

Maddin Hauser Wartell Roth & Heller P.C.
attorneys and counselors

28400 Northwestern Highway Third Floor Southfield, MI 48034-1839 (248) 354-4030 fax (248) 354-1422 www.maddinhauser.com

CHARLES M. LAX, ESQ.
Direct Dial: (248) 827-1877
Direct Fax: (248) 359-6177
cml@maddinhauser.com

May 30, 2007

Steven T. Miller, Commissioner
Tax Exempt & Government Entities
Internal Revenue Service
1750 Penn Building, Room 684
Washington, D.C. 20224

Re: May 3, 2007 Remarks

Dear Steve:

As you recall, I was in attendance when you delivered remarks at the Great Lakes Benefits Conference on May 3, 2007. My initial reaction was to applaud the message and suggest that it be disseminated throughout the benefits community. I was delighted to see that it was published recently on the IRS web site. I would now like to share my own thoughts concerning this topic with you, Joseph Grant, the EP members of the ACT, and the entire benefits community.

First, you described a demographic that I can readily relate to. I am one of the estimated 7,918 people who turned age 60 each day in 2006. In light of this, I have considered the adequacy of my own retirement income. Although I have had greater opportunities and a better understanding of the "system" than most, it continues to be a concern for even me. For other members of my generation, retirement is fast approaching and the reality that they must rely upon retirement savings and the social security system is genuinely daunting.

Second, I have had the privilege to serve on the Advisory Committee for Tax Exempt and Government Entities ("ACT") for the past three years. I will be eternally grateful to you and your colleagues for granting me the opportunity to represent the benefits community during this time. It has truly given me invaluable insight into the operation of the IRS, TE/GE, and the Employee Plans Division and provided me with the most satisfying professional experience of my career.

Your remarks signal a new urgency and possibly a new direction for the promotion and protection of retirement security by the Employee Plans Division of the IRS. Traditional programs such as Customer Education and Outreach to plan sponsors and practitioners and enhanced compliance through audits, contacts, determinations and VCP have generally been effective and should continue to have a prominent presence within the Employee Plans Division. It is your recognition, however, that the plan participant not be forgotten, which is most compelling at this

time. As you are aware, Congress has expressed this sentiment in its recent enactment of the Pension Protection Act by the expansion of plan disclosure and plan transparency requirements. This is certainly a step in the right direction; however, I agree that more is needed.

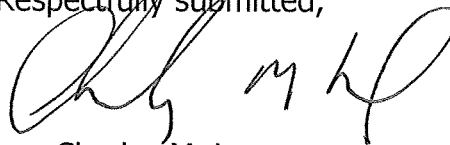
Your remarks also challenged Joseph Grant and his colleagues within the Employee Plans Division to consider systemic changes and new programs to improve retirement security for an "aging population, a disappearing savings rate, and a continued shift to DC plans." I know that they have the expertise and dedication to meet that challenge. Additionally, your remarks invited all members of the benefits community to weigh in on these issues, noting that we all must share in the responsibility for improving and protecting retirement security.

In light of your invitation, I would also like to use this letter to speak with my colleagues on the ACT and other practitioner members of the benefits community. The ACT serves as an important link between the IRS and the benefits community. We have seen the high priority and deference given to our recommendations by the leadership of TE/GE and the Employee Plans Division. In that regard, I urge my colleagues to continue their good work and consider your observations in future projects.

Furthermore, this letter shall also serve as an invitation to all benefits practitioners and members of the benefits community to consider your remarks in their respective practices and businesses. Too often we focus solely on the best interests of our clients, customers, and even ourselves, without considering the interests of the plan participants themselves. Clearly they are not mutually exclusive of each other. Instead, each of us should explore new and creative methods by which the benefits community can better utilize the tools and incentives provided by Congress to meet the responsibility of improving and protecting retirement security for all plan participants.

In conclusion, I thank you for the thought provoking message you have brought to the benefits community.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Charles M. Lax', written in a cursive style.

Charles M. Lax

669173

cc: Mr. Joseph H. Grant
Mr. Charles F. Plenge
Ms. Susan D. Diehl
Mr. Michael S. Sirkin
Mr. Daniel J. Schwartz
Ms. Dodi Walker Gross
Ms. Marcia S. Wagner
Mr. Michael M. Spickard



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TE/GE Commissioner Speaks at Great Lakes Benefits Conference

Good morning. It is always satisfying to speak at a benefits conference because of the respect I have for this community and for those of you who practice in it. Your good work makes this a cooperative and compliant community – the envy of the IRS. I feel that I am among friends.

You have heard this morning, and will hear later, a full discussion of benefits issues from our Employee Plans team.

So, as much as I would like to dive into the refreshing pool of EP rules – and I know you wish that I would – I feel I should leave that topic to those who might actually understand those rules.

Instead, I want to talk this morning about promoting and protecting retirement security. More specifically, I want to talk about our compliance efforts, the trends at work in the EP sector, and whether the enforcement work we have begun is the best way to address the sobering trends I will describe.

Let's start with what people commonly consider our job to be at the IRS. Generally, we are concerned with collecting the appropriate amount of tax. Your area is a bit different. You are, for the most part, within our regulatory responsibilities extending beyond just tax collection.

The Employee Plans function has responsibility within the Service for an immense and important sector, one that is growing in both size and importance as retirement assets increase, driven by favorable tax policies, and as baby boomers move toward the exit doors of the workplace.

EP exists to ensure that the tax expenditure in this area – \$104 billion per year – contributes to the retirement security of America’s workers.

EP ensures that this expenditure is consistent with Congressional intent by enforcing the rules (1) that govern participation and non-discrimination, (2) that require contributions to stay within legislated limits and be reported accurately, (3) that require contributions to be appropriately applied to provide retirement benefits for participants, and (4) that require assets to remain in retirement solution.

And while this continues to be necessary, I ask whether, faced with the trends I will discuss, this is enough. So let’s talk about some rather obvious demographic factors and perhaps some less obvious trends that may be degrading the future retirement security of Americans, and whether those trends mean we at the Service should consider modifying our approach.

I’d like to set the stage for a discussion of these themes by providing a broad-brush picture of our nation’s retirement readiness. How are we doing in establishing plans and setting aside the money to support us in our retirement? Here it is in a nutshell: We are getting old and we aren’t saving.

You know the basics: there are more than 950,000 plans with a filing obligation, and more than 99 million plan participants (not including IRAs, 457s, 403(b)s and the like). The Federal Reserve says that more than \$9.2 trillion are invested in retirement plans. GAO estimates that there are \$6.6 trillion in Defined Contribution plans and IRAs, and the rest in Defined Benefit plans.

\$9.2 trillion may seem like a hefty sum – but it is not adequate to fund the retirement needs of the country.

It’s estimated that 7,918 people per day turned 60 in 2006. As they retire, will they have adequate retirement income? And who will be responsible to see that they do? More and more, the answer is “the participant.”

You know better than anyone what has been happening with retirement plans. DB plans have declined in number from 148,000 in 1980 to 47,000 in 2003. During the same period, DC plans have increased from 341,000 to 653,000.

Only 43 percent of private sector workers are covered by a plan, and it’s estimated that only 60 percent of workers over 40 eligible to do so actually participate in a 401(k).

Of those who do participate in a 401(k) plan, the average account balance for someone age 60 or above was \$141,000. Our actuaries tell me that this balance will support an

annual annuity of \$12,203 for a male who retires at 65 and an annuity of \$11,172 for a female. Even with Social Security, this does not provide a sufficient retirement income for most individuals.

Nor have individuals filled in the gap with personal retirement savings. GAO reports that only 44 percent of families nearing retirement own an IRA, and among these, the median balance was \$60,000.

Nor do people appear to be saving much otherwise. GAO notes that between 2000 and 2005 the personal savings rate was 1.3 percent, one sixth of the average since World War II. And in 2006, it was a negative 1 percent.

What this suggests is that many workers are going to have to keep working rather than retire. This may already be happening.

The current average retirement age is 62 for both men and women. But in 2003, some 33 percent of men aged 65 to 69 were working, up from 26 percent in 1990. And for women in the same age group, 23 percent were working, up from 17 percent.

As a society, we are older and less frugal than ever.

Simply put, this gives us an opportunity, indeed a responsibility, to consider an important question: Given that our job is to help promote and protect America's retirement security, what is the purpose of the Employee Plans Division today, and should we change our direction?

As we begin considering whether we may need to change our approach and direction, I have asked Joseph Grant and his colleagues to consider what changes these demographics – an aging population, a disappearing savings rate, and a continued shift to DC plans – will require of EP:

- Are we providing sufficient service to the coming wave of people entering retirement? That means, as a first step, defining those services.
- Are we doing all we can to preserve promised benefits, to ensure that plan sponsors meet their obligations, and to prevent a taxpayer bailout of the DB universe of a size unseen since the savings and loan crisis?
- Should we focus more on ensuring that defined contribution plans cover all whom they must cover, and that the rights and assets of all participants are protected?

- What are our obligations to government plan participants – we have read of New Jersey-type issues in the papers – what do we owe the participants of these plans and the taxpayers of the states involved?
- Should we worry about the increasing number of mass marketed and adopted plans and what happens after the sale of the plan?
- Should we worry about consumer protection issues like expense loads and other potential drags on investment performance?
- Are we doing enough to promote plan creation and maintenance?
- What do we owe Congress and the public in terms of our ability to police and inquire into the system and report out findings, even when the data collected isn't directly related to compliance under current law? What can we add to worthwhile policy debates?

Now, those are a lot of questions. We have traditionally worked toward improving compliance through education and outreach, determination and voluntary compliance programs, and an examination program designed for one plan at a time.

In my view these programs remain essentially right-sized and well-directed, but I think EP needs to increase or modify its efforts in several respects. Given the trends, EP may no longer be able to accomplish its mission by focusing exclusively on employers and plan administrators. It may be that what is called for is an EP division that is proactive in areas that go beyond assuring technical compliance with federal tax law.

I submit there are two key changes, among those demanded by the coming wave of new retirees, the lack of sufficient savings, the change in who bears the risk of loss here, as well as the persistence of some tax and consumer abuses. Those changes are promoting enhanced transparency and promoting sound asset management practices by both participants and employers.

By enhancing transparency, I mean that the Service must broaden its educational efforts by reaching out to individual participants and retirees.

Our goal must be to increase transparency in the employee plans sector by helping

individuals understand their own situation – how much they need for retirement, how much they have invested, what they have invested in, how much they are being charged in fees, and how all of this impacts the retirement benefits they will receive.

By sound asset management, I mean that the Service must broaden its service and enforcement programs, not only to address abuse and traditional concerns such as discrimination, but also to ensure that plans and the entities that sponsor them serve, and do not exploit, participants and contributors. And we must aim at sectors, not just individual plans and sponsors. In short, we must act to assure that plan assets are being managed well and exclusively to promote the interests of plan participants. And we must do this recognizing that additional burden on employers may cause withdrawal from an essentially voluntary system.

So with that as introduction and conclusion, let me walk through the programs and discuss some of what you may see in the future. And let me say at the start that we will remain committed to a balanced approach, consisting of both service and enforcement.

First, Customer Education and Outreach. We are committed to maintaining what we have in this area, including our excellent relationship with the practitioner community. We will continue this relationship.

But going forward I think some change is needed in the CE&O function. By and large, our focus in the past has been on plans, plan sponsors, their representatives and the professional employee benefits community.

We are going to continue that work, but we also need to reach out, deliberately, to plan participants, to those who have opened IRAs, and to retirees. We need to consider what we can do to provide them with practical information and education about a wide range of issues.

For example, should we provide education about the fees and costs that plans and IRA trustees impose? How should one determine if the fee is reasonable? How do the fees impact the monthly income an individual is going to have in retirement? Others may have the lead on this and we will work with the Department of Labor and others, but I believe we have a responsibility to ensure participants are educated and protected.

We also need to help employers deal with the complexity of the law and target those parts of the economy that seem to lag in covered employees.

Our second traditional program is the determination letter program. I think it is fair to ask if fundamental change is needed here. Do we need a program in which practitioners come in for what is essentially a comfort ruling and the resulting reliance?

I think my answer is that the program generally works, but change is needed. This has already begun.

Our new determinations program is in place, and we are now receiving a steadier stream of applications on an annual basis. However, the program has yet to fully prove itself to you or to me. We will not be afraid to tweak or modify.

In addition, we need to identify early on those plans and trends that need serious scrutiny and additional development work. We will drill down into such areas. We expect, at the same time, to be able to move the vast majority of plans without problems of that sort along at a faster rate.

Let's talk voluntary compliance. The voluntary compliance program, EPCRS, is one of EP's signature programs. We were pioneers in this area, but in recent years we have found ourselves overwhelmed at times with the success of the program. The program continues to grow.

Here we continue to see more and more self-correction that is never reviewed by the Service. That is great, but one wonders whether at some point we will need to review some of those corrections and perhaps establish some reporting requirements. But the EPCRS program remains a shining example of what the IRS generally should be doing.

Let's talk about examinations. What new direction should we take here?

Our exams have found abuses in the EP area – our work in the ESOP and insurance plan areas shows that. So attacking abuse needs to be a continuing part of our business. We also need to think about whether we have some other areas we should focus on.

And the focus may be shifting so that some of our effort is in areas that the Service has not traditionally spent a lot of time on, but that are becoming more significant, given the trends I've discussed.

Again, ask the questions – what can we do to support broad meaningful coverage and how do we help those increasingly faced under a DC plan regime with all the hard choices – the participants?

So, we are considering how to examine 401(k) plans to see if they are well run, from the standpoint of the plan participant. Is the plan operated with the welfare of the participant in mind, or is it operated for the benefit of those running the plan, or the employer? We are interested in fees, investment choices and good communication of

plan information. This is the sound asset management focus I spoke of.

We also are looking at doing compliance work in the Master & Prototype and Volume Submitter worlds. The issue there is whether the plans, as operated in the field by the ultimate adopters, bear an acceptable resemblance to the plans that are carefully scrutinized and approved by the IRS. It is fine to start out with a very good plan document, but if it turns to something else entirely in operation, that is a problem. And it is a problem that needs to receive more attention from us.

A comprehensive look at enforcement by EP should also include government plans. How could it not, with one in five Americans employed by governments? These plans cover huge numbers of people, and they include the richest plans in the nation. Coverage and asset protection are of vital importance here, as recent headlines indicate.

As we talk about the examination program, I again want to touch on abusive transactions and how we should approach this area into the future. I am sure others will address this issue in detail; I'll limit myself to a couple of comments.

First, it is troubling that tax schemes began to use retirement vehicles and continue to do so. So our work in this area will continue.

Second, let me be frank with you about our approach to these cases. We are not going to treat abusive situations as we normally treat employee plans cases. They are not retirement plans, and we will not try to negotiate a correction or work out a solution. We are going to shut them down. There is no place for them within the EP community.

Some of the change to a new approach is already underway as the EP Compliance Unit hits its stride. The goal of the unit is to expand our compliance presence using "enforcement contacts." And it is working. The unit gives us an efficient way to touch large groups of similarly situated taxpayers.

It is going to conduct correspondence examinations and support our efforts to attack abusive tax schemes. And into the future it will be moving on initiatives that will help both the fisc and participants, such as plan participation in 403(b) plans. The EPCU allows us the flexibility to design and execute compliance projects to accommodate a shift of mission. I promise that things will get even more interesting as we continue to use it.

Let me wind up.

I've mentioned transparency and a broader regulatory approach to assure sound plan asset management practices as themes that I think EP should embrace as we consider

our path to the future.

In closing, however, I would like to invite the benefits community to think about some fundamental questions that I believe the Congress and the Treasury Department will be considering:

- First, do the tax incentives currently in place to encourage retirement plans and savings work effectively, especially for those at the lower end of the economic scale?
- Second, does the assumption that plans should be employer-sponsored and employer-administered remain valid?

And in case you think I am off base in my observations today, consider two challenges just issued by GAO:

- First, GAO says that given the complicated array of financial products being offered as possible retirement savings vehicles, including products with hybrid features involving combinations of savings, investments, or insurance, regulators should ensure that consumers understand the benefits and risks of these products.
- Second, regulators, consumers, and businesses must be increasingly vigilant of fraudulent and abusive marketing practices. As financial institutions move into new and non-traditional markets, regulators must maintain their ability to ensure open and fair access to markets, and consumer protection.

I could not agree more: these are significant challenges, not only for the Service, but for all with responsibility for retirement security.

We have always been concerned to see that eligible employees are covered by plans, and that plan assets are managed with the best interest of plan participants in mind. We will carry this concern forward. But we will also make a greater effort to promote transparency in the EP sector from the standpoint of the plan participant, the consumer.

Transparency in this context means ensuring that participants have the information they need to make good choices, and to understand the long-term implications of such things as plan expenses and alternate investment strategies. Good decisions require good information.

In addition to this transparency, I believe we must also target enforcement to those

areas that will promote coverage and protect assets.

Through enhanced transparency, and a broader, proactive regulatory approach, we can help provide the nearly 100 million plan participants a better opportunity to achieve a financially sound retirement.

Thank you for your time.

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