduce or eliminate their match within the next 12 months. When you look at small businesses, the problem is amplified since most operate in specialty niches and do not have a diversity of revenue streams. Since medical benefits are crucial in attracting and retaining employees, often the 401(k) match is the first thing to go. If eliminating the match is not enough, a more drastic measure is to terminate the plan. Plan terminations have increased in 2009, but are not yet significant.

With all of these negative factors putting downward pressure on participants eagerness to save and take the risk that is necessary to achieve a positive financial outcome, many participants are now putting their heads in the sand and investing in cash, money market or stable value options within their 401(k). Fortunately, the Pension Protection Act (PPA) gave employers defensible means to make the default investments more than just low yielding investments like stable value funds or money markets. But the risk for the American worker

remains -- that once the bear market ends, if they stay invested only in fixed-income investment products, the value of their retirement savings will eventually be eroded by inflation.

## **RECOMMENDATIONS**

While the cost of implementing and maintaining a retirement plan has decreased significantly over the past decade, when revenues are down, a cost is a cost, and employers can use any help they can get. Start-up fees, on-going recordkeeping fees, and administrative fees can be easy targets for a CFO looking to cut costs. Obviously, the company match and profit sharing contributions, which are generally discretionary, are the first to go. Then the whole plan.

One incentive to encourage small businesses to maintain their plans would be to enhance the current tax credit that is used to offset the startup cost and the cost of educating employees about the new plan. Created under The Economic Growth and Tax Relief and Reconciliation Act (EGTRRA) the credit is available to offset costs paid or incurred in tax years beginning after December 31, 2001, for retirement plans that first become effective after that date. The credit currently equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of \$500 per year for each of the first three years of the plan.

This credit is limited to those employers with 100 or fewer employees who received at least \$5,000 in compensation for the preceding year; at least one participant must be a non-highly compensated employee.

This credit should be broadened to include any employer with less than 500 employees, and it should also be broadened to offset employer contributions to a retirement plan. This credit could look like the current tax credit for low income & middle income consumers which is detailed in the grid below.

<b>Joint Married</b>	<b>Head of Household</b>	<b>All Other Filers</b>	<b>Saver's Tax Credit</b>
\$0 - \$30,000	\$0-\$22,500	\$0-\$15,000	50% of contribution
\$30,001-\$32,500	\$22,501-\$24,375	\$15,001-\$16,250	20% of contribution
\$32,501-\$50,000	\$24,376-\$37,500	\$16,251-\$25,000	10% of contribution
Over \$50,000	Over \$37,500	Over \$25,000	0% of contribution

This credit could be modified to reward the employer for making an employer contribution. It might look something like this.

<b>Number of Employees</b>	<b>Employers Tax Credit</b>
2-200	50% of contribution
201-350	20% of contribution
351-500	10% of contribution
Over 500	0% of contribution

Given these tough times, perhaps these credits could accrue to be used later once prosperity returns, although that would not stimulate the inflows that these participants need when they need them the most.

The best way to help participants from making poor financial decisions with potentially devastating results is to improve financial literacy for consumers. I believe it is critical that our schools, grades K-12, offer curriculum that helps educate the plan participants of tomorrow about equity markets, the importance of saving, and how saving in the future is so different from that of their

upbringing. Consumers can't simply take the practices of previous generations, implement them today, and expect to have the same outcome.

Two years ago, I was asked to cover a college professor's personal finance class on the second day of classes. He warned me that most of the students would not yet have purchased their texts, so most of them probably had not completed their reading assignment. He also warned me that some of the students fall asleep or talk in class.

I began class on time, covered the chapters that they were supposed to read before coming to class, then spent the rest of the class covering basic financial concepts like how to choose a mutual fund and how and why to purchase a home instead of renting. I can honestly say there were no students sleeping in my class. They listened and hung on every word until finally, a doctoral candidate said, "Mr. Keeler, I have been in school almost my entire life and I am just NOW hearing about this? This is really important stuff; it seems crazy that no one taught us this earlier on!"

Public service announcements could cover a lot of ground towards this end, and serve as "continuing-education" for those lucky enough to have learned about saving, investing and the equity markets years ago. The National Foundation for Financial Education (NEFE), The Financial Planning Association (FPA), and numerous, independent non-profits can offer stimulating and compelling research that reinforces that value of saving and investing prudently. FPA, for example, maintains a partnership with Junior Achievement in which personal financial literacy is taught to students by CERTIFIED FINANCIAL PLANNER™ practitioners, but this is not enough. More needs to be done to encourage states to adopt mandated financial literacy curricula in public schools. According to Jump\$tart Coalition, a national financial literacy group, only three states require at least a one-semester course dedicated to personal finance, while another 17 allow it to be integrated in another curriculum, usually math.

With improved financial literacy comes renewed confidence and a more sophisticated understanding of our financial markets. Especially in middle-income families and the underserved, there is a backdrop of mistrust of the companies that the participants invest in. Helping participants understand that the money they invest is theirs, and will always be, is important. It is also very helpful for participants to understand the process that their contributions go through from the paycheck to the 401(k) account.

## **CONCLUSION**

Madam Chairman, Ranking Member Graves, ladies and gentleman, we are at a crossroads. We are at a very important time in which Americans are losing faith in the financial system, and frustration is building. Retirement assets have shrunk by roughly 40%, with paper losses in the trillions of dollars. The investing public is questioning the value of saving for retirement. They need to be reminded and convinced of its overall importance to meeting their retirement goals. There have been many times over the past 200 years that Americans came together and rallied for a common cause. Sense of entitlement, jealousy and resentment often take the back seat when times get tough if a situation is approached properly. This is OUR problem. Participants may surprise you -- if they are made aware of the problem, and armed with the knowledge to make sound financial decisions, we will be impressed by the outcome. I thank you for taking the time to address an issue of such critical concern, and I appreciate the opportunity to offer my insights. I am happy to respond to any questions.