Statement for the

House Ways and Means Committee
Select Revenue Measures Subcommittee

The Role of Individual Retirement Accounts (IRAs) in the U.S. Retirement System

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IRAs in the American Retirement System

By Dallas Salisbury, EBRI

Chairman Neal and members of the Subcommittee on Select Revenue Measures, thank you for your invitation to testify today on the role of individual retirement accounts, or IRAs, in our retirement system. I am Dallas Salisbury, president and CEO of the Employee Benefit Research Institute.

Since beginning our work in 1978, the Employee Benefit Research Institute has published 317 *EBRI Issue Briefs*.® The very first was on the subject of "Universal IRAs and Deductible Employee Contributions." Since that time we have published data on IRAs on an ongoing basis. Chapter 15 of the *EBRI Databook on Employee Benefits* is on IRA participation and Chapter 16 is on *IRA Assets.*[1]

Twenty-three percent of workers ages 21–64 owned an IRA at the end of 2005, an increase from 15.9 percent in 1996.[2] We know IRA ownership increases with family income and age: Among workers with annual family income of $10,000–$19,999, 8.3 percent owned an IRA, compared to 35.1 percent of those with family income above $75,000. We also know education is a more striking indicator: 2.7 percent of those without a high school diploma have an IRA, compared to 46.5 percent of those with a graduate degree.

IRAs have become the largest single vehicle for retirement assets in the United States. Assets have continuously grown in IRAs as a function of new contributions (about $49 billion in the most recent year for which data are available), but the asset growth is mostly due to rollover distributions from both employment-based defined benefit (pension) and defined contribution retirement plans such as 401(k)s (more than $210 billion, according to the latest data).[3] As a result, total IRA assets now exceed the assets in private-sector employment-based defined contribution plans: IRA assets reached $4.75 trillion at year-end 2007, compared with $3.49 trillion in private-sector defined contribution plans.[4] The Internal Revenue Service (IRS) reports that 7.9 million taxpayers age 65 or older withdrew money from an IRA in 2004, amounting to $76.8 billion.[5]

Since IRAs have been increasingly important to Americans' retirement security, EBRI has focused a lot of its research on IRAs. For a 2001 NASI conference, EBRI simulated the projected increase in the IRAs importance in retirement wealth.[6] At that time, we estimated an increase from 28 percent of retirement wealth for males born in 1936 to 40 percent for males born in 1964. Females were estimated to have an increase from 18 percent to 32 percent for the same birth cohorts. Since that time, the increased importance of 401(k) plans, and the likely plan design modifications that are likely to result from the passage of the Pension Protection Act (PPA) in 2006 will undoubtedly result in an even larger percentage of retirement wealth contained in IRAs.[7]

The values accumulated in IRAs would likely be even greater if all monies contributed and/or rolled over to these accounts were not available for pre-retirement withdrawals. Simulations from the EBRI/ICI 401(k) Accumulation Projection Model in 2002 showed that the income replacement rates that could be expected from a combination of 401(k) account balances and IRA rollovers that resulted from 401(k) contributions would increase between 11 and 18 percentage points (depending on salary level) if pre-retirement withdrawals were never taken from IRA balances[8].

At the request of this Committee, the General Accountability Office undertook a review of individual retirement accounts that was published this month. The staff of the Employee Benefit Research Institute was pleased to cooperate with the GAO in their research.

The GAO report does a good job of setting out the current data on IRAs.

The report also points out the lack of success in encouraging plan development among small employers due to lack of resources, unsteady revenues, and lack of knowledge and/or misconceptions in how plans operate.

Small employer surveys undertaken by EBRI in the past also pointed out the lack of employee demand for the retirement plans, where higher pay and/or health insurance was deemed to be more important in the view of employers.[9] EBRI Value of Benefits surveys over the past 25 years have consistently found that workers put health insurance first,[10] and our most recent EBRI Health Confidence Surveys have found that over a third of workers have reduced their retirement savings due to rising health care costs.[11] All of these trends affect plans with payroll deduction in general, and programs like non-employer-based IRAs (where automatic deductions have not been arranged).

The GAO has pointed out the lack of information on the use of payroll deduction IRAs (or those that allow a direct debit from a savings or checking account). GAO does not discuss this topic on IRAs, but the data is lacking regardless. This is another manner to get workers' dollars into an IRA before the individual can spend it.

The GAO report suggests tax credits to employers (on p. 29) to increase the adoption of payroll deduction IRAs. Congress will need to consider the fact that tax credits to employers for starting these plans have proven to be ineffective. The EBRI Small Employer Surveys found that small employers do not understand the tax laws surrounding plans.

EBRI Small Employer Surveys also have found overall opposition to proposals that small employers be required to set up arrangements with financial institutions. However, there is support among small employers for sending additional retirement contributions as part of their existing payroll tax deposits and letting the government deal with all of the administrative issues.

This suggests that proposals like those discussed in the GAO report for "automatic IRAs" for some segment of the population (most proposals would not apply to about 25 million workers in very small firms) would need to be carefully designed in order to prove successful. In fact, research conducted by EBRI on the administrative issues in individual Social Security accounts[12] suggests ways in which an "automatic IRA" could be made available to all workers, were accessibility and accumulation the primary objectives. It could be done with lower administrative expense and lower business burden than proposals that are more limited in their scope, but rely on payroll deduction. This is the case because of the significant portion of the workforce that is not paid through automated and linked payroll systems.

Working through our American Savings Education Council and our ChoosetoSave.org® programs, and based upon our 18 years of Retirement Confidence Surveys,® EBRI has found that individuals need to become convinced of the need to save for the future before they will (a) do it, and (b) preserve the funds upon job change. While $214.9 billion was rolled into IRAs in 2004, most workers that receive distributions of less than $20,000 do not roll over their entire distributions, and cash out at least some portion of their retirement savings.[13]

As GAO points out, there is a great deal we do not know about IRAs as a result of limited data reporting. Since 1995, EBRI has been working with the Investment Company Institute and administrative firms to build a large database on 401(k) plans that has begun to allow many questions to be answered about the role of those plans in our retirement system. This year we are starting to build a companion database of IRA data that will begin to fill many of the gaps in information identified by the GAO report.

As GAO notes, the IRS does collect a significant amount of IRA information. Were that information more widely available in a timely fashion, it would be of great assistance to both the public and the private sectors. For example, the Census Bureau's Current Population Survey reports that very few of those over age 55 and 65 report income from IRAs, Keoghs or 401(k) plans. Yet, the IRS tax records recorded $140 billion in payments out of IRAs alone in 2004. The Federal Reserve's Survey of Consumer Finance, and the HHS Health and Retirement Survey, also under-report income from these programs, when it is possible to compare individual self-response with "administrative" records like tax returns. A major issue for the nation revolves around the financial status of those near or in retirement, and the availability of IRS administrative records could make a significant contribution to policy-making. We hope that the IRA administrative records database being developed by EBRI will do so as well.

As the GAO report underlines, the primary role of IRAs in our retirement system today is to provide a tax-deferred account for the retirement assets of those who have left an employer-sponsored defined benefit (pension) or defined contribution (401(k)-type) plan. Rollovers amounted to $214.9 billion in 2004, compared to $48.7 billion in contributions.

The goal that ERISA set for IRAs in 1974 as a way for ***all of those outside of an employer based plan*** to save for retirement ***has not been realized***. This underlines the central role played by both Social Security and employer-sponsored plans in Americans' future retirement security.

I thank the Committee again for the invitation to testify.

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