The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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PRESIDENT'S RETIREMENT SAVINGS ACCOUNT PROPOSAL

[11596] February 1, 2000 TO: PENSION COMMITTEE No. 10-00 RE: PRESIDENT'S RETIREMENT SAVINGS ACCOUNT PROPOSAL

____ In his State of the Union address, President Clinton renewed his call for the establishment of a new retirement savings program, the Retirement Savings Account (RSA), targeted to middle and low- income households. The attached materials excerpted from the press release issued in conjunction with the State of the Union speech, provides some details on the program. The President also is proposing a tax credit program under which small employers could obtain a tax credit to establish a retirement plan and make contributions for nonhighly compensated employees, which also is discussed below. Retirement Savings Accounts Although the proposed RSA program is similar in many respects to last year’s Universal Savings Account (USA) proposal, there are some significant differences. The most notable difference is that USAs would have been administered by the Federal government; RSAs, on the other hand, would be either subaccounted for within a 401(k) plan or established separately as an IRA-like account. While details are slight, it appears that RSA assets could be invested in the same manner as 401(k) or IRA assets. The RSA proposal -- unlike last year’s USA proposal, which provided automatic government contributions to certain income-eligible individuals -- consists solely of a matching program. The program would be phased in over 4 years. Eligibility and Contribution Limits. Workers between the ages of 25 and 60 with family earnings of at least $5,000 would be eligible for the RSA program. Eligibility for the RSA program would extend to individuals with incomes up to $40,000 and couples with incomes up to $80,000. Specifically, individuals could contribute up to $1,000 annually to an RSA and be eligible for a Government matching contribution in amounts ranging from $1,100 (for individuals with incomes of $12,500 or less) to $200 (for individuals with incomes of $25,000 to $40,000). Couples could contribute up to $2,000 annually and be eligible to receive a Government matching contribution ranging from $2,200 (for couples with incomes of $25,000 or less) to $400 (for couples with incomes of $50,000 to $80,000). Tax Treatment of Contributions. Contributions would be tax deductible and taxes on RSA earnings would be deferred until distribution. Government Matching Formula. The President proposes to provide a two-to-one (200 percent) match on the first $100 dollars an individual and the first $200 a couple contributes under the program. This two-to-one match rate would phase out as income increases. For the next $900 an individual contributed under the RSA program ($1,800 for couples), the government would provide a one-to-one (100 percent) match. This one-to-one match also would be subject to a phase out as income increases. For individuals that do not have tax liability, the match would come in the form of a tax credit to the employer or the financial institution for 100 percent of the matching contribution paid into the RSA. The match rate would phase down to 20 percent over the income ranges described above. Tax Treatment of Withdrawals; Distribution Rules. Certain pre-retirement withdrawals from the RSA would be permitted, but only after 5 years and only for qualified purposes, such as paying for medical care, home purchase or higher education. Nature of the Account. RSA assets would be held in employer-sponsored plans, such as a 401(k) plan, or by individuals in IRA-type accounts. There would be a “similarly broad choice of investments” as is available in those vehicles. Financial Institution Role. As noted above, for individuals that do not have tax liability, the match would come in the form of a tax credit to the employer or the financial institution for 100 percent of the matching contribution. The mechanics of this aspect of the proposal are not explained. (Although not discussed in the attached material, financial institution or employer participation in the RSA program is intended to be voluntary.) Tax Incentives For Small Employers To Offer Retirement Plans In an effort to expand pension coverage among small employers, the President proposes offering employers with up to 100 employees a tax credit to pay for 50 percent of the qualified contributions made to a retirement plan for nonhighly compensated employees. To qualify for the tax credit, the employer would be required to provide a benefit equivalent to at least one percent of pay for those nonhighly compensated employees working at least half time. An additional tax credit would be available for small employers to offset the administrative costs associated with starting a new plan and educating employees. Russell G. Galer Senior Counsel Attachment

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