

Flexibility and Retirement Savings in the United States

Paul Schott Stevens
President

Investment Company Institute

July 21, 2005

US-UK Dialogue on Pensions

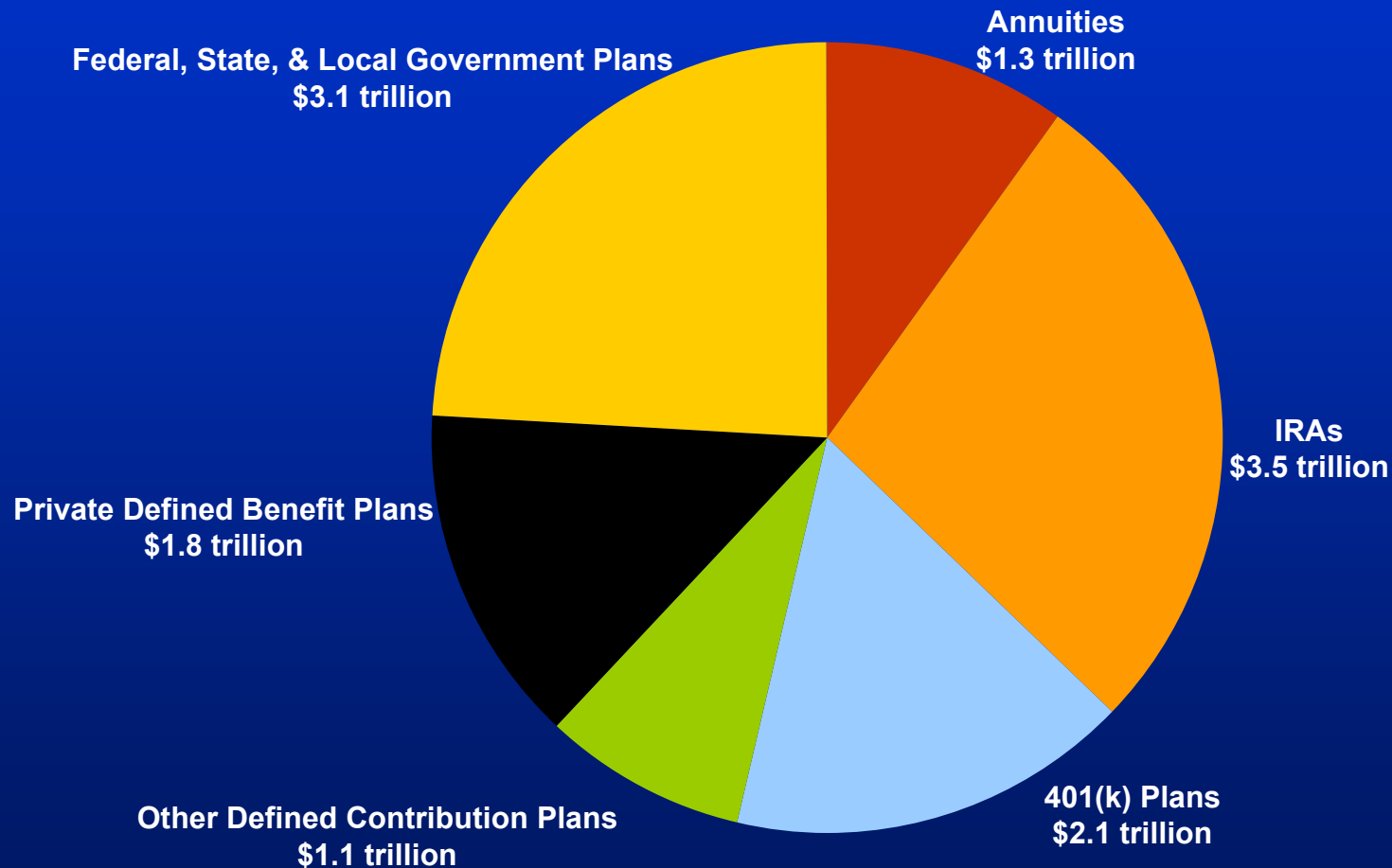


Overview

- Policy Implications
- U.S. Retirement Planning Has Many Components
- Numerous Opportunities to Save for Retirement Over a Career
- Empirical Research
- Conclusions
- References

U.S. Retirement Saving Has Many Components: Total \$12.9 Trillion

(assets at year-end 2004)



Sources: Investment Company Institute; Federal Reserve Board; National Association of Government Defined Contribution Administrators; American Council of Life Insurers; and Internal Revenue Service, Statistics of Income Division.

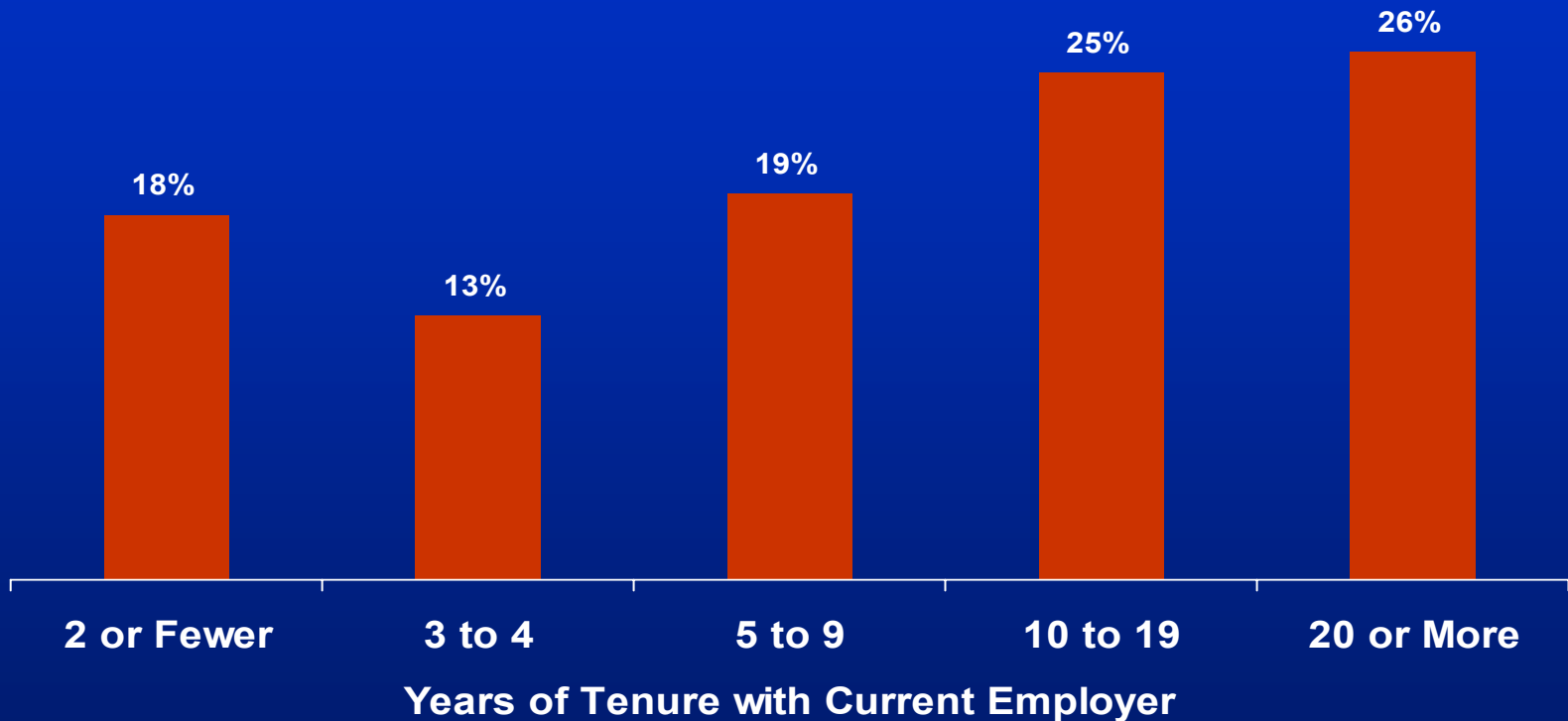
Numerous Opportunities to Save for Retirement Over a Career

- Tax policy, plan design, and individuals' personal characteristics influence retirement saving
- 53 percent of U.S. workers were at employers offering employer-sponsored retirement plans in 2003
- 47 percent of U.S. workers left to their own devices
- Uptake of IRAs low—only 3 percent of eligible taxpayers made deductible traditional IRA contributions (in 2001)
- Additional saving by individuals on their own

Sources: Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends," *EBRI Issue Brief*, October 2004; Sailer and Holden, "Use of Individual Retirement Arrangements to Save for Retirement," August 2004; U.S. Internal Revenue Service, "Individual Retirement Arrangements (IRAs)," *Publication 590*; and Stevens, "Funding Our Future: Ensuring a Strong Public and Private Retirement System," May 11, 2005.

Changing Jobs—Tenure Distribution of Workers Age 55 to 64

(percent of workers)



Note: Percentages do not add to 100 percent because of rounding.

Source: U.S. Department of Labor, Bureau of Labor Statistics, "Employee Tenure in 2004," September 21, 2004.

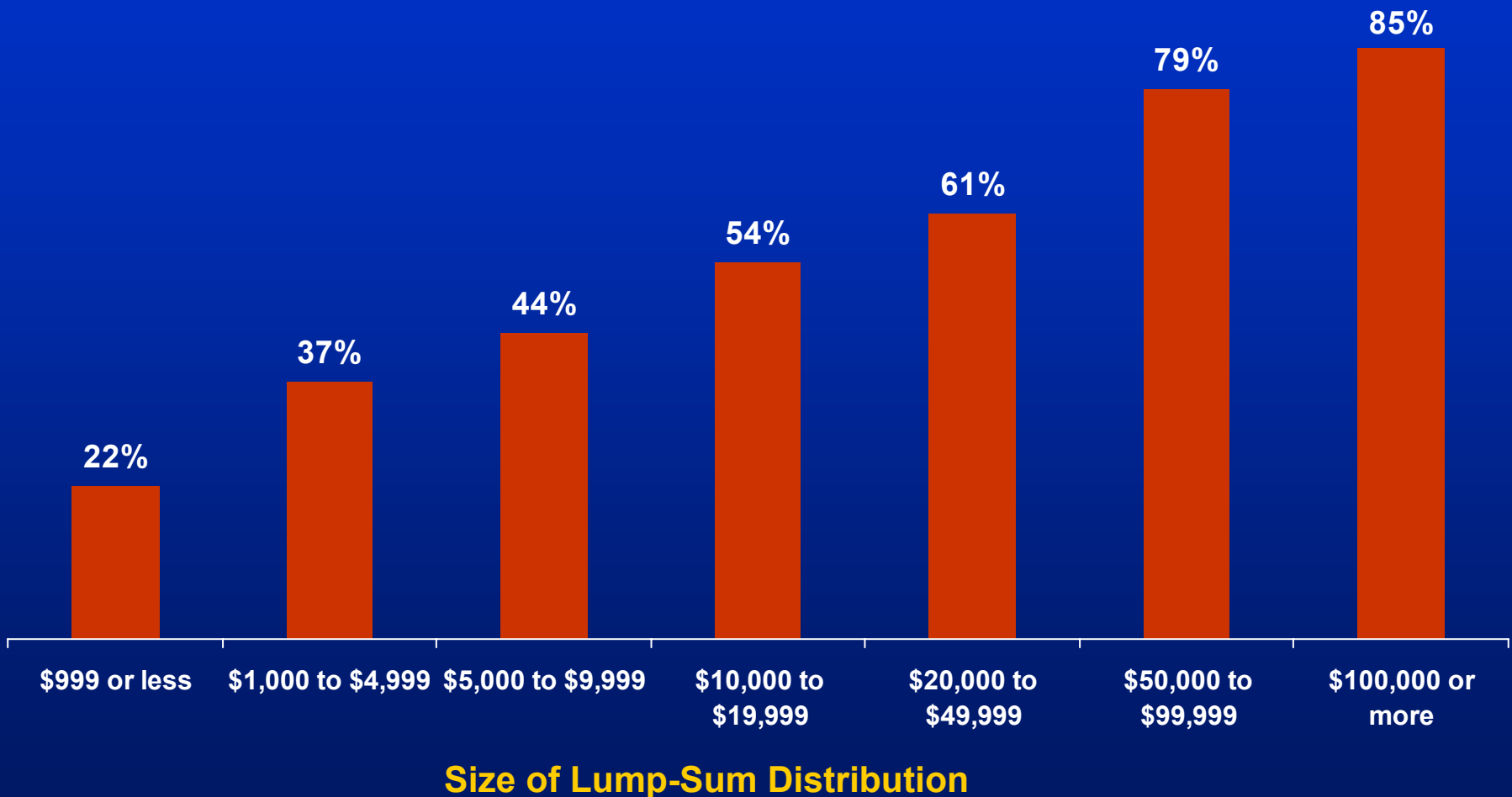
Flexibility Important—But Not Without Safeguards

- Tax incentives to encourage contributions and preserve deferral of taxes on investment returns
- Simplicity of rules facilitates participation
- Behavioral finance: importance of “mental accounting” or “buckets”
- Tax penalties to prevent early withdrawal

Sources: Holden et al., “The Individual Retirement Account at Age 30: A Retrospective,” *ICI Perspective*, February 2005; Shefrin and Thaler, “The Behavioral Life-Cycle Hypothesis,” *Economic Inquiry*, October 1988; and U.S. Internal Revenue Service, “Individual Retirement Arrangements (IRAs),” *Publication 590*.

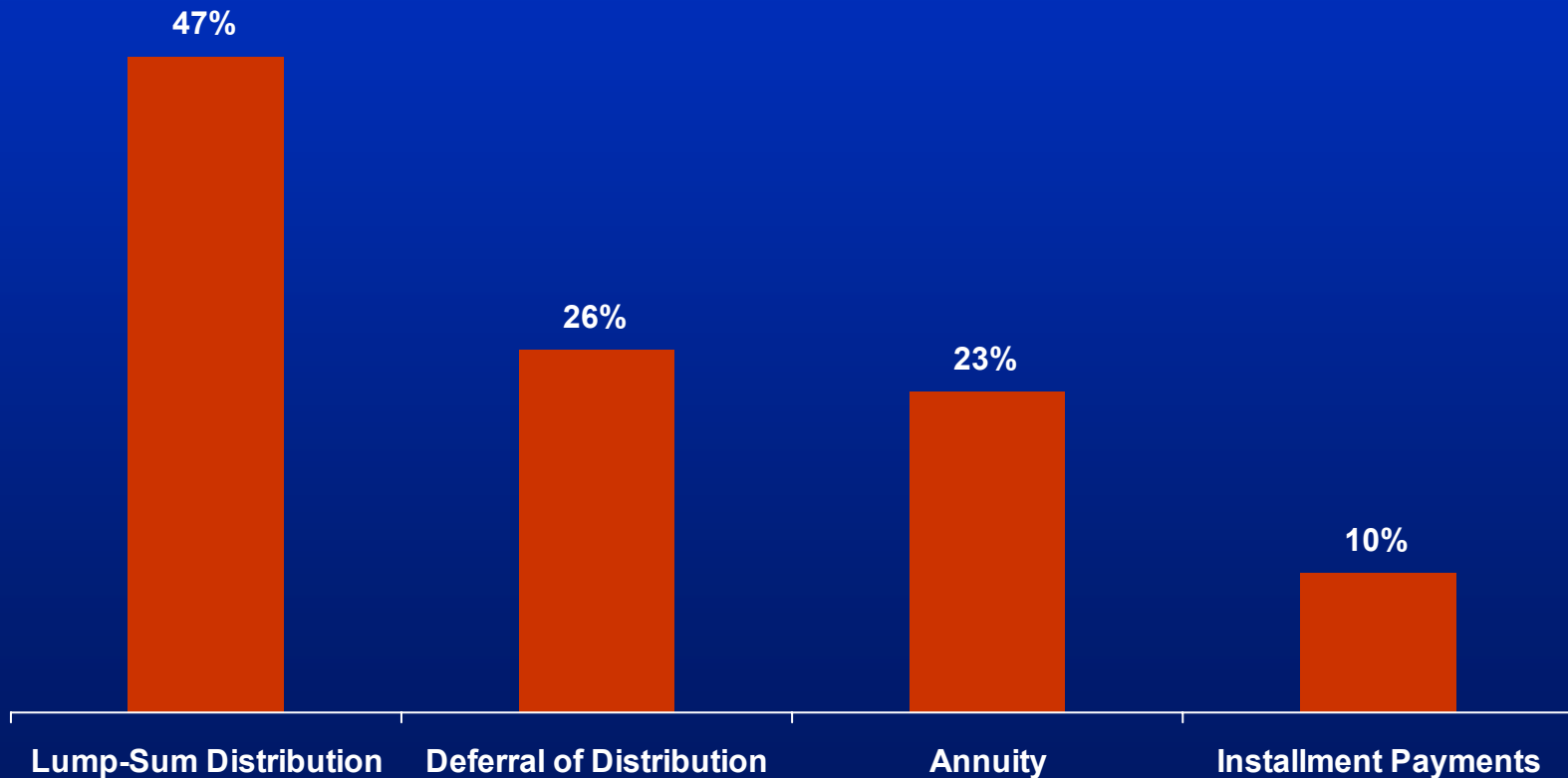
Workers' Behavior at Job Change— Rollover of Entire Balance

(percent of workers receiving lump-sum distributions)



Defined Contribution Plan Distribution Decision at Retirement

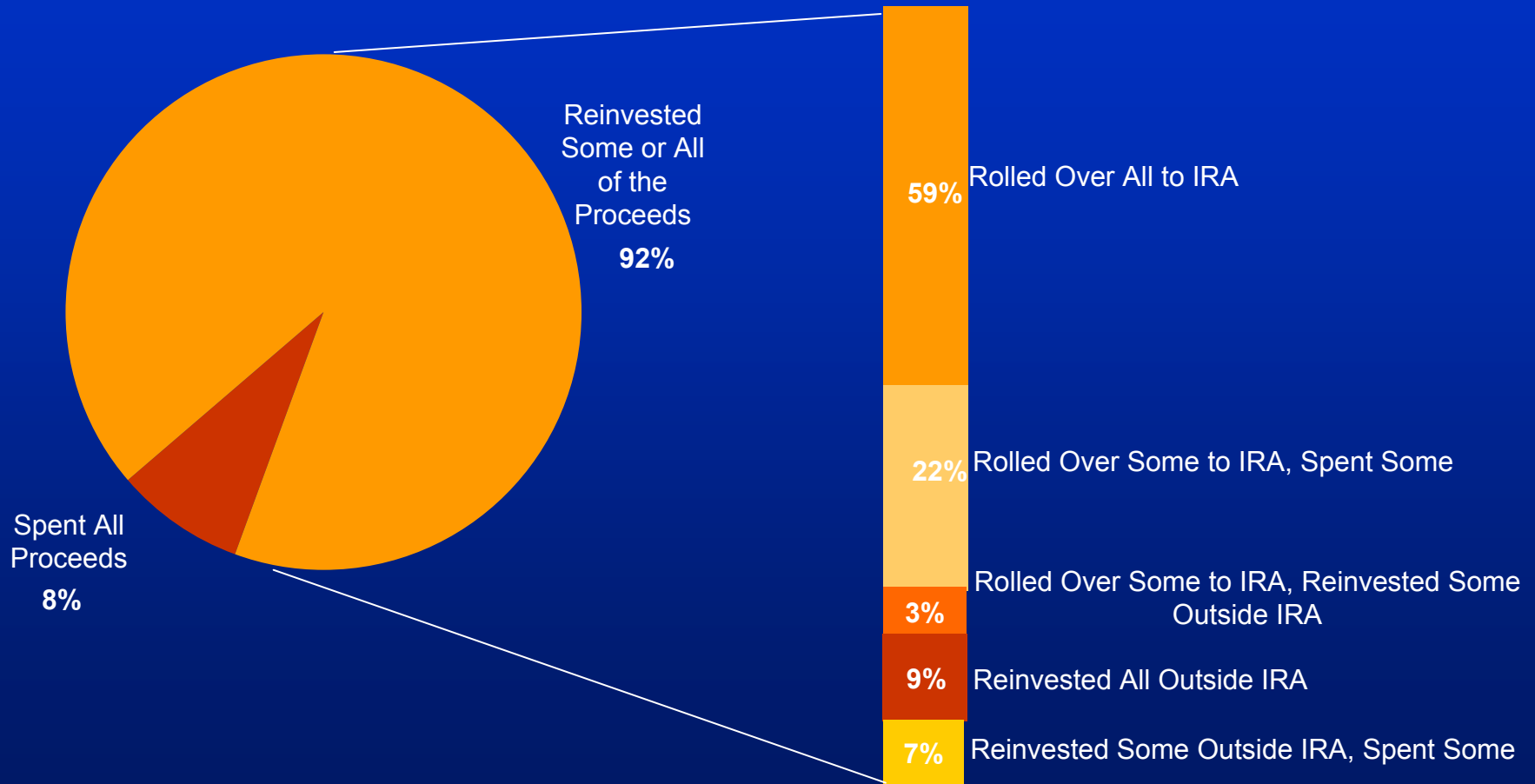
Distribution Options Selected at Retirement by Retirees Having More than One Option
(percent of respondents who had multiple options—multiple responses)



Note: Individuals retired from a defined contribution plan between 1995 and 2000. Data as of May 2000.

Source: Investment Company Institute, "Financial Decisions at Retirement," *ICI Fundamentals*, November 2000.

Bulk of Lump-Sum Distributions at Retirement Are Rolled Over



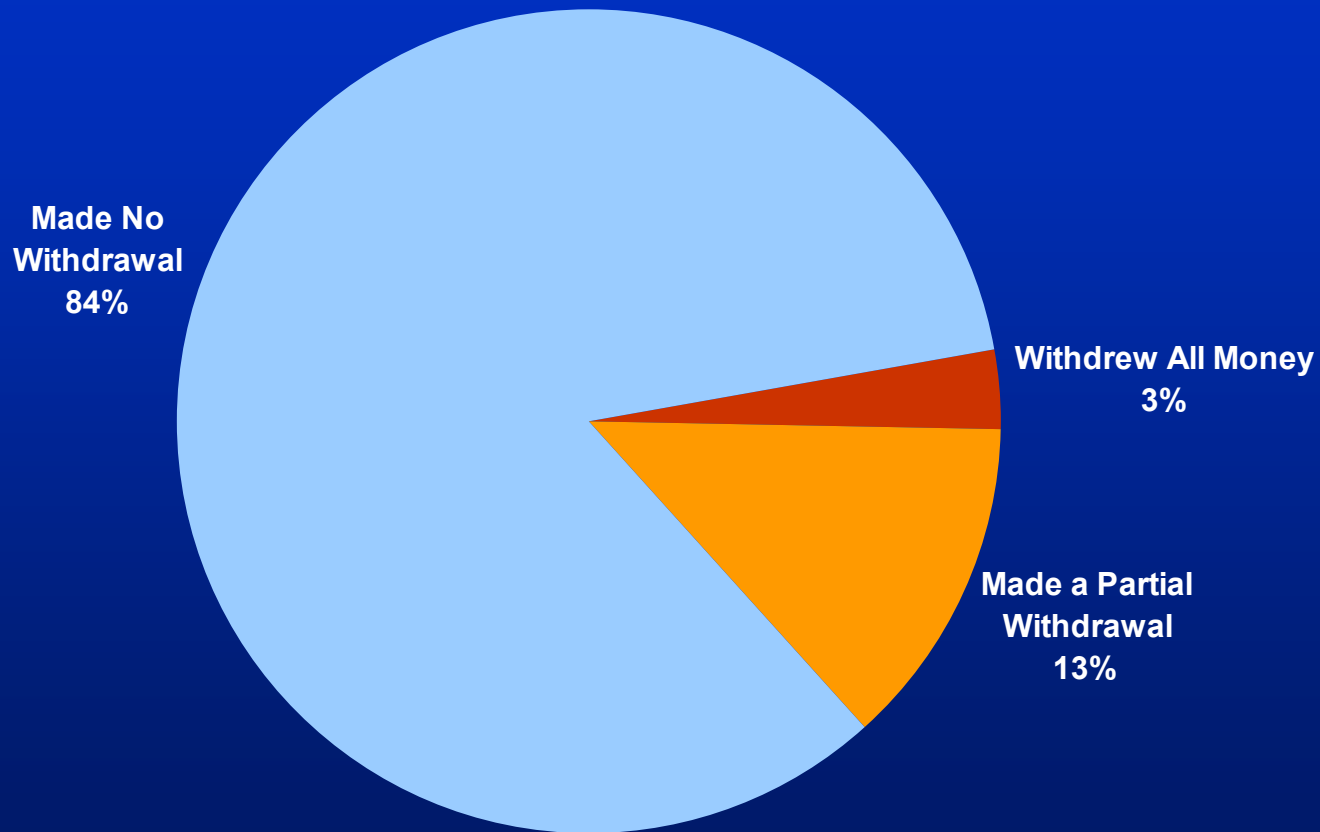
Preservation of Retirement Savings in IRAs

- In 2004, about 40 percent of U.S. households owned IRAs
- IRAs are important complements to employer-sponsored plans
 - In 2004, 46 percent of households owning traditional IRAs had rollover assets in their traditional IRAs
- IRAs do not allow loans
- Withdrawals from IRAs are permitted, but may be subject to penalty

Sources: Investment Company Institute, "IRA Ownership in 2004," *ICI Fundamentals*, February 2005 and U.S. Internal Revenue Service, "Individual Retirement Arrangements (IRAs)," *Publication 590*.

Few Households with IRAs Take Withdrawals

(percent of households with traditional IRAs)

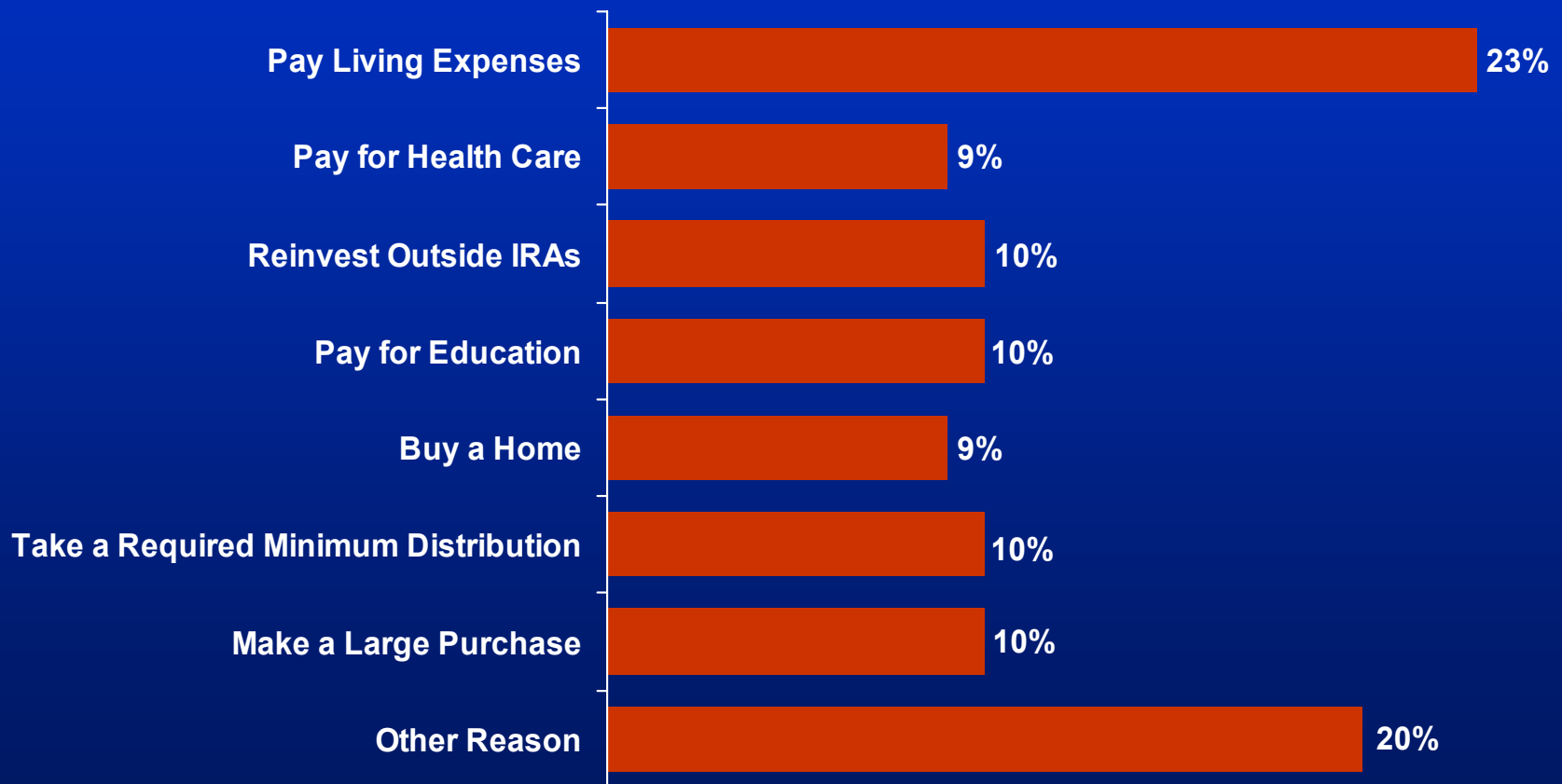


Note: Withdrawal activity in any given year on average between 1999 and 2003.

Source: Holden et al., "The Individual Retirement Account at Age 30: A Retrospective," *ICI Perspective*, February 2005.

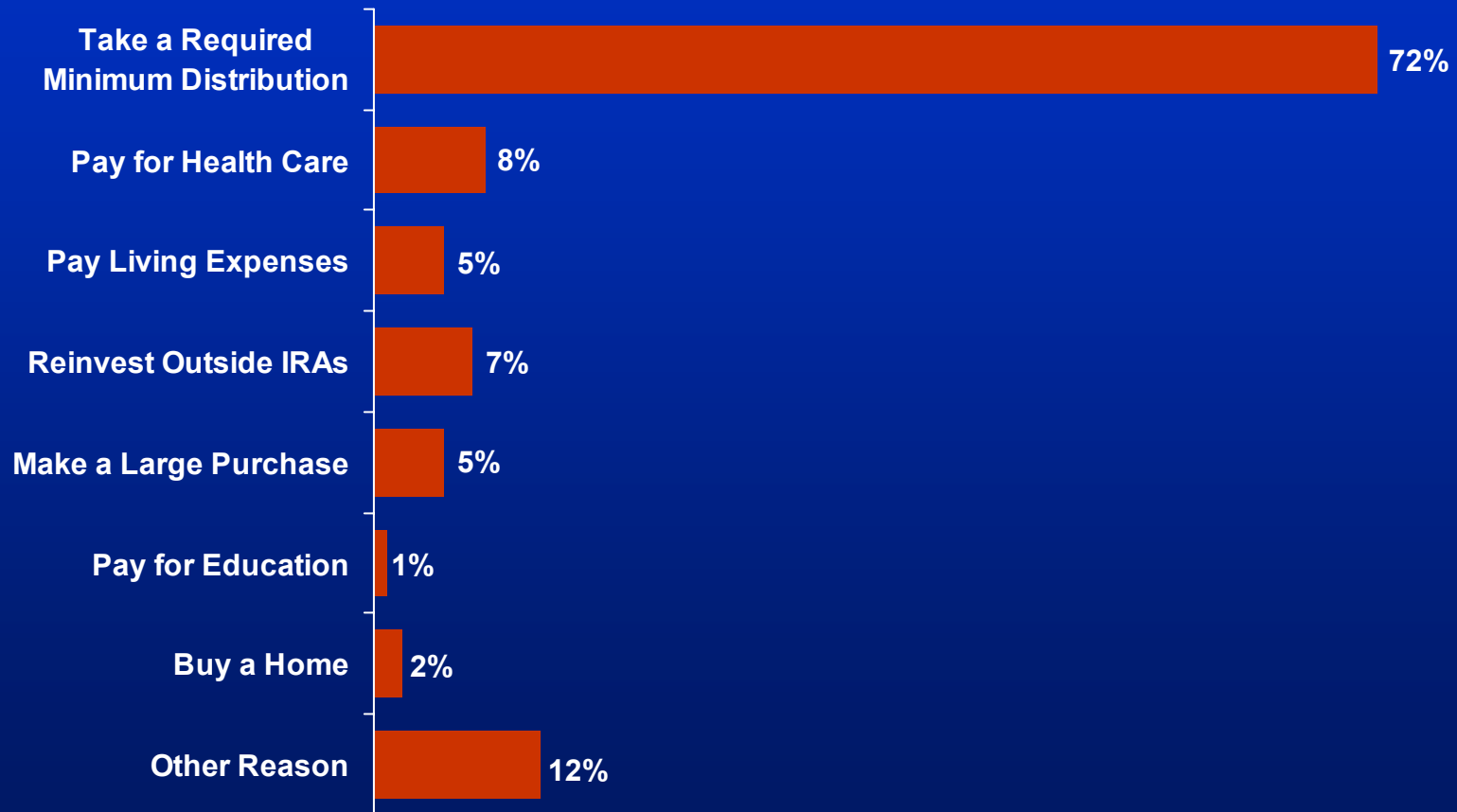
Reasons for IRA Withdrawals When Under Age 59

(percent of households taking traditional IRA withdrawals—multiple responses)



Reasons for IRA Withdrawals When Age 70 or Older

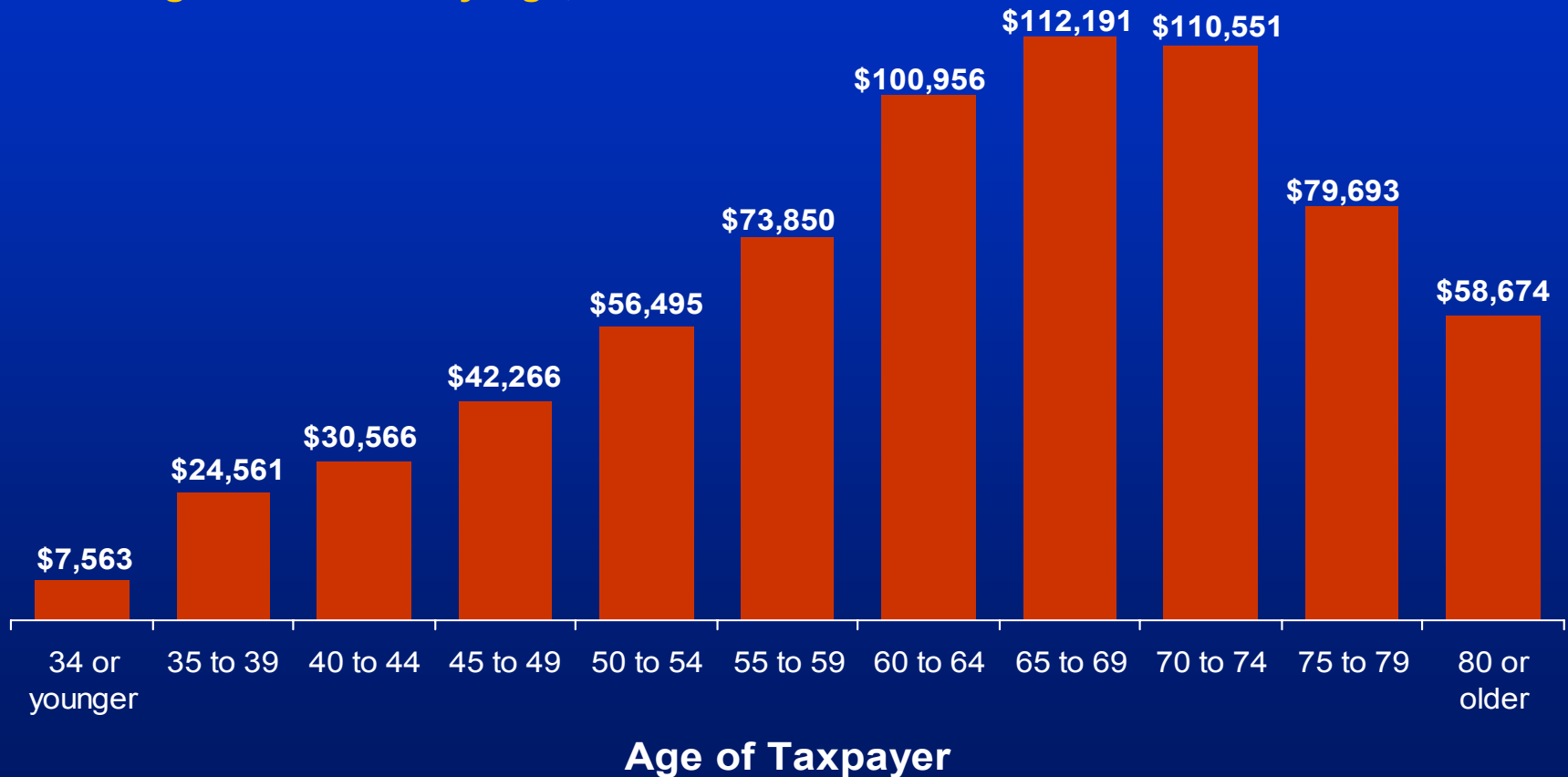
(percent of households taking traditional IRA withdrawals—multiple responses)



Source: Holden et al., "The Individual Retirement Account at Age 30: A Retrospective," *ICI Perspective*, February 2005.

Asset Life-Cycle: Accumulation to Distribution

Average IRA Assets by Age, Year-End 2000



Source: Sailer and Nutter, "Accumulation and Distribution of Individual Retirement Arrangements, 2000," IRS Statistics of Income Division, *SOI Bulletin*, Spring 2004.

Conclusions

- Policy Implications
 - Flexibility Facilitates Saving
 - Simplicity Facilitates Saving
 - Safeguards—Penalties Help Preserve Savings
- U.S. Retirement Planning Has Many Components
- Numerous Opportunities to Save for Retirement Over a Career
- Empirical Research
 - Options/Actions at Job Change
 - Distribution Decisions at Retirement
 - Role of IRAs/IRA Withdrawals

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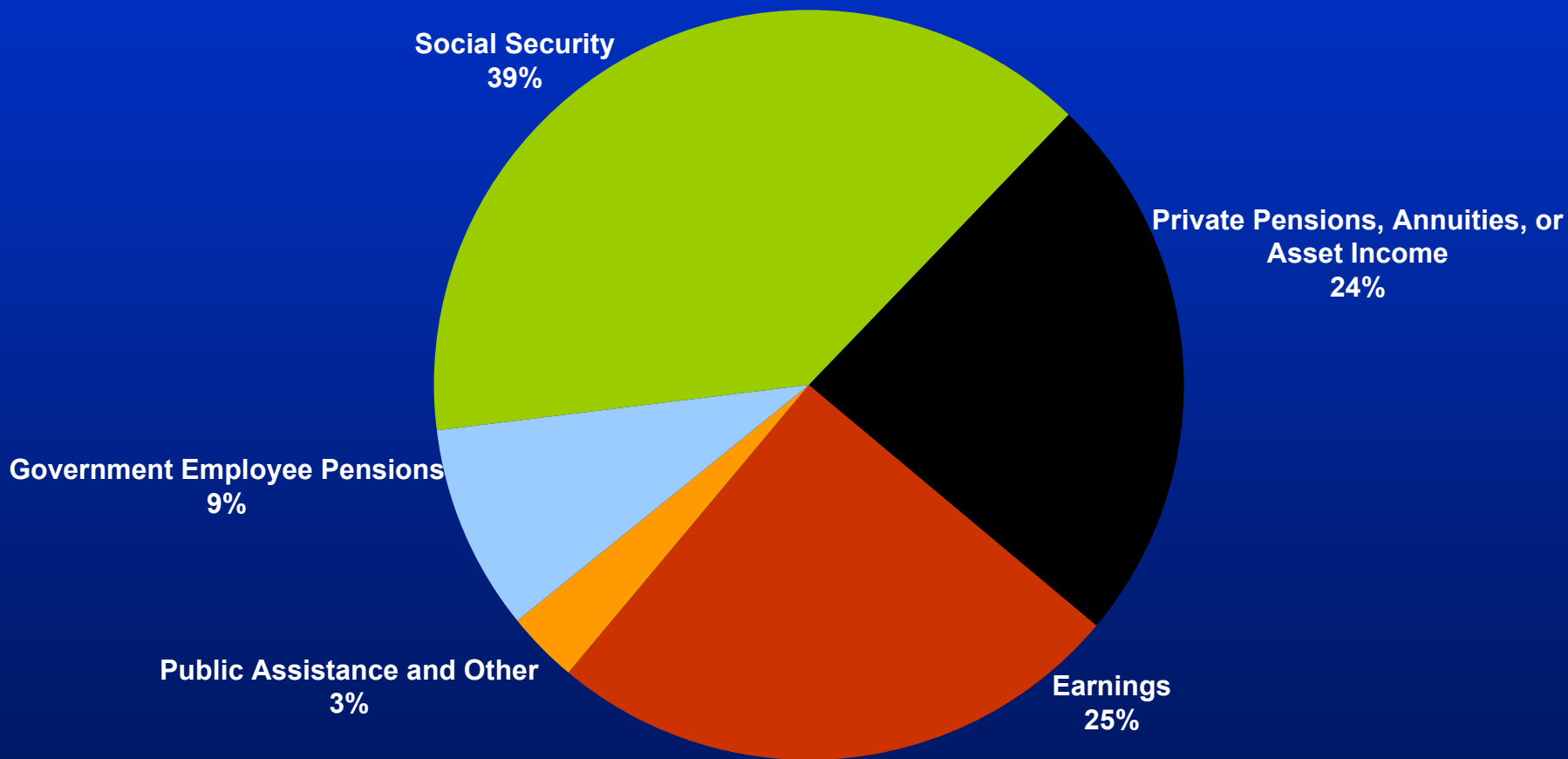
<http://www.irs.gov/pub/irs-pdf/p590.pdf>

Appendix

- Multiple Sources of Retirement Income
- Rollover Activity at Job Change
- Traditional IRA Withdrawal Rules
- 401(k) Participants and Loan Activity
- 401(k) Participants and Hardship Withdrawals

Multiple Sources of Retirement Income

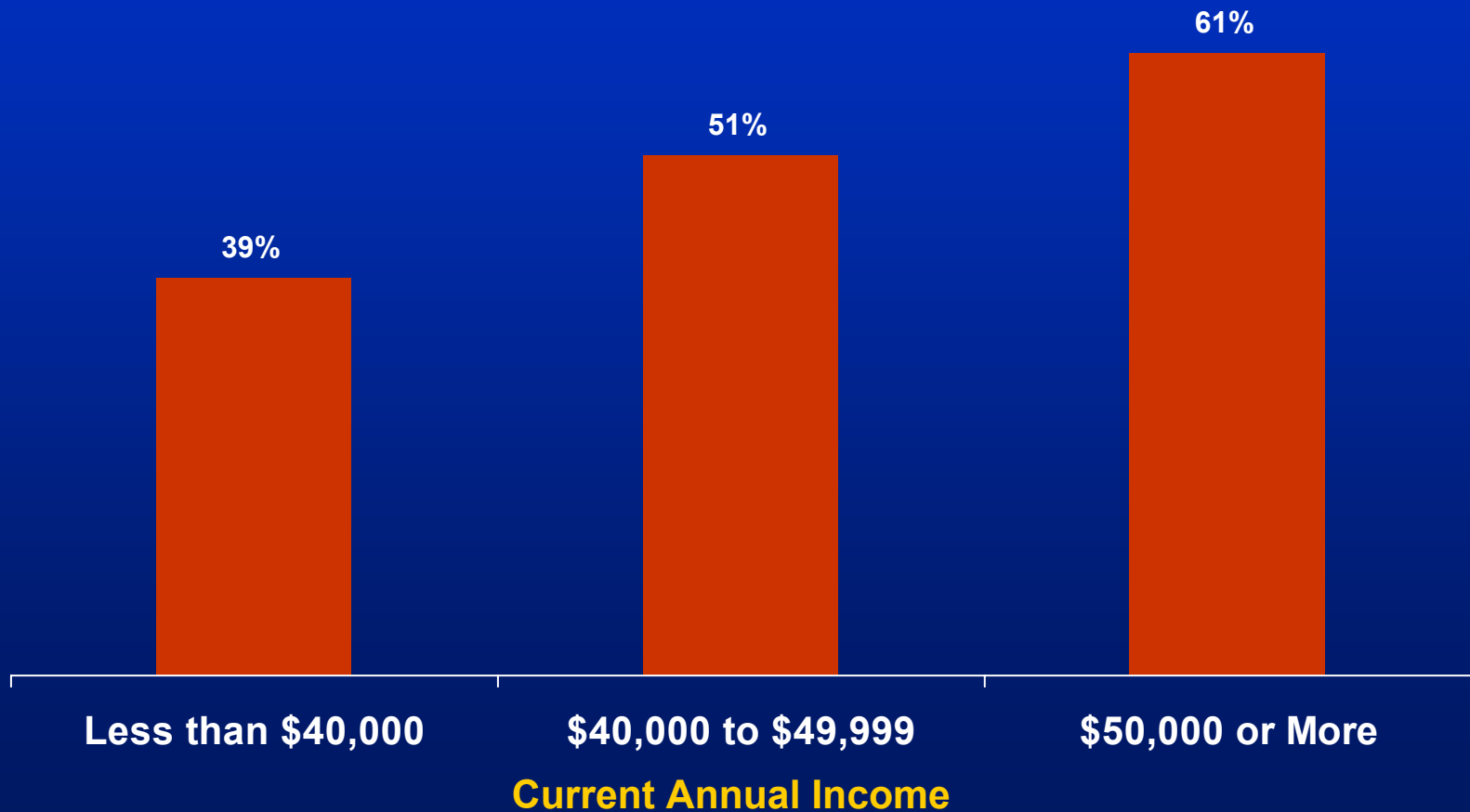
(percent of income of individuals age 65 or older)



Source: Social Security Administration, *Income of the Population 55 or Older*, 2002.

Workers' Behavior at Job Change— Rollover of Entire Balance

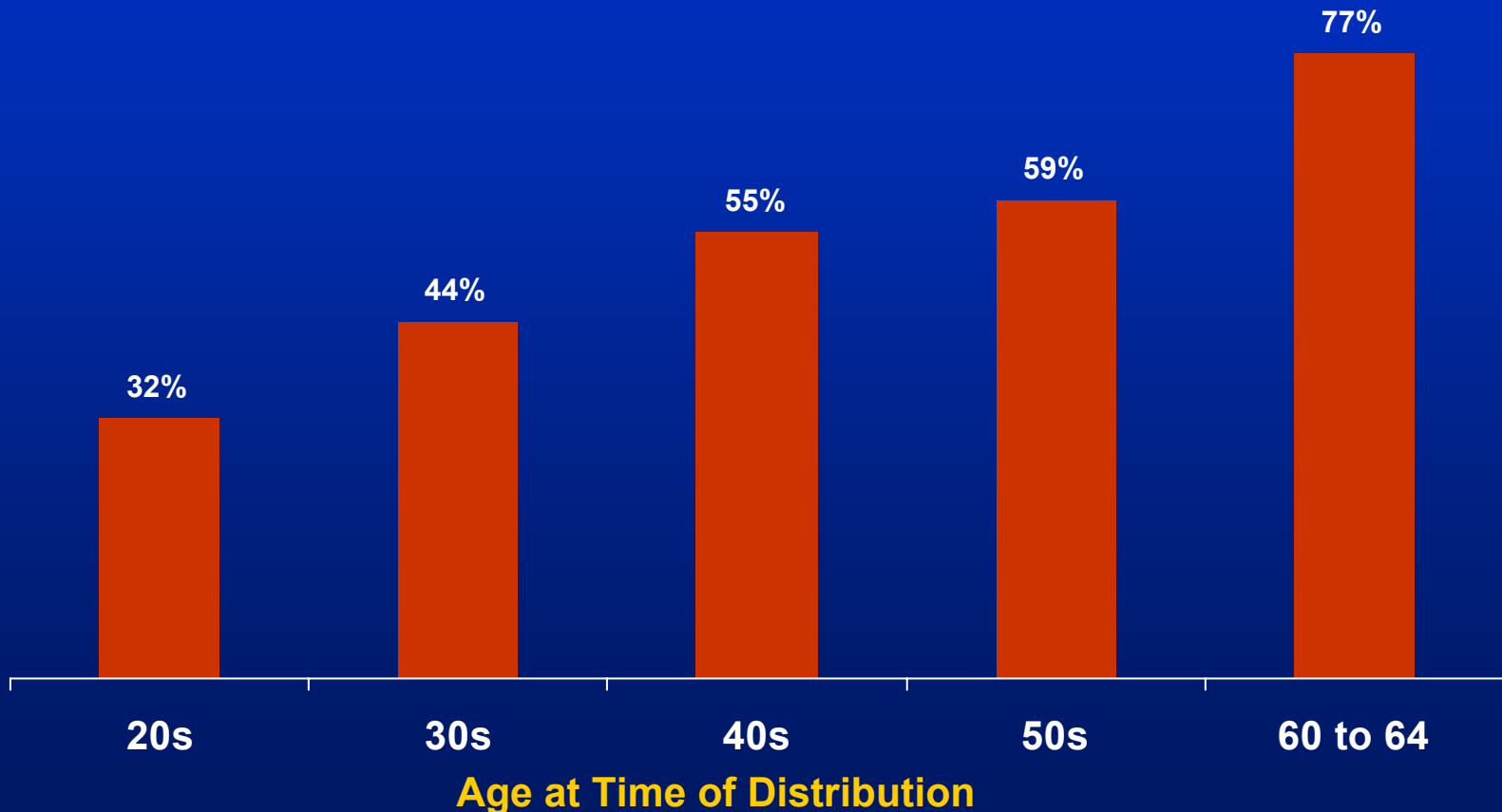
(percent of workers receiving lump-sum distributions)



Source: ICI Tabulations of Survey of Income and Program Participation (SIPP) 2001 Panel, Pension Module; Data for 2003.

Workers' Behavior at Job Change— Rollover of Entire Balance

(percent of workers receiving lump-sum distributions)



Source: ICI Tabulations of Survey of Income and Program Participation (SIPP) 2001 Panel, Pension Module; Data for 2003.

Withdrawal Rules for Traditional IRAs

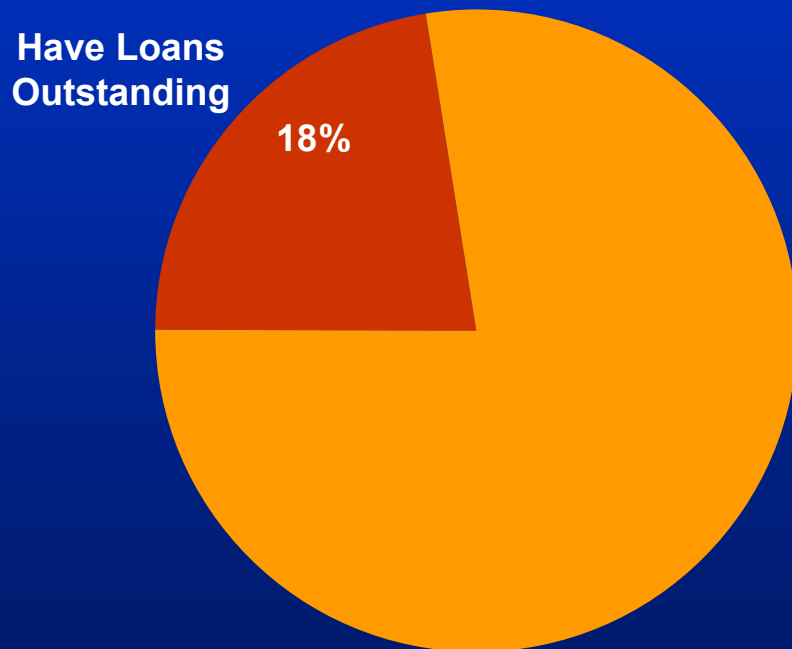
- All withdrawals/distributions may be subject to income tax
- Premature withdrawals prior to age 59½ generally have a 10 percent penalty unless
 - Received in substantially equal periodic payments
 - Used for first-time home purchase (up to \$10,000)
 - Used for qualified education expenses
 - Used for qualified medical expenses/health insurance
 - IRA owner is disabled (or has died)
- Withdrawals are required after taxpayer reaches age 70½ or pay penalty (50 percent) for failing to withdraw the required minimum distribution

Source: See U.S. Internal Revenue Service, "Individual Retirement Arrangements (IRAs)," *Publication 590* for details.

401(k) Plan Participants and Loan Activity

- EBRI/ICI and other research has shown offering a loan provision increases participant contributions to the 401(k) plan.
- Other research has shown offering a loan provision increases participation in the 401(k) plan.
- Use EBRI/ICI data to analyze 401(k) participant loan activity.

Loans are Widely Available...But Rarely Taken

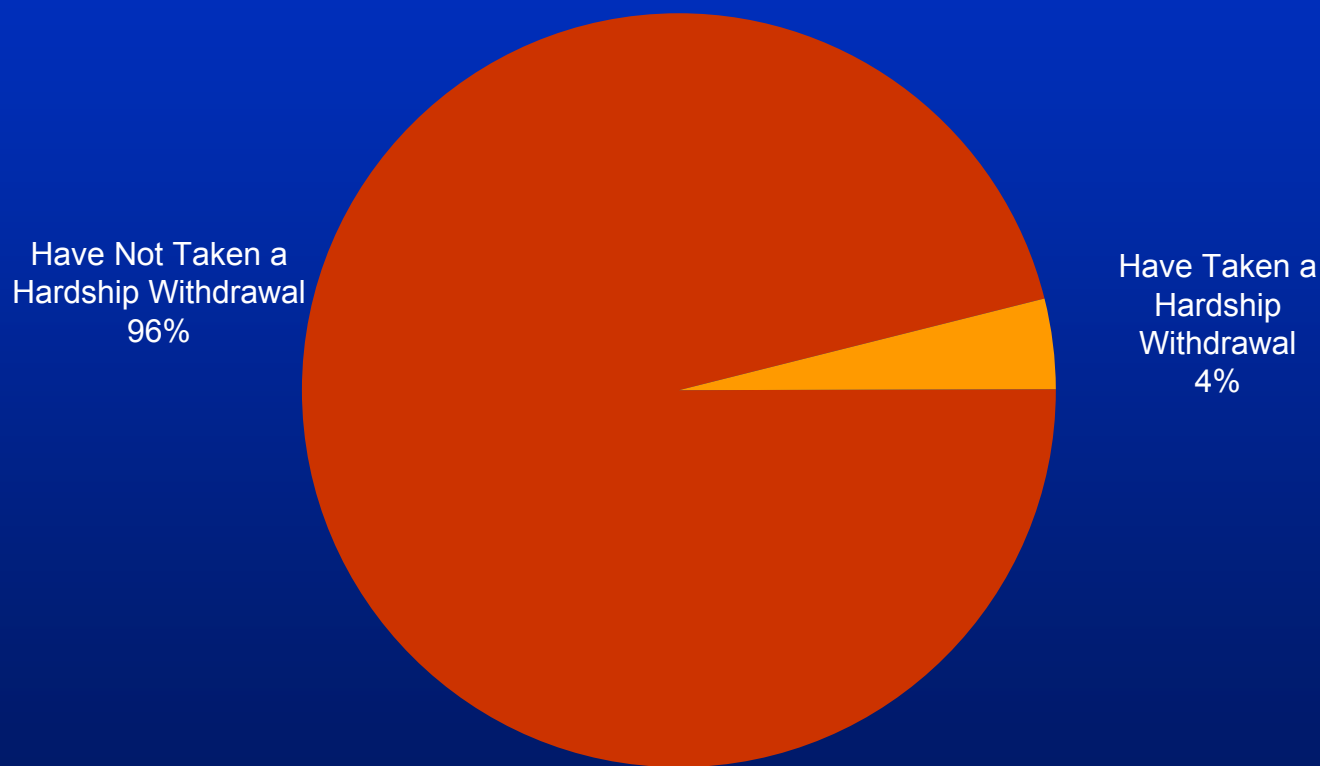


401(k) Participants in Plans Offering Loans

- Among 401(k) participants with loans, on average, the level of the unpaid balance represented 13 percent of the account balance (net of the unpaid loan balance) at year-end 2003.

Few 401(k) Participants Take Hardship Withdrawals

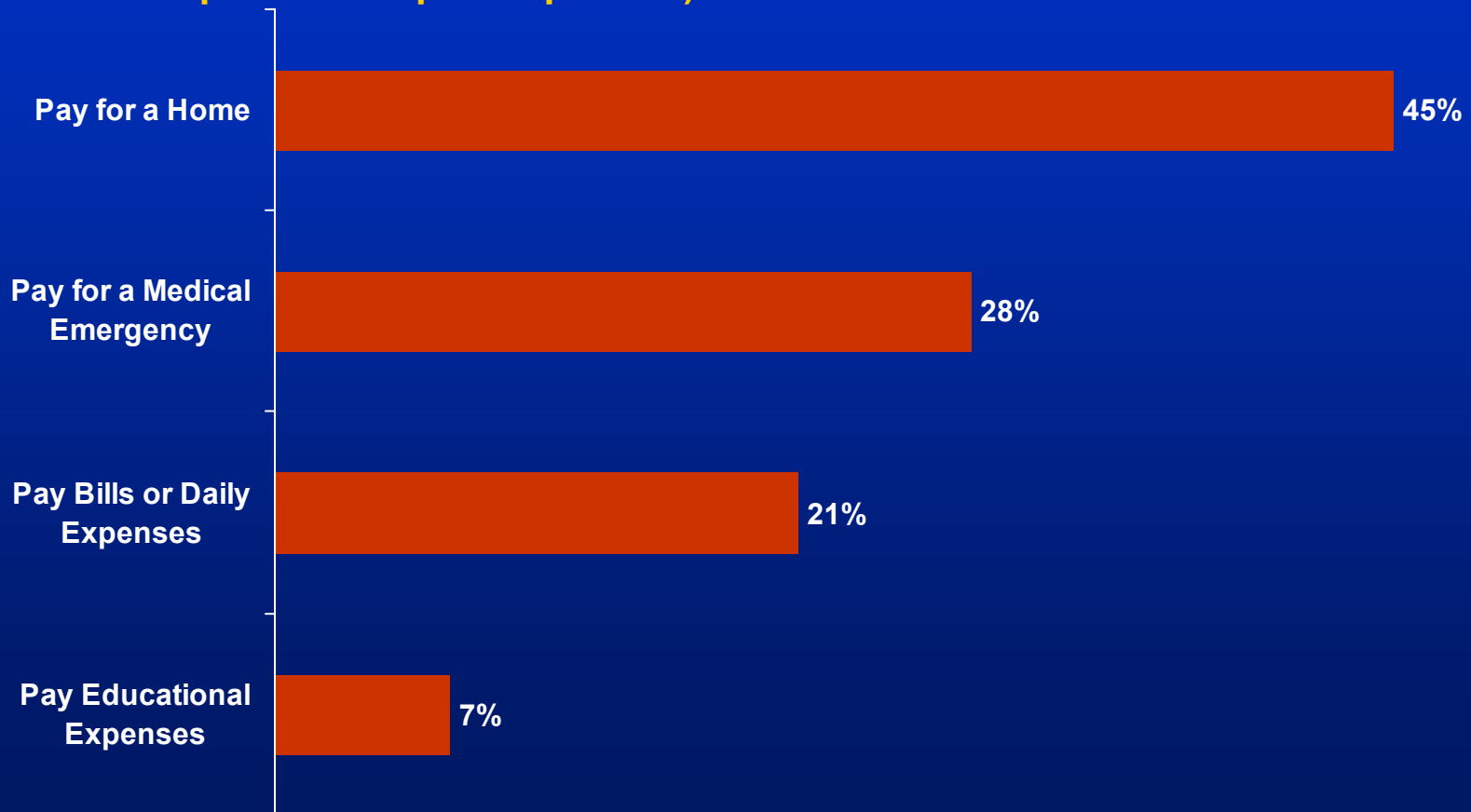
(percent of 401(k) participants whose plans allow hardship withdrawals)



Source: Investment Company Institute, "401(k) Plan Participants: Characteristics, Contributions, and Account Activity," *ICI Research Series*, Spring 2000.

Reasons for 401(k) Hardship Withdrawals

(percent of 401(k) plan participants who have taken a hardship withdrawal from current plan—multiple responses)



Source: Investment Company Institute, "401(k) Plan Participants: Characteristics, Contributions, and Account Activity," *ICI Research Series*, Spring 2000.

