Democrats Expected to Tweak, Not Scuttle, IRAs and 401ks

By Editor Test *Sun, Jun 7, 2009*

Speaking at LIMRA's Retirement Industry Conference in Orlando on April 3, an attorney-lobbyist predicted that tax incentives for insurance and retirement products will undergo scrutiny by the White House and Congress.

Contrary to conventional wisdom, the Obama administration is more likely, not less likely, to pursue an activist social spending agenda in the face of the global financial storm, said Washington attorney James M. Delaplane at the annual LIMRA Retirement Industry Conference in Orlando April 1-3.

In his wide-ranging presentation, Delaplane, a partner at the Washington law firm of Davis & Harman LLP and a financial services industry lobbyist, also discussed how the arrival of the Obama team and the Democratic advantages in Congress might affect the interests of the retirement industry.

The combination of Democratic control of Congress and the trauma of the financial debacle will bring greater scrutiny of the financial services industry in general and will make it "tough to get new tax incentives for savings vehicles" passed, Delaplane said.

With votes from the two liberal Republicans from Maine, Olympia Snow and Susan Collins, Democrats can muster a filibuster-proof majority in the Senate, he noted. A phalanx of liberal legislators from California—Nancy Pelosi, Henry Waxman, and George Miller in the House and Diane Feinstein and Barbara Boxer in the Senate—also contribute to the Democrats' strength.

Emphasis on middle-class retirees

The Obama-led Democrats bring a "distributional perspective" to government, Delaplane said. They will favor programs that help lower middle class earners over programs that help the rich—who are defined informally as those earning $250,000 or more a year. Since the tax benefits of insurance products, for example, accrue disproportionately to those in high tax brackets, he said, the administration is likely to question those benefits.

A tactical change in the budget rules may be used to further that strategy. Democrats may revive the "pay-as-you-go" budget rule—i.e., the requirement that new spending must be offset by cuts in spending or rescission of tax breaks—which the Bush presidency did not follow, Delaplane said. If they do so, insurance tax incentives might be sacrificed to pay for middle class tax relief.

Clues to Obama's legislative priorities are evident in the budget he sent to Congress in March, Delaplane said. For instance, a program requiring workers without access to a retirement plan to enroll in an IRA and a program that would finance a government matching contribution to retirement accounts were both in the budget. An initiative to require auto-enrollment of employees in their employers' defined contribution plans was not.

Social Security reform "has a pulse" in the new administration, Delaplane said, despite the conventional wisdom that tampering with the popular social insurance program is politically dangerous. The retirement security of the middle class is one of Obama's principal concerns, he added, noting that the president has created a task force on middle class families under the direction of vice president Joe Biden.

Tweak of 401ks foreseen

There will probably be no radical reform of the 401k-based defined contribution system in the foreseeable future—despite Congressman Miller's criticisms that the 401k plan "has deep flaws that were hidden during the good times" and that the "30-year experiment with the 401k has failed," Delaplane said.

Miller chairs the House Education and Labor Committee, which has held widely publicized hearings on the 401k. Three congressional committees are said to be studying the collapse of retirement account values last year, a phenomenon that legislators are calling the "Boomer Bust."

Ironically, there's little evidence that the crash is changing Boomers' behavior. Although a study by Transamerica in January showed that Americans have lost confidence in their ability to retire comfortably, Delaplane said, the number of people taking hardship withdrawals or borrowing money from their retirement accounts has not gone up.

If the White House or the congressional Democrats do push for 401k reform, they are likely to focus on greater fee transparency and to question the value of target date funds (TDFs), which are said to become less risky as the owner approaches retirement, Delaplane said.

Though the government has allowed TDFs to serve as default investment choices for retirement plan participants who don't choose their own investments, TDFs apparently have problems. For instance, they aren't standardized. Equity allocations within supposedly comparable TDFs have been found to vary from a low of 8% to a high of 62%. And they aren't necessarily safe. One TDF designed for people retiring in 2010 reportedly lost 40% of its value since last fall.

Another likely area of scrutiny will be the glaring absence of retirement distribution options in most defined contribution plans. "Annuities as a default distribution option is on the radar—not for 2009 but in three or four years," Delaplane said.

Democrats may also reevaluate the tax deferrals associated with IRAs. According to Delaplane, those accounts cost the government an estimated $110 billion in revenue each year. Since Obama's people generally regard tax deferral as a transfer to the wealthy, Delaplane predicted that Democrats might try to replace the IRA tax benefit with a 28% tax credit or a federal matching contribution.