TRANSAMERICA CENTER
FOR RETIREMENT STUDIES℠

TCRS 2004-04: President Bush's Retirement Savings Proposals

On February 2, 2004, the Bush Administration unveiled a series of proposals that would overhaul the structure of retirement savings in the United States. These proposals are designed to streamline and reduce administration costs of employer-sponsored retirement plans and increase individuals' savings opportunities through retooled retirement accounts and the introduction of non-retirement savings accounts. Some of the intended benefits are to motivate small business owners, many of whom do not offer a retirement plan to sponsor one, and to increase individual savings rates. Whether the intended benefits of these proposals would be achieved has become a hot topic in the retirement industry, the media, and on Capitol Hill.

The Transamerica Center for Retirement Studies (TCRS) has evaluated the Bush Administration's retirement savings proposals and prepared this analysis to help promote an understanding of the proposals and their impact. Also included is an overview of recent legislative developments.

Key features of the proposals are outlined below.[1,2] (Please note that the proposals were initially introduced in January 2003 and were subsequently revised prior to their reintroduction in February 2004.)

- ***Lifetime Savings Accounts (LSAs)*** are individual accounts in which individuals of any age could contribute up to $5,000 annually, indexed to inflation, for any purpose. Contributions would not be tax deductible; however, investment earnings would accumulate tax-free. Withdrawals could be made at any time for any reason. Also, the accounts would have no income requirements and not be subject to minimum required distributions. Accounts could be opened and funded by an individual other than the account holder in the account holder's name. Limited rollover and conversion stipulations from Coverdell Education Savings Accounts and Section 529 Qualified State Tuition Plans are included. *Note: Major changes from the 2003 proposal include the reduction in the annual limit from $7,500 to $5,000 and family transfers now only permitted between spouses and not other family members.*

- ***Retirement Savings Accounts (RSAs)*** are individual accounts in which individuals of any age could contribute up to $5,000 annually, indexed to inflation, from earned income. The maximum contribution for married couples would be the lesser of annual earned income or $10,000 (indexed). These accounts are similar to current Roth IRAs in that contributions are not tax deductible and investment earnings accumulate tax-free. However, unlike the Roth IRA, no upper income limit would apply. Current Roth IRAs would be renamed RSAs and subject to the new rules as such. Existing traditional IRAs could be converted to RSAs – converted amounts would be taxed as ordinary income and conversions prior to January 1, 2006 could be included in taxable income in four yearly installments. After 2004, traditional IRAs could not accept new contributions – with the exception of receiving rollover funds from employer-sponsored retirement plans. *Note: Major changes from the 2003 proposal include the reduction in the annual limit from $7,500 to $5,000 and the clarification that it may be used as an add-on to an employer sponsored retirement plan.*

- ***Employer Retirement Savings Accounts (ERSAs)*** are employer sponsored retirement accounts that, beginning in 2005, would consolidate 401(k), 403(b), SIMPLE, grand fathered SARSEPS and governmental 457 plans into a single plan type. The Internal Revenue Code's plan qualification rules would be simplified and all other rules would conform, for the most part, to 401(k) plan rules. Hallmarks of the proposal include elimination of current ADP/ACP tests, to be replaced by simplified nondiscrimination testing and expanded safe harbor provisions. *Note: Major changes from the 2003 proposal are that cross-testing, average benefit percentage testing and permitted disparity would be retained without modification. Current top-heavy rules would also be retained. And, custodial account ERSA plans, similar to SIMPLE IRAs, would be permitted for employers with less than 10 employees.*

Transamerica Center for Retirement Studies (TCRS): Views on the Proposals

While it is highly uncertain which aspects of these proposals will pass or whether they will pass at all, especially given that 2004 is an election year, they will undoubtedly bring focus and stimulate debate regarding how to best solve the issues around the decline in Americans' savings rates, the aging of the population, and an imminent retirement savings crisis.

TCRS is working diligently with government relations experts to better understand the proposals, assess their intended (and perhaps unintended) impact, and work with legislators at crafting the most effective solution.

While TCRS supports the spirit of the proposals -- to stimulate long-term savings and reduce the administrative complexity of employer sponsored retirement plans, we have serious concerns about them.

Specifically, while LSAs sound like a wonderful savings opportunity, there is no evidence that they would increase net savings. In fact, we believe that LSAs would simply detract from long-term savings and therefore threaten the retirement security of most Americans. With no withdrawal restrictions and an annual contribution limit of $5,000 (indexed), common sense dictates that most American savers would max out their funds available for discretionary savings on the LSAs with little or none remaining for RSAs.

We support the expansion of existing IRA rules generally; however, we are concerned that the current deductibility of traditional IRAs has provided a key incentive for long-term savings by those eligible for the deduction, many of whom do not have access to an employer sponsored retirement plan, and that removal of the deduction will remove this incentive. We will continue to analyze the RSAs as more details are revealed.

As for the ERSAs, the Administration has cited that reduced administrative complexity (i.e., simplified nondiscrimination testing, safe harbor expansion) will motivate small business owners, the majority of whom do not have a plan, to sponsor a plan. This is indeed a wonderful opportunity. However, TRS believes that any simplification effort must recognize and accommodate the characteristics of the different markets. We believe simplification can be accomplished without consolidating the 403(b) and governmental plan types under 401(k) rules, and that to force all plan types into a one-size fits all type rules would disrupt and potentially freeze those markets.

Finally, we believe a crucial component for retirement security is missing from the Administration's proposals as they lack annuitization incentives for ensuring a retiree's income will last his or her lifetime.

Portman & Cardin in 2004

In recent years, Congressmen Robert Portman (R-OH) and Benjamin Cardin (D-MD) have taken the lead in pension reform. Their highly successful bipartisan efforts have focused on creating more opportunities for Americans to save for retirement and to encourage employers to sponsor retirement plans. Their landmark pension legislation, adopted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), included catch-up contributions for workers age 50 and over, enhanced pension portability through removal of rollover barriers, encouraged small business pension coverage, and simplified pension regulations.

Shortly after the Bush Administration's publication of its retirement savings proposals, Congressmen Portman and Cardin announced that they will soon introduce alternative legislation. Highlights of their proposals are expected to include:

- Provisions to accelerate contribution limits, catch-up contribution limits, and make EGTRRA permanent (previously included in HR 1776)
- Incentives for annuitization of distributions from qualified plans over a person's lifetime (previously included in HR 1776)
- Universal and non-deductible IRAs similar to the Bush Administration's RSA proposal; however they would be focused on increasing participation by low-income workers by including a saver's credit that could take the form of a government matching contribution
- Simplification of employer retirement plans; however, unlike the President's proposals, it would not require all plans to come within the 401(k) rules. It is envisioned that ERSAs would serve as an umbrella-type concept, preserving current regulations responsive to the various markets, including the small employer and 403(b) markets

We expect a counterpart to the new Portman-Cardin proposal will soon be announced in the Senate.

What to Expect from the Transamerica Center for Retirement Studies

Retirement savings is everyone's issue and everyone's opportunity. At TCRS, we welcome the important dialogue that all of these pension proposals will generate. While it is highly uncertain whether and how much of these proposals will be enacted into law, we will be actively participating in the legislative process by voicing the concerns of our clients and providing empirical data and statistics to further illuminate the current retirement savings situation as well as help assess the impact of proposed solutions.

Please rest assured that TCRS is following the situation closely and will communicate any important developments on a timely basis.

For additional information, please log on to TCRS website located at:

http://www.ta-retirement.com/thecenter.

The Transamerica Center for Retirement Studies was established in 2002 with the objective of providing information to small business owners, their advisors, and their employees regarding retirement planning issues.

[1] CRS Report for Congress (received through CRS Web), Retirement Savings Accounts: President's Budget Proposal for FY2005, Patrick J. Purcell, Specialist in Social Legislation, Domestic Social Policy Division, February 6, 2004

[2] ASPA ASAP, No. 04-05, A Publication of the ASPA Government Affairs Committee, Administration Announces Revised Savings Proposals, Changes Made to Address ASPA's Concerns, Brian H. Graff, Esq., February 2, 2004