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T-110

"Promoting Retirement Plan Coverage Among Small Employers"

Ways and Means Subcommittee on Oversight

Hearing on Pension Issues

by
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Held Tuesday, March 10, 1998

Summary

- The most notable gap in employment-based retirement plan coverage occurs among small employers. Typically, the smaller the employer, the less likely the employer is to sponsor a plan. Likewise, workers at smaller employers are less likely to participate in an employment-based retirement plan. Coverage rates over time have remained basically unchanged among small employers.

- Chief among the reasons highlighted as to why small employers do not sponsor a retirement plan are financial cost /lack of affordability and the burden of administering a plan, with the latter often contributing to the former. Other factors cited were the lack of need for a plan and a preference among employees for cash compensation. Many employers noted that they had a high turnover work force and therefore their employees would not be interested in a plan with vesting requirements.

- Research in this area has indicated that improved business profitability, increased tax advantages, and increased employee demand may lead small employers without a plan to start one.

- The Small Business Job Protection Act of 1996 created the Savings Incentive Match Plan for Employees (SIMPLE), a simplified retirement plan for small businesses. SIMPLE plans can either be an individual retirement account (IRA) or part of a 401(k) plan. These plans have proven popular, as employers have established SIMPLE plans in greater numbers than most in the retirement community anticipated. The plans have proven especially popular among smaller employers with fewer than 10 employees, with a preference shown for the SIMPLE-IRA.

- As Congress considers various proposals to promote retirement plan coverage among small employers, expectations should be kept realistic. Coverage rates among small employers are unlikely ever to approach those of large employers simply because of the financial reality that many small businesses face small and uncertain profits, combined with what is currently a weak interest in contributing to a retirement plan among many young and low-earning workers. These realities mean that it is not enough simply to target the small employer, but it is also important to target employees with messages regarding the need to plan and save for their retirement.

Introduction

As of 1993, the latest year for which nationally representative data are available, 64 percent of all civilian nonagricultural wage and salary workers worked for an employer that sponsored a retirement plan, and 49 percent of all workers participated in a retirement plan sponsored by their employer.[1] Probably the most notable gap in employment-based retirement plan coverage is among small employers. While 85 percent of workers at employers with 100 or more employees have an employer that sponsors a plan, only 50 percent of workers at employers with 25 to 99 workers, and 20 percent of workers at employers with fewer than 25 employees have an employer that sponsors a plan. The findings regarding participation are similar. Two-thirds of workers at employers with 100 or more employees actually participate in an employment-based retirement plan, compared with 36 percent of workers at employers with 25 to 99 workers and 15 percent of those at employers with fewer than 25 workers.

Why the Gap?

Why do sponsorship rates and participation rates lag so much among small employers? EBRI first examined this issue 10 years ago in a book entitled *Pension Policy and Small Employers: At What Price Coverage?* Chief among the reasons highlighted as to why small employers do not sponsor a retirement plan were financial cost /lack of affordability and the burden of administering a plan, with the latter often contributing to the former. Other factors cited were the lack of need for a plan and a preference among employees for cash compensation. Many employers noted that they had a high turnover work force and therefore their employees would not be interested in a plan with vesting requirements. They also felt that retirement income was at best a remote goal for the young workers who often make up their work force. Finally, small employers expressed a preference to reward performance selectively by paying bonuses. What developments would lead small employers to start a plan? The same research indicated that improved business profitability, increased tax advantages, and increased employee demand may lead small employers without a plan to start one.

Coverage rates have remained basically unchanged among small employers over time. A list of likely reasons for not having a plan would look pretty much the same: cost/administrative burden, low/uncertain profits, and lack of demand on the part of workers at small employers would likely lead the list. However, because of a lack of recent research in this area, EBRI, ASEC, and Mathew Greenwald and Associates have expanded the 1998 Retirement Confidence Survey project to include a survey of small businesses, both those with a retirement plan and those without one. The survey will explore the reasons that small employers do not offer a retirement plan and the changes that would lead them to consider doing so. Among small employers that do offer a retirement plan, the survey will explore the types of plans they offer and their motivations in offering these plans. Results should become available in May, and EBRI would be happy to share them with the committee when available.

Recent Developments

The Small Business Job Protection Act of 1996 created a simplified retirement plan for small business called the savings incentive match plan for employees (SIMPLE). SIMPLE plans can be adopted by employers who employ 100 or fewer employees on any day during the year and who do not maintain another employment-based retirement plan.

A SIMPLE plan can be either an individual retirement account (IRA) for each employee or part of a 401(k) plan. If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules), and simplified reporting requirements apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

A SIMPLE plan can also be adopted as part of a 401(k) plan. In that case, the plan does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply.

Small employers have established SIMPLE plans in greater numbers than most in the retirement community anticipated. Although no nationally representative data are yet available, a non-random survey by the Investment Company Institute (ICI) of its members[2] indicates that plan establishment has been concentrated among employers with under 10 employees and that the SIMPLE-IRA is preferred over the SIMPLE-401(k). More specifically, the survey found that 18,261 SIMPLE IRA plans, with 95,431 participants, had been established, and 42 SIMPLE 401(k) plans, with 785 participants, had been established.[3] Eighty-seven percent of SIMPLE plans were established by employers with 10 or fewer employees, and 97 percent of employers establishing a SIMPLE plan had 25 or fewer employees.[4]

Congress is now considering proposals by the Clinton Administration and others to create a "simple" version of a defined benefit plan for small employers. Creation of such a plan would mean that small employers interested in establishing a retirement plan via the "simple" route would no longer be restricted to choosing a defined contribution plan. Other proposals being considered to promote retirement plan coverage among small employers include a tax credit for businesses establishing a new plan.

Conclusion

As Congress considers various proposals to promote retirement plan coverage among small employers, expectations should be kept realistic. Coverage rates among small employers are unlikely ever to approach those of large employers simply because of the financial reality of small and uncertain profits faced by many small businesses, combined with what is currently a weak interest in contributing to a retirement plan among many young and low-earning workers. These realities mean that is not enough simply to target the small employer, but it is also important to target employees with messages regarding the need to plan and save for their retirement.

Endnotes

[1] These figures are Employee Benefit Research Institute tabulations of the 1993 Current Population Survey employee benefits supplement.

[2] Survey results were based on responses from 26 firms, including two-thirds of the largest 25 mutual fund firms. The survey objective was to quantify the number of SIMPLE plans and accounts that were established between January 1 and July 31, 1997, among members of ICI's pension committee.

[3] Given the limited nature of the sample, these figures likely undercount significantly the total number of SIMPLE plans established during this time period.

[4] The survey used "accounts established per employer plan" as a proxy for employer size, which likely understates the average size of each employer to some degree.