THE Pension Digest

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New IRA Legislation Waiting in the Wings
...more hope for passage seen this time

Although hopes of new IRA legislation have been raised and dashed numerous times during the past several years, Congress now seems closer than ever to bringing viable legislation to the desk of President Bush, with some indications that he will sign.

The bipartisan Senate Finance Committee on July 29 approved and passed on to the full Senate a tax proposal that included provisions offering a number of saving and investing incentives to American taxpayers. Consideration is under way, and most expect final action by the full Senate in September.

Included in this package were the following IRA provisions:

* IRA deductibility expanded. Phase-out income levels for those who are active participants in an employer retirement plan increased to $80,000 for an individual; $120,000 for a married couple. As under current law, anyone who is NOT a participant in an employer plan may deduct the full amount of their $2,000 contribution, regardless of income. This will mean full IRA deductibility for most Americans, calculated at all but the top 4%.

(The version of this legislation forwarded by the Senate Finance Committee to the full Senate for deliberation originally would have allowed for the restoration of the fully deductible $2,000 IRA contribution, REGARDLESS of one's income or participation in an employer retirement plan. This provision was modified to the above-described version.)

* indexing of the $2,000 maximum contribution limit to keep pace with inflation

* first-home purchase, qualified medical or educational expenses or long-term unemployment would qualify for penalty-free tapping of an IRA account (also includes tax-sheltered

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New Legislation Impact . . .

"NEW IRA" WOULD REQUIRE SPECIAL HANDLING BY BANKS

As this issue of The Pension Digest goes to press, the possibility of major modifications to current IRA regulations appears very real, and is included in Congress' current deliberations on a new tax bill. Changes in these proposals seem to come weekly, if not daily.

One of the provisions proposed has been the so-called "back-ended" or Super IRA — non-deductible when contributed but non-taxable when withdrawn. The benefit to the taxpayer is at the "back end". There is uncertainty as to whether this provision will still be around for full Senate consideration, or part of the conference committee process that reconciles differing House and Senate versions of a bill.

But the implications of this IRA option for custodian institutions are significant enough that they bear discussion, even though such a provision is subject to deletion or restoration at almost any point prior to final passage.

Super IRA Has Been Overshadowed

The new non-deductible or super IRA has been somewhat overshadowed by the prospect of substantially or completely-restored deductibility of IRAs. This is understandable, given the

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New Legislation Impact . . .

RESPONDING TO CHANGES IN IRA RULES & REGULATIONS

Understanding the potential for change that may accompany new legislation on IRAs is one thing. Knowing how to react to those regulatory changes is another. Here are some thoughts on what financial institutions should be prepared to do — and not do — if and when anticipated changes come.

1. Be Prepared to Market

If new IRA rules closely resemble legislation now being considered in the U.S. Senate, there will be a much larger IRA marketplace, with many more IRA funds in need of a custodial destination. Some money will go to financial institutions without major effort, out of customer force-of-habit. But we believe that those institutions seeking a major share of these stable, core-type deposits, and

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New IRA Legislation — *Continued from page 1*

annuities and Code section 501(c)(18) plans

* back-ended IRA option, earlier proposed by President Bush, that would allow only non-deductible contributions, but with tax-free withdrawal - including interest - after five years

  * funds could be transferred from regular IRAs to this new IRA without penalty, but would remain taxable

  * IRA funds must remain in this plan for at least five years to avoid normal early-withdrawal penalties, even if the individual reaches age 59-1/2 before five years elapse

Bush May Approve Measure He Once Opposed

The provision to expand full IRA deductibility was part of earlier legislation vetoed by President Bush. But Bush is said to now be more willing to sign legislation that includes this, provided the bill contains a balance of other elements he favors.

One stumbling block may be the reconciliation of the Senate (assuming this bill passes the full Senate) and House versions of the tax bill, passed in July. The price tag on the House version was $16.5 billion, while the current Senate version is $32.5 billion. The House version did not include the restoration or expansion of IRA deductibility.

In early Senate debate, Rhode Island's John Chaffee sought to eliminate IRA restoration on the grounds that it would worsen the budget deficit. His request lost by a 3-1 margin. Senator Lloyd Bentsen of Texas, the most persistent proponent of IRA reform in recent years, countered by arguing that - by next year - inflationary pressure on wages and salaries will have eliminated 50% of American families from IRA deduction eligibility.

Other Pension Provisions

* elimination of five-year averaging of lump-sum distributions from qualified retirement plans

* elimination of the $5,000 death benefit exclusion, which allows qualified plan beneficiaries to shelter $5,000 of a lump-sum distribution from taxes

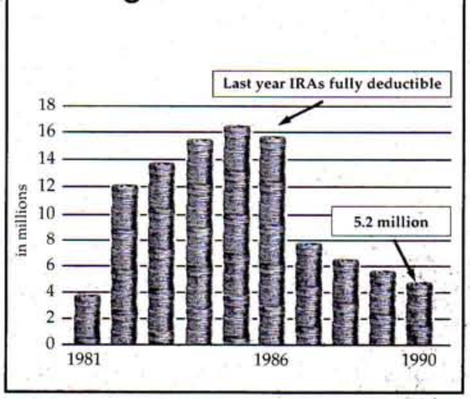
* new small business PRIME account, an IRA-based plan allowing employees to make elective contributions up to $3,000 per year, with an employer match of 100%, up to 3% of the employee's compensation.

* Salary Reduction SEPs (Simplified Employee Pensions) would be allowed for businesses with 100 or fewer employees, with no 50% employee participation requirement.

* 401(k) plans would be available to non-profit organizations other than state and local governments.

CWF will continue to keep you informed on these legislative developments, and any regulatory actions that may impact IRAs and other retirement plans.

Tracking IRA Contributions



From the introduction of universal IRA deductibility in 1981, IRA contributions skyrocketed from under $4 million to $16 million in 1986, the year that deductibility was curtailed for many workers. Since then, contributions have fallen to less than $6 million, as fewer and fewer Americans qualify for IRA deductibility.

CWF 1992 Pension Conference Repeats '91 Success

Bankers from around the nation gathered August 9-12 for the CWF Conference Classic, the second annual retirement plan conference held by Collin W. Fritz and Associates. The site was again Madden's Resort & Conference Center, one of the Upper Midwest's most renowned resorts, located on Gull Lake near CWF's home offices in Brainerd, Minnesota.

Total attendance rose from 1991's conference, but attendee numbers still allowed for small, highly interactive focus groups. Subjects covered at this three-day conference included IRAs, qualified plans, retirement plan software and marketing.

Planning is already under way for the 1993 CWF retirement plan conference. Be watching for the announcement of these dates.

Impact of Truth-in-Savings Act on IRAs Awaited

There is no "buzzword" more familiar and ominous to financial institutions these days than the term "Truth-in-Savings." With the final regulation scheduled to be released September 19 following a 5-1/2-month public review and comment period, financial institutions large and small are bracing for the added administrative, recordkeeping and customer service burdens they will have to bear.

Some expect that before the final regulations take effect, there will be major simplification of current proposed regulations, providing that the law's mission of protecting the banking consumer through uniform and understandable savings terms and earnings calculations is maintained. But whether the proposed regulations remain as-is, or are modified, remains to be seen.

Application to Retirement Accounts

The Board of Governors of the Federal Reserve System is charged with not only enforcing, but interpreting, the will of Congress in its administration of the new Truth-in-Savings regulations. I terms of which accounts will be covered, the Board is said to have proposed to define the word "account" as any deposit account available to, or held by, a "consumer."

We at Collin W. Fritz and Associates interpret this to mean the inclusion of IRA accounts, at least in principle, because they are opened by and for an individual consumer. It should be noted, however, that the Board has asked for comment on whether the law should apply to custodial accounts in which the custodian may not be a "natural person" (remember that a financial institution is the custodian in a typical IRA account).

With respect to accounts held for businesses, the Board has proposed that it NOT cover these accounts, believing that the act was designed to protect consumers, as defined in its most commonly understood meaning.

This would exclude Simplified Employee Pension (SEP) plans, as well as single (Keogh) or multi-participant qualified retirement plans.

We will pay close attention to developments following the September 19 Final Regulation issuance date, and wil keep you updated on how these final regulations impact your institution with respect to its retirement plans.

Special Handling — *Continued from page 1*

statistical evidence showing that deductibility has in the past been the primary motivator for `A contributions.

But if the Super IRA survives the legislative process with its main provisions intact, there will be *two* IRAs in our future. What will this mean to financial institutions in terms of reporting and plan administration?

Why This New Plan?

In our opinion, this IRA was conceived out of concern for the loss of immediate tax revenues if substantially-restored deductibility of regular IRAs becomes a reality. By offering the option of paying taxes on current income, but no taxes on earnings, the budget-minded in Congress hope to spread out the impact of IRA tax-sheltering provisions...some taxes now, some later.

What's Different About This Plan?

This IRA would:

- allow only non-deductible (taxable) contributions, whose earnings, however, would be tax-free.

- funds must be held in the account five years to merit this tax-free-earnings treatment

- funds could be transferred into this new IRA from existing, traditional IRAs without penalty, but would be taxable

- funds must remain in this IRA for five years to avoid penalty, even if this this means remaining past age 59-1/2

What May Change for Custodians?

From our vantage point, these are some of the things that may change for custodian/trustee institutions if this should become law.

* different plan documents for opening IRA plans, because of the significant differences in plan provisions

* separate data processing programs for recordkeeping and reporting purposes

* having the ability to track contributions, so that there would be no uncertainty of when a contribution has been on deposit for five years, and therefore eligible for tax-free withdrawal

This last item is a key one. Just who would bear the burden of proof as to timing and taxability — the customer or the custodian institution — is not clear.

But what is clear is that, if this becomes law, custodian institutions may find themselves initially having to rely heavily on their consulting and data processing resources for assistance until all the "bugs" can be worked out.

Marketing
Pension Products and Services

Pension Advertising Assistance Now Available

With the traditional fall surge in retirement plan activity, and with legislation pending that could greatly increase demand for IRAs, financial institutions should be thinking about their marketing plans for this sector of their business.

While many institutions have discovered the importance of maintaining a visible retirement plan image and presence in their market on an ongoing basis, some have not done so due to factors such as expense, and difficulty in finding a creative resource that understands the special needs of this market.

To better serve these institutions, Collin W. Fritz and Associates offers not only our line of point-of-purchase and direct mail brochures, but also print ads, counter displays, radio spots and posters. We can also work with you on a custom basis to create any other marketing vehicle you might desire.

Media advertising items are offered on a market area-exclusive basis, to insure against overlap of identical marketing messages by competing institutions. Institutions in a given market area requesting CWF services will be given this exclusivity on a first-come basis.

For more information call 1-800-346-3961, and ask for Mike Rahn.

Responding to Changes —*Continued from page 1*

willing to market for them, will get these deposit dollars in much greater proportion than institutions that leave it to chance.

Not only may new-found deductibility make the regular or self-directed IRA more attractive, but developing competition for these deposits might drive up interest rates being offered, removing a significant stumbling block currently standing in the way of more IRA deposits. Having a plan in place to attract these deposits is sound strategic thinking.

(If your institution needs assistance in marketing for these accounts, refer to the announcement on marketing assistance elsewhere in this issue.)

2. Be Prepared to Train

If pension legislation passes, there will be rule changes that staff must be familiar with. Perhaps there will also be sufficient customer demand to warrant the cross-training of staff not currently working with IRAs.

Training can come in several ways, including :

- publicly-held "day programs" conducted by pension specialists such as CWF or other providers

- in-house seminars if your staff (or several banks' combined staff) is large enough to support the fee for a private program

- access to a proven consulting service

- internal IRA procedure manuals to guide staff through day-to-day IRA administration situations and problems

3. New IRA Documentation for Opening New Plans

As soon as new documentation in the form of IRA plan agreements and necessary transaction/reporting forms are available, they should be placed in use for all new IRA accounts. New transaction forms for existing accounts will also be needed.

4. Amending of Existing Plans

While amending is at the top of nearly everyone's checklist for anticipated law changes, amending invariably carries with it a grace period. This should be reassuring to financial institutions.Typically the amending grace period is 12 months.

Therefore, amending <u>is not</u> something that should be attempted immediately. Drafting of a "quality" amendment, one that takes into consideration all provisions of revised IRA law, requires careful preparation to protect both customer and custodian interests.

We recommend working with a provider that specializes in retirement services. Amending is a necessary, costly and compliance-sensitive procedure, and for these reasons should be done properly the *first* time.

For additional information, contact our consulting or education departments at 1-800-346-3961.

Loophole in Rule on 20% Withholding From QP Distributions May Prove an Inconvenience to Financial Institutions

...some transfer-initiated IRAs may be short-lived

Last month we discussed the new rule requiring 20% withholding from qualified plan distributions if they are not transferred directly to another retirement account. This rule — part of a larger bill authorizing the extension of jobless benefits — was intended to ensure that taxes would be paid on distributed QP funds if they were not properly rolled over to an IRA or another employer plan.

But while the rule makes it impossible for an employee to take a direct QP distribution without having 20% withheld for potential taxes, the law left a gaping hole that some QP participants may be shrewd enough to take advantage of.

In such cases financial institutions may find themselves "used" by the QP participant, and may be unable to do anything about it.

Scenario:

A QP participant terminates his position, and will receive a $35,000 distribution from his employer's plan. If he takes a distribution with the intention to roll over these funds or use them for some other purpose, 20% - $7,000 - must be withheld by the plan administrator.

But a direct transfer requires no withholding, so the participant elects to have the plan assets transferred to a new IRA account at 1st Neighborhood Bank. He has no intention, however, of keeping these funds in the IRA at this time, and elects to revoke this IRA within the seven-day period allowed for revocation.

He now has the distributed QP funds in their entirety. He may roll them over in time to keep them tax-sheltered. Or he may not, and may instead use these funds and be liable for taxation, and possibly a premature distribution penalty, depending on his age.

But in any event, the IRS' rule and intent has been thwarted. The agency will have to wait until tax filing time to hopefully get its due from this participant.

Institutions May be a "Revolving Door." Can They Charge for This Transaction?

Opening an IRA plan is a time-consuming process. Financial institutions do not want to make the effort to open a plan, only to have it revoked days later. Can an institution charge a fee or fees to protect itself against this?

Our immediate reaction is "no". While certain fees may be charged provided the institution's IRA plan document has Article IX language authorizing it, and such fees are reflected in the disclosure, fees or penalties may not be levied against the principal amount in a revoked IRA.

How About the IRA's Earnings?

Revenue Procedure 91-70, which outlined the rules requiring the reporting of both contributions and distributions from revoked IRAs, does not prescribe that all earnings be returned with a revoked IRA, but rather describes how these earnings are to be reported if they are returned.

Therefore it appears that institutions could levy a penalty or fee to the extent of earned interest, unless the IRA plan document or the time deposit form have language that would require the return of interest.

If institutions wish to reserve this option, we suggest that their time deposit form have the following wording: "If this time deposit was made in conjunction with the establishment of the IRA and the seven-day revocation period has not elapsed, then my withdrawal will be subject to your penalty equal to the interest earned on the amount withdrawn."

However, depending on the amount of the funds transferred into an IRA and the number of days they remain on deposit, this interest amount may be negligible, and fall short of compensating an institution for its time, and may fail to discourage a customer from taking advantage of the institution in this scheme to thwart the IRS' 20% withholding rule.

Loophole Will Most Likely be Closed

It is our belief that this loophole will not remain available, and will be noticed and eventually closed.

But for now, it is a situation that will probably arise for some institutions. PD

Compliance Reminder: Use Proper IRA Projection Schedules

Because of a number of IRA projection schedule problems encountered recently in our compliance reviews, we are offering this brief reminder. When an IRA is established, IRA projections must use an interest rate equal to or less than the rate being offered to that particular IRA customer.

This means that if your IRA forms contain projection charts using an interest rate of 4% (or greater) and you are now paying less than 4%, you must make changes so that you comply with this rule. The IRS fine for using noncomplying interest rates to generate projections is $50 per affected accountholder. Possible ways of complying are: (1) purchase and use forms that contain projection schedules with 2% (or other rate lower than currently offered); and (2) purchase and use a special insert page which contains the projections at the lower percentage rate.

Please contact Collin W. Fritz and Associates, Ltd. if you need further assistance. 1-800-346-3961 PD