THE Pension Digest

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IRA/ Keogh Deposits: Do Banks Face a Diminished Role?

(The following information was first discussed with Collin W. Fritz and Associates customers at the 1991 CWF fall pension conference. It includes statistics compiled by the Employee Benefits Research Institute (EBRI), and information from the Federal Reserve Board, National Council of Savings Institutions, Investment Company Institute, Office of Thrift Supervision, Credit Union National Association, and the American Council of Life Insurance. Because of some similarities of purpose, IRA and Keogh funds are often combined when deposit trends are analyzed.)

Financial institutions such as commercial banks and savings & loans have long been thought of as the traditional "home" of retirement plans such as IRAs and Keoghs. But over the past five years, a trend that may be disturbing to these financial institutions has emerged. That trend is the loss of their institutions' market share in IRA and Keogh deposits.

The first half of the 1980's saw an explosion of deposit growth, primarily because of the liberalization of IRA rules, allowing universal deductibility of IRA contributions regardless of one's status as a participant in an employer-sponsored retirement plan.

But with the Tax Reform Act (TRA) of 1986, this changed dramatically, with IRA deductibility taken away or reduced for many workers, based on their participant status and income. Yet deposits continued to grow through the second half of the decade, albeit at a reduced pace. The total average annual growth over this period was roughly 20%, until 1989-90, when it slipped to 12%.

The continued effects of TRA '86, somewhat uncertain economic times, and inflation's gradual "indexing out" of many with formerly deductible contributions, may have brought about this recent decline. This year it is estimated that less than 60% of workers will be able to take the full $2,000 deduction. By 1995 this is expected to approach a level of only 50%.

Without question, the major source of volatility in combined IRA/Keogh deposits has been the decline in IRA deposits, rather than Keogh dollars. But as disturbing as this overall trend might be, a more disturbing trend for traditional financial institutions is their loss of market share to other types of deposit locations. Banks, S & Ls and credit unions are now in heavier competition with mutual funds, stock brokerage self-directed IRA accounts, and life insurance companies.

Trends in Actual IRA/Keogh Market Share, by Institution

Who's getting the biggest slice of the pie? In 1985 we would have said commercial banks, with 26.3%. But by 1990 their share had eroded to just over 23%. Still substantial, but slipping. S & L's have dropped from a position of holding roughly 23% of the 1985 market, to a distant fourth place in 1990, with just 14.5%. Mutual savings banks (5.1% to 4.2%) and credit unions (6.0 to 5.1%) have dropped market share slightly, and life insurance company share of the IRA/Keogh market has grown modestly (8.8% to 9.2%).

But the growth in market share held by mutual funds (from 17% to 25%) and stock brokerage self-directed accounts (from 13% to 18%) has been the most

Continued on page 2

Also In This Issue — IRA Custodians Cautioned on Financial Projection Rates • Confidence in GICs Remains • CWF Distribution, Election Forms Revised • IRS Revises, Eases Magnetic Media Waiver Request Form • Profit Sharing Council Criticizes Elimination of Five-Year Averaging, Other Qualified Plan Provisions • ✓ Check It Out

Deposits—*Continued from page 1*

respectable of the group. Why has this growth occurred?

Mutual funds and self-directed accounts may be flourishing partly because of growing sophistication among IRA/Keogh investors, who either want a managed fund with higher earnings potential, or want to hands-on manage their retirement assets themself. It may also be that the "safe-and-sound" argument for more traditional retirement investing may not be carrying quite the same weight it once did, particularly among younger retirement savers.

But it is also true that these newer IRA/Keogh providers are being very aggressive in promoting their services, often using earnings rates to initially attract prospects, whether or not the investment finally chosen is actually the one advertised.

While commercial financial institutions were most ready and able to take advantage of the initial rush to IRAs in the early 1980's, the later arriving competitors are showing considerable muscle, and adding market share chiefly at the expense of commercial banks.

Average Annual Growth 1985 TO 1990, by Type of Institution

Another way to analyze the performance of these institutions is by their average increase in IRA/Keogh asset dollars over the same five year period.

1.	mutual funds	28%
2.	stock brokerage self-directed IRA accts	27%
3.	life insurance co's	26%
4.	commercial banks	17%
5	credit unions	16%
6.	mutual savings banks	15%
7.	savings & loans	9%

Interpretation of these statistics is necessary, because - just looking at them superficially, all look fairly respectable, with all but one showing double digit average annual growth over this period.

Although commercial banks' growth looks very acceptable by most business standards - 17% - it is overshadowed significantly by the average annual growth of mutual funds, brokerages and insurance companies. For the traditional long-time leader in IRA/ Keogh assets, this does not look so satisfactory.

Commercial banks still have higher market share than either stock brokered self-directed IRA accounts or life insurance holdings in IRA/Keogh assets. But both grew at a 50% faster RATE over these five years than commercial banks. If this trend continues, it's not inconceivable that the stock brokerages offering self- directed accounts may overtake commercial banks sometime in the not-too-distant future.

The life insurance companies also seem to be trending in that direction, but have a lot of ground to make up in market share before that happens.

What Will Happen to the Overall IRA/Keogh Market?

The greatest unpredictability lies in the IRA portion of this retirement product duo. As we alluded earlier, each year more and more workers (covered by employer retirement plans) who receive nothing more significant than cost-of-living wage increases, are excluded from IRA deductibility, because the income thresholds are themselves not indexed. A family earning $40,000 five years ago, and able to deduct 100% of their maximum IRA contribution, loses all deductibility today if their income has risen to $50,000.

Thus for IRAs - given current rules - the market will grow in absolute numbers due to an expanding work force. But it will proportionately decline in step with the decrease in the percent of the worker population eligible to deduct their contributions.

What Might Reverse This Anticipated Trend?

1. If we were to see a decline in employer retirement plans offered to workers, more families would be able to deduct their entire IRA contribution. However, this is not a predicted trend.

2. Legislative change re-expanding the IRA market by either:

(A) relaxing deductibility rules to make more persons eligible

(B) enhancing penalty-free access to IRA assets, so that reluctance to tie up assets long-term would be tempered. Proposals have included access for first-home purchase, catastrophic medical expense, education, etc.

(C) indexing the income-based phase-out levels, so that as incomes rise with inflationary pressure, IRA deductibility would not be lost, as is the case now.

If no significant changes occur, what will result from institutions grappling for market share in a non-boom market?

1. We will learn who really wants the IRA/Keogh business, because growth in use of one type of institution will be at the expense of others. This means that incremental growth will be a result of aggressive customer relations or salesmanship, not order-taking.

2. If commercial banks decide that administration fees must be charged to make custodial IRA accounts profitable, we will learn whether they are able to cope with the fact that brokerage and mutual fund fees are much less visible to customers, and are often a sales advantage to the latter firms. PD

Table 1
Distribution of IRA and Keogh Assets by Financial Institution, 1985-1990

Financial Institution	1990	1989	1988	1987	1986	1985
		(in billions)				
Total Assets	563.9	501.7	426.8	366.2	304.9	230.4
Commercial Banks	130.1	108.7	93.9	82.9	72.7	60.6
Savings and Loans	81.8	85.3	78.8	70.4	63.5	52.8
Mutual Savings Banks	23.8	23.1	20.9	15.2	14..9	11.8
Mutual Funds	142.4	124.7	96.8	82.3	63.4	39.4
Credit Unions[a]	28.8	26.0	24.4	22.5	19.4	13.8
Life Insurance	51.9[b]	51.9	44.0	34.0	26.1	20.3
Stock Brokerage Self-Directed Accounts[a]	105.0	82.0	68.0	58.9	44.9	31.7
		(percentage of total assets)				
Commercial Banks	23.1%	21.7%	22.0%	22.6%	23.8%	26.3%
Savings and Loans	14.5	17.0	18.5	19.2	20.8	22.9
Mutual Savings Banks	4.2	4.6	4.9	4.2	4.9	5.1
Mutual Funds	25.3	24.9	22.7	22.5	20.8	17.1
Credit Unions[a]	5.1	5.2	5.7	6.1	6.4	6.0
Life Insurance	9.2	10.4	10.3	9.3	8.6	8.8
Stock Brokerage Self-Directed Accounts[a]	18.5	16.3	15.9	16.1	14.7	13.8

Source: Employee Benefit Research Institute tabulations of data from the *Federal Reserve Board Weekly Statistical Release*, the Office of Thrift Supervision, the National Council of Savings Institutions, the Investment Company Institute, the Credit Union National Association, and the American Council of Life Insurance.
a Figures represent IRA assets only.
b Latest figures available are for December 1989.

IRA Custodians Cautioned on Financial Projection Rates

With interest rates on savings instruments trending downward, IRA custodian/ trustees need to be aware of the possibility of making incorrect financial projections when new IRA accounts are opened.

The possibility for error lies in the financial projection portion of the IRA plan document's disclosure section. Depending on your vendor and the age of your forms, the projections may have been calculated at interest rates ranging from 4% to 6% or—probably unlikely—higher.

The hazard lies in making a financial projection at an interest rate higher than that actually offered for the deposit instrument in which the IRA contributions are placed with the custodian institution. This is contrary to IRS regulations, and could result in a $50 penalty for every account that is in violation. For example, if the custodian is offering 5-1/2% interest on a CD in which IRA contribution dollars are placed, the financial projection cannot be made at 6%, for it would be suggesting higher earnings than would be realistic under the existing terms at the time the IRA is opened.

How can you avoid this potential problem? Check your IRA plan documents to see what interest rate is used to project IRA deposit growth. If your bank is offering less than your document is projecting, you must correct his situation. Correcting options include:

a. purchasing entirely new forms that have a safely conservative projection schedule rate, or

b. obtaining a revised disclosure page with a satisfactory projection schedule rate, filling out this substitute page and attaching it to the plan document.

If you have further questions, please contact a CWF consultant, or Mr. John Olsen in our forms department at 1-800-346-3961.

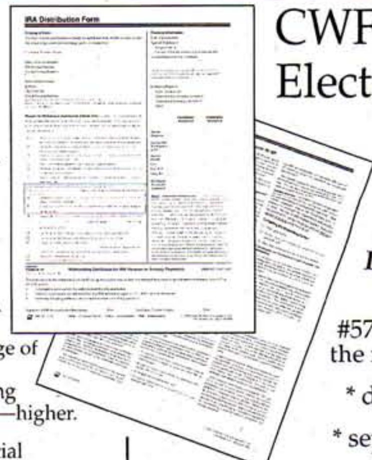
Confidence in GICs Remains

Guaranteed Investment Contracts (GICs) as pension plan investments have come under fire in recent months, due to concerns about the solvency of the insurance companies that provide them. The August Pension Digest referred to this issue with respect to the failure of Executive Life of California.

Nevertheless, the majority of benefits executives polled in a recent survey maintain their faith in GICs as pension plan investments, according to survey results obtained by the International Foundation for Employee Benefit Plans (IFEBP).

But that doesn't mean these executives are taking solvency completely on faith. Roughly one-half (45%) indicated that their organizations have evaluated GIC providers within the last quarter, with solvency concerns particularly in mind.

More than half — 63% — use an independent advisor to evaluate and choose a GIC provider. The vast majority — 85% — indicated satisfaction with their plan fiduciaries' evaluation, selection and monitoring of GIC providers. Almost an identical percentage periodically evaluate the financial condition of their GIC provider(s).



CWF Distribution, Election Forms Revised

Three key IRA forms used in IRA plan administration have been revised by Collin W. Fritz and Associates to more closely reflect new IRS interpretations of regulations or to simplify the forms for bank use.

IRA Distribution Form – #57

Customers with an existing inventory of current (4/90 version) #57 forms need not discard their forms, despite the superiority of the new form. Some of the 8/91 version changes include:

* distribution reason explanations have been simplified

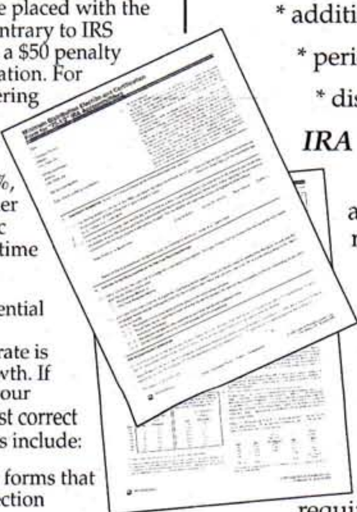
* separate reporting area for bank fees, withholding, etc.

* re-distributed information front and back for greater readability

* addition of a code number for transfer-inherited IRAs

* periodic distribution schedule terms are now to be filled in

* discussion of withholding rules and excesses more clearly defined



IRA 70-1/2 Distribution Form – #203N

Changes to this form were made in light of a recent interpretation by an IRS representative, made to Collin W. Fritz and Associates. We recommend that the existing version (11/89) no longer be used.

Features of the 9/91 version include:

* a named beneficiary automatically means a joint life expectancy calculation for the required minimum distribution (a single life expectancy results in a larger RMD amount)

* only recalculation or one-year-reduction election need be made

* beneficiary and RMD calculation method certifications added, for situations when IRA account is transferred into an institution after required minimum distributions have begun

IRA Beneficiary Election Form – #204N

The same comments for Form #203N apply also to this form. We recommend that the existing version (12/88) no longer be used.

Features of the 9/91 version include:

* based on recent information from the IRS, a spouse beneficiary may at any time elect to treat a deceased spouse's IRA as their own — initial elections need not be "locked in"

IRS Revises, Eases Magnetic Media Waiver Request Form

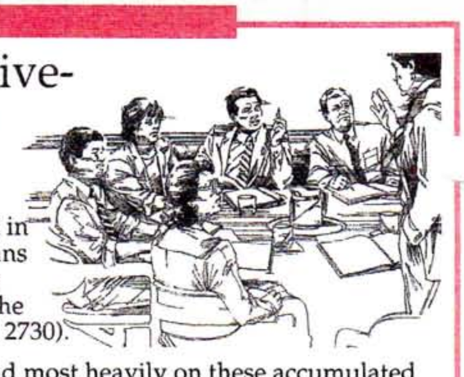
The form used by custodian/trustee institutions to seek a waiver from the required filing of information returns (such as 1099-R, 5498, W-2P, etc.) on magnetic media has been changed. Under normal IRS rules, those institutions filing 250 of any one of these forms (not all forms in aggregate) must file on magnetic media. But the IRS does provide a process for waiving this requirement, by making application to that agency.

The changes in the procedure are both contained on the Form 8508, and are as follows:

1. new instructions on the Form 8508 advise custodian/trustees that the form must be filed 45 days prior to the due date of the returns for which the waiver is being requested. This is a relaxation of the rules, which previously had placed the prior notice requirement at 90 days.

2. The Form W-2P has been removed from the form's list of information returns to which magnetic media regulations apply. This is because the Form W-2P has been eliminated for 1991 reporting, its functions now being fulfilled by Form 1099-R.

Profit Sharing Council Criticizes Elimination of Five-Year Averaging, Other Qualified Plan Provisions



Five-Year Averaging Elimination

Legislation eliminating five-year averaging for lump-sum distributions — introduced in 1991 by Representative Dan Rostenkowski (D-IL), chairman of the House Ways and Means Committee—was recently attacked for penalizing retiring lower-income employees. The charge was leveled by the pension advocacy group Profit Sharing Council of America. The legislation was part of Rostenkowski's 1991 Pension Access and Simplification Bill (H.R. 2730).

The Council contends that this will especially hurt lower-paid employees, who depend most heavily on these accumulated funds, but who may not necessarily be able to take their distributions over a more extended period of time. Eliminating five-year averaging would, according to PSCA, place many of these employees and their lump-sum distributions in the highest possible marginal tax bracket. This would take a very substantial tax bite out of their accumulated retirement plan funds.

Grandfathered Ten-Year Averaging

The PSCA also objected to H.R. 2730's proposed elimination of grandfathered ten-year averaging with capital gains treatment, for certain pension asset amounts prior to 1974. The PSCA contends that by retroactively removing this promised tax advantage from this group of pensioners, younger employees will take note of the unpredictability of Congressional tax policy, and choose not to commit current earnings to long-term savings in an employer qualified plan. This, says PSCA, would be counterproductive to Congress' stated goal of increasing long-term savings by U.S. citizens.

Taxation of Net Unrealized Stock Appreciation

Rostenkowski's piece of legislation also has proposed eliminating tax deferral of net unrealized appreciation of employer stock held in a qualified plan. This would affect QP participants to whom employer stock has been distributed, but which has not yet been sold, and whose appreciation in value therefore remains "unrealized."

The PSCA contends that since private investors are not taxed on the appreciation of stocks until that appreciation is realized, workers would be inequitably treated if required to pay taxes on such unrealized appreciation. PD

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Question: Is it true that an IRA beneficiary may have to take distributions faster — perhaps even a lump-sum distribution — if the accountholder had elected to determine the life expectancy factor by use of recalculation rather than the one-year reduction method?

✔ Answer. Yes. It is important that IRA accountholders understand that there is a trade-off or risk in using the recalculation method versus the one-year reduction method.

The proposed regulation at E-8 reads: "Upon the death of the employee (or the employee's spouse), the recalculated life expectancy of the employee (or the employee's spouse) will be reduced to zero in the calendar year following the calendar year of death. In any calendar year in which the last applicable life expectancy is zero, the plan must distribute the employee's entire interest prior to the last day of such year in order to satisfy section 401(a)(9)."

Illustration. The following chart shows how this rule works in practice. Let's assume that Isabella Roche had a balance of $80,000 on 12-31-90. To keep it simple we will also assume that there are no earnings. She must take a distribution for 1991. She is 70 and 70-1/2 in 1991. Her husband who is age 67 is her beneficiary as of her required beginning date. Her husband dies in 1993. Isabella then names her daughter as her beneficiary. Isabella then dies in 1995.

How do these deaths affect the RMD calculation for Isabella and for the daughter beneficiary?

Under the recalculation method Isabella must use a single life expectancy factor in the 1994 RMD calculation since her husband died in1993. This means the amount which she must withdraw increases substantially. Under the one-year reduction method his death does not affect Isabella's RMD amount or calculation.

Under the recalculation method, Isabella's daughter, the beneficiary, has a tough tax planning situation. Once her mom dies in 1995, the daughter will have to withdraw the entire remaining balance within two tax years — the remainder of 1995 and 1996. Under the one-year reduction method, the daughter could continue the same schedule since it is not modified when a death occurs.

In summary, the general rule is that a beneficiary of an accountholder who dies after his or her required beginning date must continue or speed up the payout schedule as established by the accountholder. However, when the accountholder elected to use the recalculation method, there is in fact no schedule to continue since the schedule itself calls for a total distribution. PD

The Pension Digest invites your questions and comments. Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

	Age of Account-holder	Age of Beneficiary	Life Exp. Factor if Elect Recalculation	Life Exp. Factor if Elect 1-Yr Reduction	Balance if Recal-culation	Balance if 1-Yr Reduction	Amount to be Distributed With Recalc.	Amount to be Distributed With 1-Year Reduction
1991	70	67	22.0	22.0	80,000	80,000	$3,636	$3,636
1992	71	68	21.2	21.0	76,364	76,364	3,602	3,636
1993	72	69 (dies)	20.3	20.0	72,762	72,728	3,584	3,636
1994	73	0	13.9	19.0	69,178	69,092	4,977	3,636
1995	74 (dies)	0	13.2	18.0	64,201	65,456	4,487	3,636
1996	0	0	0	17.0	59,224	61,820	59,224	3,636