

President Obama's Plan for Retirement Savings Reform: Change?

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By Chantel Sheaks

The concept of saving for retirement is relatively new in the United States. U.S. Social Security is a mere 75 years old and, with some notable exceptions, most company-sponsored retirement plans are even younger. Yet, as the stock market plunges along with the value of individuals' retirement savings and companies see their defined benefit pension plan contributions skyrocket, many Americans are asking if it's time for the United States to take another look at how we pay for retirement.

Social Security benefits remain a key element of retiree income, but responsibility for providing for most of the income we'll need in retirement has shifted squarely in recent years onto individuals' shoulders. What are the implications of this shift given the current economic crisis? Put another way, what is the future of retirement in the United States?

Before his inauguration, President Obama briefly outlined his plans for retirement reform. Setting aside for now the entire issue of retiree medical coverage, which is a key component of the retirement decision, this *InsightOut*:

- Focuses on the administration's reform proposals concerning Social Security, and various aspects of employer-sponsored retirement savings plans
- Poses questions to employers that help them assess the possible implications of these reforms, if enacted, for their organizations and their employees.

SOCIAL SECURITY – HIGHER TAXES FOR SOME

It is no secret that Social Security will experience a shortfall very soon. In fact, in their report for 2008, the Trustees projected that the Social Security Trust Fund will be exhausted by 2041 when expected contributions are projected to be insufficient to sustain expected benefit levels. This imbalance can be addressed in three ways — cutting benefits in the

existing structure, delaying the age at which full benefits are available, and/or raising Social Security payroll taxes.

President Obama opposes any legislation that raises the Social Security normal retirement age (currently age 67 for those born in 1960 and after). He is also against privatizing Social Security and has opposed cutting benefits. Under current law, both employers and employees split the Social Security payroll tax of 12.4 percent on compensation up to a specified amount each year (\$106,800 for 2009).

However, in recognition that something needs to be done to address the increasing benefit cost, the Obama plan would require individuals earning more than \$250,000 per year to pay more in Social Security payroll taxes. Under his plan, an additional Social Security payroll tax of two to four percent (shared between the employer and employee) would be levied on those employees who earn more than \$250,000 per year.

Questions for Employers

- What proportion of your workforce earns \$250,000 or more annually? What impact would the additional Social Security contribution of two to four percent required from employers have on your organization's ability to meet its bottom line?
- If there is an increase in the Social Security payroll tax, would you look for other ways to compensate employees so that they would not be subject to the increased payroll tax?

- Is your organization in an industry that anticipates shortages when baby boomers start retiring? If so, would Obama's opposition to raising the normal retirement age from its current level encourage enough baby boomer retirements at your organization to create a labor shortage?

RETIREMENT SAVINGS: PENSION PLAN TRANSPARENCY, MANDATES, TAXES, AND BANKRUPTCY

Transparency: President Obama has not proposed substantive pension reform. This may be due to Congressional fatigue after passing the Pension Protection Act of 2006, the most expansive pension reform in more than 30 years.

His reform plans do focus on the transparency of pension investments. His proposal would require pension plans to provide detailed annual disclosures to participants about the fund's investment. These disclosures would include, but may not be limited to, details about the projects in which funds have been invested, the performance of those investments, and appropriate details about probable future investment strategies.

Obama's Web page claims that this requirement would "provide retirees important resources to make their pension funds more secure." It is unclear how this disclosure would help individuals secure their defined benefit plan retirement income as the investments underlying these plans from which this retirement income is derived are not controlled by participants.

Given the Financial Accounting Standards Board's increasing emphasis on disclosure in company financial statements and the already high level of disclosure requirements, the incremental administrative cost for these disclosures regarding defined benefit plans may be fairly modest. However, although employers may already have this information, they would incur other administrative costs associated with disclosing it to participants, including compiling the information in an easily understandable way and distributing it.

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Questions for Employers

- How many different defined benefit plans do you sponsor?
- How much administrative effort and cost would your organization incur in complying with these disclosure requirements?
- What is the level of your workforce's financial literacy? Would disclosing more information to participants about investments in a defined benefit plan cause more confusion than any gain in transparency?

Employer Mandates: Obama's plan mandates that employers who do not currently offer a retirement plan enroll their employees in a direct-deposit individual retirement account (IRA) that is compatible with their existing direct-deposit system. Employees may opt out of the enrollment. After enrollment, employees would have the option to change their contribution level, eliminate it entirely, and reallocate investments offered under the IRA. Participation in the program would be optional for employers with 10 or fewer employees or those that have been in business for less than two years.

To cut down on the cost of administration, temporary tax credits will be available to employers to defray the cost of establishing these plans, which would include annual disclosures to plan participants that detail the amount of fees incurred and investments made. In addition, the Obama plan would require that businesses choose a default investment plan with an investment portfolio similar to that of the federal Thrift Savings Plan, low-management fees, and no employer stock.

Questions for Employers

- What, if any, new burdens such as additional disclosures or investment education might this mandate impose on your organization?
- Does your organization sponsor a defined contribution plan? If so, might you still consider adopting this mandate?
- If employers are allowed to add a match or other contribution to the IRA, would you do so? If so, what would happen to any match or other contribution you may currently add to your employees' defined contribution accounts?

Tax Incentives and Cuts: The Obama plan would expand the existing Saver's Credit to "match" (i.e., provide a tax credit equal to) 50 percent of the first \$1,000 of savings for families that earn less than \$75,000 and would make the tax credit refundable (meaning that those without any tax liability could receive the credit). The savings match will automatically be deposited into designated personal accounts by using the account information listed on the IRS tax filing. Self-employed individuals will be offered attractive savings plan opportunities and the option of directly depositing into these savings accounts any tax refund that they may otherwise be entitled to receive.

The idea behind the initial Saver's Credit is to cushion the impact of saving on the take-home pay of low-income workers. This was achieved by giving them back a tax-credit equal to a portion of their savings. Obama's proposal would treat the tax credit as additional savings.

The Obama plan also would eliminate all income taxes on seniors making less than \$50,000 per year.

Questions for Employers

- If the individual is a participant in an employer-sponsored plan, could the tax credit "match" be deposited in the employer plan?
- If the tax credit is deposited in the employer plan, what restrictions would be imposed on that money (such as no hardship withdrawals or loans on such amounts)? What administrative burdens would there be if such restrictions were placed on these amounts?
- Would the tax exclusion encourage older individuals to return to work, on a limited basis, and, in some cases, help employers in industries where there is a worker shortage?

Bankruptcy Reform: Obama's plan also would reform bankruptcy laws to add protection to employees of organizations in bankruptcy. Specifically, his plan would, in part:

- Limit the amount of bonuses for executives
- Increase the amount of unpaid wages and benefits that workers can claim in bankruptcy court against their employer
- Limit the circumstances under which retiree benefits could be reduced

Questions for Employers:

- Would the bankruptcy reforms discourage employers from filing for bankruptcy?
- Are additional reforms needed to protect pension benefits during bankruptcy?

CONCLUSION

In light of the economic challenges the country faces and the deteriorating state of individuals' preparedness for retirement, retirement security should remain high on the Obama administration's agenda. Protecting the federal budget as well as individual and company budgets should be priorities. Moreover, the solutions adopted should be integrated with solutions that address the cost of health care during retirement. However, considering the other issues competing for immediate attention, it may be a while before retirement reform has its turn in the spotlight.

About the Author:

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