ICI INVESTMENT COMPANY INSTITUTE®

RESEARCH PERSPECTIVE

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November 2009 Vol. 15, No. 3

The Evolving Role of IRAs in U.S. Retirement Planning

Key Findings

- **By any measure, individual retirement account (IRA) assets have grown dramatically.** Created by the Employee Retirement Income Security Act (ERISA) in 1974, IRAs have grown to account for 25.4 percent of U.S. retirement wealth and 8.5 percent of total U.S. household financial assets at year-end 2008.
- **A significant fraction (40.5 percent) of U.S. households owned some form of IRA at year-end 2008.** IRA ownership and account balances were widespread across many different socioeconomic dimensions, including age, income, and educational attainment. For example, more than half of IRA-owning households had incomes between $25,000 and $99,999.
- **Tax law changes in the early 1980s contributed to the IRA's growth in popularity.** Between 1982 and 1986, the traditional IRA was made "universal" when tax law changes started allowing all workers under age 70½ to make tax-deductible contributions, after which new contributions soared. However, the Tax Reform Act of 1986 placed income limits on tax-deductible contribution eligibility for those with access to an employer-sponsored retirement plan, leading to a decline in contribution rates.
- **Most of the money flowing into IRAs is through rollovers of lump-sum distributions from employer-sponsored retirement plans.** Rollovers from employer-sponsored retirement plans have increased for a few reasons. First, maximum allowable vesting periods have been shortened, so employees are now more likely to accrue benefits than they were three decades ago. Second, private-sector pensions have shifted from defined benefit (DB) plans toward defined contribution (DC) and cash-balance (CB) plans that usually pay accrued benefits as a lump sum when the employee separates. These trends are compounded by the fact that the U.S. economy has a relatively high rate of job turnover, and most of the lump sums distributed from retirement plans are rolled over into IRAs when employees change jobs or retire. This leads to a predictable rising pattern of IRA balances as a birth cohort ages.
- **Employer-sponsored IRAs (SEP, SAR-SEP, and SIMPLE), introduced at various points during the past three decades, are a relatively small but stable share of the total IRA market.** At year-end 2008, employer-sponsored IRAs accounted for 6.2 percent of all IRA assets.
- **Withdrawals from IRA accounts have grown dramatically over the past decade—both in dollar amounts and as a share of retiree income—as the earliest waves of IRA owners are entering their retirement years.** Withdrawals are still a very modest share of IRA assets, however, because IRA assets have grown even more rapidly and many current retirees indicate they only take out the government-mandated required minimum distribution (RMD).
- **Although IRAs—and the employer-sponsored plans in which much of the IRA funds were originally accumulated—are an important source of income for retirees, that fact is not captured in many household survey-based estimates of retiree income.** This discrepancy occurs for two reasons: (1) IRA withdrawals tend to be greatly under-reported on household surveys because of the way most income questions are posed, and (2) relative to traditional pensions where a stream of annuity income generally begins immediately at retirement, IRAs only lead to measured income when withdrawals are actually made.

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IRAs Are a Rapidly Growing Share of Household Wealth

Individual retirement accounts (IRAs) became a feature of the U.S. tax code when Congress passed the Employee Retirement Income Security Act (ERISA) in 1974. IRAs were initially a fairly small component of retirement saving, but subsequent changes in law and the evolution of employer-provided retirement plans have elevated the importance of IRAs for many U.S. households. Many workers now find themselves at the end of their careers with significant resources through contributions or rollovers into IRAs, and the management of those resources is a key to retirement economic security.

IRA assets have grown rapidly in both absolute and relative terms. Only $25 billion in 1980, aggregate IRA assets grew to $4,736 billion by the end of 2007 (Figure 1).[1] Although the decline in equity prices after October 2007 had a large impact on IRA balances, aggregate IRA assets were still $3,572 billion at the end of 2008. In relative terms, IRAs accounted for only 2.5 percent of U.S. retirement assets and 0.4 percent of total household financial assets in 1980 (Figure 2). By the end of 2007, the IRA share of retirement assets had grown to 26.3 percent, and the IRA share of total household financial assets had grown to 9.3 percent. The stock market downturn after October 2007 decreased the IRA share only slightly; at year-end 2008, IRAs represented 25.4 percent of U.S. retirement assets and 8.5 percent of total household financial assets. The drop was less pronounced than in the aggregate dollar values because retirement and other financial wealth outside of IRAs also declined in value.

IRA Owners Represent a Wide Swath of the U.S. Population

Both direct contributions and rollovers from employer-sponsored retirement plans have led to widespread ownership of IRAs. Unlike many other categories of wealth ownership—such as direct equity holdings—total IRA assets were not highly concentrated among the very wealthiest of families, and a significant fraction (40.5 percent) of U.S. households owned some form of IRA.[2] IRA ownership and account balances were widespread across many different socioeconomic dimensions, including age, income, and educational attainment.[3]

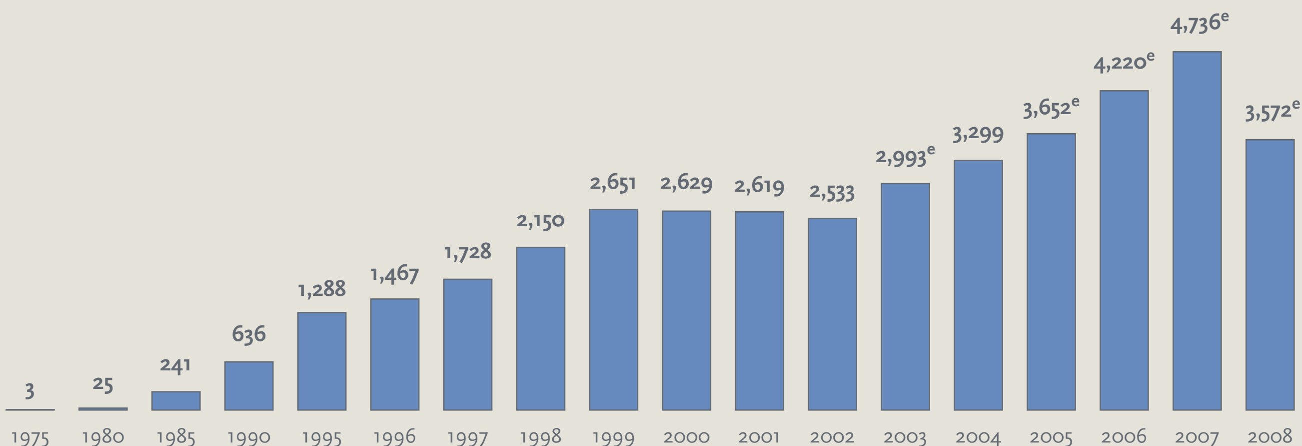
Characteristics of U.S. Households Owning IRAs

The characteristics of U.S. households owning IRAs have remained relatively stable over time. Exploring ICI household survey results between 2000 and 2008, almost two-thirds of individuals heading IRA-owning households were between the ages of 35 and 64 (Figure 3). About 30 percent of these IRA-owning household heads had at

Figure 1

Total IRA Assets

Billions of dollars, year-end, selected years

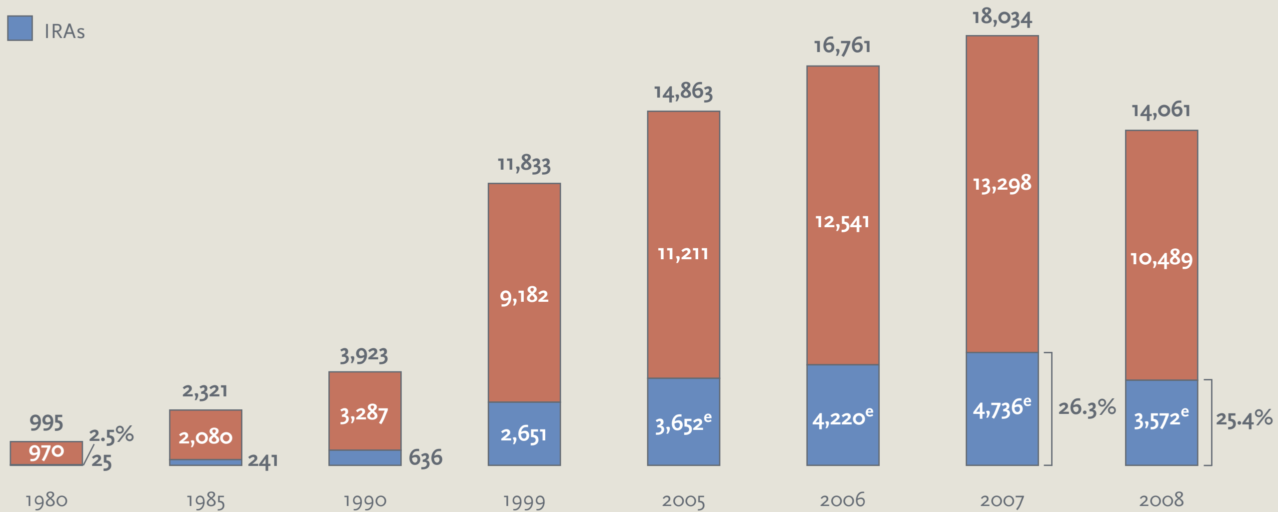


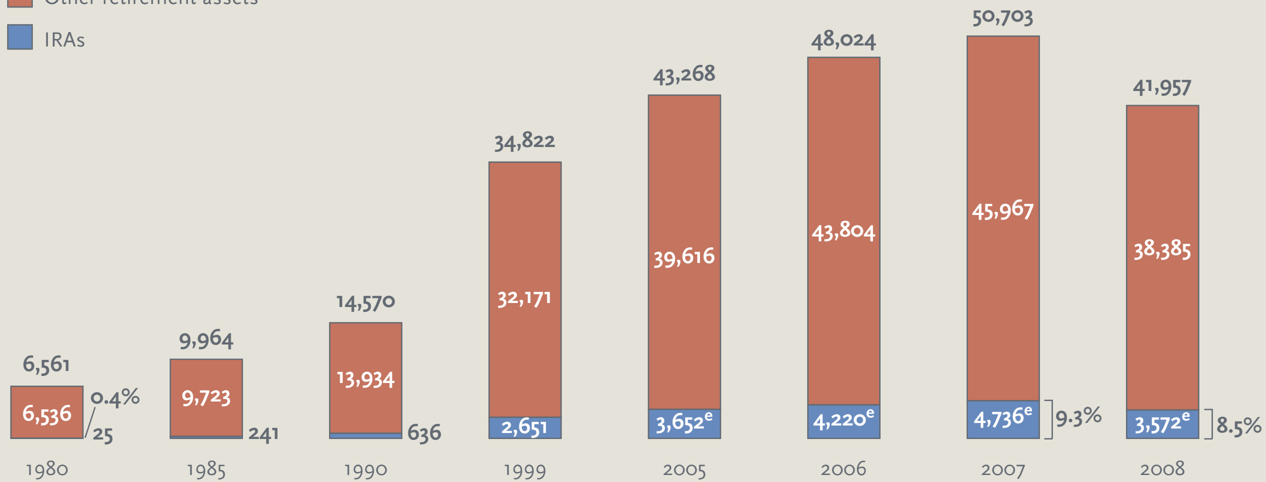
e Data are estimated.
Note: Total IRA assets include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).
Note: See Figure A1 in the appendix for additional data on total IRA assets.
Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

FIGURE 2

IRA Assets Represent a Growing Share of Retirement Assets and Household Financial Assets

Billions of dollars, year-end, selected years





[1] Retirement assets include IRAs, annuities, and employer-sponsored DB and DC plans.

[2] Household financial assets include deposits, fixed-income securities, stocks, retirement savings, mutual funds, equity in noncorporate business, and other financial assets. Financial assets of nonprofit organizations are also included. Household financial assets do not include the household's primary residence.

[e] Data are estimated.

Note: See Figure A1 in the appendix for additional data on IRAs as a percentage of retirement assets and household financial assets.

Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

most a high school diploma, while more than 40 percent had completed four years of college or more. The vast majority of these individuals were married or living with a partner and employed full- or part-time. Between 2000 and 2008, less than 30 percent of individuals heading IRA-owning households were retired from their lifetime occupations.

At $77,900, the median household income of IRA-owning households has remained nearly the same in real terms since 2000 (Figure 3). For all years, more than half of IRA-owning households had incomes between $25,000 and $99,999. The median household financial assets of IRA-owning households had risen slightly in real terms from $189,500 in 2000 to $200,000 in 2008 (Figure 4). In addition, median IRA assets of these households had risen from $25,300 in 2000 to $40,000 in 2008.

The Source of Growth in Traditional IRAs Has Changed

The source of growth in IRAs has changed over time because of changes in tax law and because of the evolving employer-sponsored retirement plan system. Initially, IRAs were seldom used because deductible contributions were limited to individuals not covered by an employer-sponsored retirement plan. The Economic Recovery Tax Act (ERTA) of 1981 allowed tax-deductible contributions regardless of whether or not the individual had access to an employer-provided retirement plan, after which new contributions soared (Figure 5).[4]

Subsequent changes in tax law limited contributions to IRAs. The Tax Reform Act of 1986 (TRA 1986) placed income limits on tax-deductible contributions for those with access to an employer-sponsored retirement plan,

Figure 3

IRA Owners Are Typically Middle-Aged, Married, and Employed

Percentage of U.S. households owning IRAs,[1] selected years

Age of head of household	2000	2004	2008
Younger than 35	16	16	15
35 to 44	24	22	19
45 to 54	25	25	24
55 to 64	18	18	21
65 or older	17	19	21
Median	48 years	48 years	51 years
Household income[2, 3]			
Less than $25,000	9	8	9
$25,000 to $49,999	20	21	19
$50,000 to $99,999	35	33	36
$100,000 or more	36	38	36
Median[3]	$77,500	$76,100	$77,900
Head of household education			
No high school diploma	6	5	5
High school diploma	25	27	24
Some college or associate's degree	28	25	28
Four-year college degree or more	41	43	43
Other characteristics			
Married or living with a partner	72	72	73
Employed full- or part-time	72	71	72
Retired from lifetime occupation	24	26	28

[1]IRAs include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).
[2]Total reported is household income before taxes in the year prior to the survey year.
[3]Dollar amounts have been adjusted to 2008 dollars using the "current methods" version of the consumer price index for all urban consumers (CPI-U-RS).
Source: Investment Company Institute IRA Owners Survey

Figure 4

Financial Characteristics of IRA Owners

Percentage of U.S. households owning IRAs,[1] selected years

Household financial assets[2, 3]	2000	2004	2008
Less than $50,000	25	22	18
$50,000 to $99,999	12	10	12
$100,000 to $249,999	19	25	22
$250,000 to $499,999	22	19	21
$500,000 or more	22	24	27
Median[2]	$189,500	$229,200	$200,000
Household financial assets in IRAs[1, 2]			
Less than $50,000	64	63	55
$50,000 to $99,999	14	17	14
$100,000 to $249,999	13	14	18
$250,000 to $499,999	4	4	7
$500,000 or more	5	2	6
Median[2]	$25,300	$28,600	$40,000
Share of household financial assets in IRAs (median)	22%	21%	29%
Household retirement plan coverage			
Household has DC account or DB plan coverage (total)	76	75	78
DC retirement plan account[4]	66	68	69
DB plan coverage[5]	48	44	40

[1] IRAs include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).

[2] Dollar amounts have been adjusted to 2008 dollars using the "current methods" version of the consumer price index for all urban consumers (CPI-U-RS).

[3] Household financial assets include assets in employer-sponsored retirement plans but exclude the household's primary residence.

[4] DC retirement plan accounts include 401(k); 403(b); and state, local, or federal plan accounts. The account(s) may be held at current or previous employers.

[5] For years 2000 and 2004, DB plan coverage includes households where any household member was covered by a DB retirement plan at work. In 2008, DB coverage includes households where any household member was receiving or expecting to receive regular income from a DB plan.

Source: Investment Company Institute IRA Owners Survey

and new contributions fell dramatically (Figure 5). In 1997, Congress increased these income eligibility limits for tax-deductible IRA contributions—which had not been raised since 1986—and also created Roth IRAs. Eligibility to contribute to a Roth IRA is based on income and filing status, and those income limits are higher than for traditional deductible IRA contributions. Thus, for individuals with access to an employer-provided retirement plan, the income limits for Roth contributions are now higher than the income limits for traditional IRAs.[5]

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001 raised contribution limits—which had not been raised since 1981—and introduced additional "catch-up" contributions for individuals aged 50 or older. Even with this recent loosening of limits on IRA contributions, contributions to traditional IRAs (in nominal terms) are still below their pre-1986 levels. Both the continued presence of income restrictions and the wider availability of employer-sponsored retirement savings plans—contributory defined contribution (DC)

and employer-sponsored IRAs—have likely contributed to the persistently lower contributions to traditional IRAs. Also, the availability of Roth IRAs may have also reduced contributions to traditional IRAs.

Although new contributions to traditional IRAs have been only a modest source of growth in recent years, increased access to accrued benefits in the form of lump-sum payments from employer-sponsored retirement plans has taken over and fueled rapid growth in traditional IRAs. The most common disposition of accumulated DC plan balances distributed to the employee at job separation or retirement is to roll the funds directly into a traditional IRA.[6] The aggregate data on rollovers from all types of retirement plans are derived from IRS information on returns, and thus they lag somewhat. The evidence suggests, however, that rollovers dwarf new contributions as a source of growth and nearly doubled between 1996 and 2004 (Figure 6).[7]

Trends in Employer-Sponsored Retirement Plans Have Fueled IRA Growth

Influencing Trends on IRA Ownership

The widespread ownership of IRAs across U.S. households is strongly associated with the role that IRAs play as a repository for retirement wealth accumulated in employer-sponsored retirement plans. Given the connection between employer plans and IRAs, the increased importance of IRAs has been influenced by trends in the U.S. labor market generally and trends in retirement coverage more specifically. These trends include the aging of the workforce, the shortening of vesting periods in retirement plans, and the increased availability of lump-sum distributions at job separation and retirement. The importance of these trends for IRA accumulation is compounded by the high rate of job turnover that is a characteristic of the dynamic U.S. labor market.

Figure 5

Rules Affect Traditional IRA Deductible Contributions*

Selected years

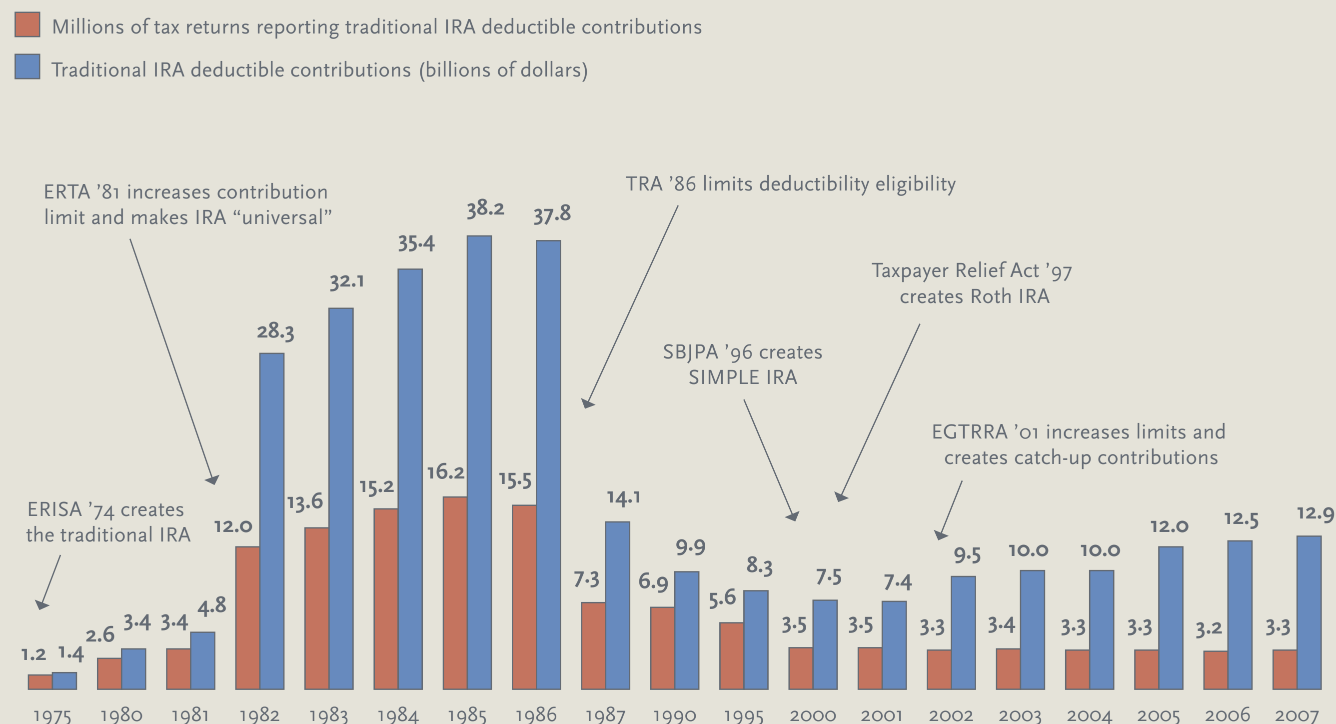


*Figure reports deductible IRA contributions reported on individual income tax returns (Form 1040).

Sources: Internal Revenue Service Statistics of Income Division, Individual Income Tax Returns, Publication 1304, *various years; Internal Revenue Service,* SOI Bulletin, *various issues; and summary of legislative changes*

ICI's IRA Owners Survey

Data in this report on the demographic and financial characteristics of IRA owners are derived from ICI's IRA Owners Survey. The May 2008 survey was based on a sample of 800 representative U.S. households owning traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs). The standard error for the total sample is ±3.5 percentage points at the 95 percent confidence level. IRA ownership does not include ownership of Coverdell Education Savings Accounts (formerly called Education IRAs).

For more information on the survey, see Holden and Schrass 2009.

Demographic trends: Retirement saving generally increases with age, so demographics imply that overall IRA ownership and IRA balances have been increasing in absolute terms. As the Baby Boom generation has aged, the proportion of the U.S. population in their peak retirement savings years has increased, elevating the importance of all types of retirement savings for the population as a whole. However, changes in employer-sponsored retirement plans have also helped increase the prominence of IRAs relative to other types of retirement saving.

Vesting trends: Over time, statutory changes have reduced the maximum allowable vesting period in employer-sponsored retirement plans.[8] For example, the maximum vesting period for "cliff" vesting—where the employee is not vested at all during the period and is 100 percent vested after the period—was restricted to 10 years in 1974, and reduced again to five years in 1986.[9] Although the same rules apply to both DB pension plans and DC retirement plans, special rules were introduced in 2001, restricting the maximum allowable cliff vesting period to three years for matching contributions to a 401(k) plan.[10] Shorter vesting periods mean that individuals changing jobs are more likely to have accumulated assets that could be rolled into an IRA.[11]

Figure 6

Rollovers Generate a Significant Portion of Flows into Traditional IRAs

Billions of dollars, 1996–2008

	Contributions[1]	Rollovers[2]	Withdrawals[3]	Total assets[4] (year-end)
1996	$14.1	$114.0	$45.5	N/A
1997	15.0	121.5	55.2	$1,642[e]
1998	11.9	160.0	74.1	1,974
1999	10.3	199.9	87.1	2,423
2000	10.0	225.6	99.0	2,407
2001	9.2	187.8	94.3	2,395
2002	12.4	204.4	88.2	2,322
2003	12.3[e]	205.0[e]	88.3	2,719[e]
2004	12.6	214.9	101.7	2,957
2005	N/A	N/A	112.3	3,259[e]
2006	N/A	N/A	124.7	3,749[e]
2007	N/A	N/A	148.0	4,197[e]
2008	N/A	N/A	N/A	3,183[e]

[1] Contributions include both deductible and nondeductible contributions to traditional IRAs.
[2] Rollovers are primarily from employer-sponsored retirement plans.
[3] Withdrawals consist of taxable IRA distributions reported on IRS Form 1040, which have been primarily from traditional IRAs.
[4] Total assets are the fair market value of assets at year-end.
[e] Data are estimated.
N/A = not available
Sources: Investment Company Institute and Internal Revenue Service Statistics of Income Division

Employer-sponsored retirement plan trends: In addition to trends in vesting, changes in the types of retirement plans that employers offer have also played a role in fueling IRA growth through increased rollovers. These trends include the shift from DB to DC, and—within the universe of DB plans—a move away from traditional DB plans toward cash balance (CB) plans.

Employer-sponsored retirement plan coverage across all earnings groups has been fairly stable over the past several decades (Figure 7).[12] However, the type of retirement plans being offered by private-sector employers has trended toward DC plans. For example, in 1989, among those full-time workers with pension coverage through their current employer, 65.1 percent had DB plans, while 56.2 percent had DC plans (Figure 8).[13] The two percentages sum to more than 100 percent because a significant fraction (21.4 percent) had both DB and DC coverage. By 2007, the percentage of covered full-time workers with DB plans had fallen to 36.1 percent, while the percentage with DC plans had risen to 81.0 percent. As in 1989, a significant minority of full-time workers in 2007 (17.1 percent) had both types of coverage through their employers.[14]

The Survey of Consumer Finances

The Survey of Consumer Finances (SCF) is a triennial survey of U.S. households sponsored by the Board of Governors of the Federal Reserve System. The most recent survey was conducted between May and December of 2007 and included interviews with 4,422 households. The SCF collects detailed information about the household balance sheet, income, pension coverage, labor force participation, and demographic characteristics of U.S. households.

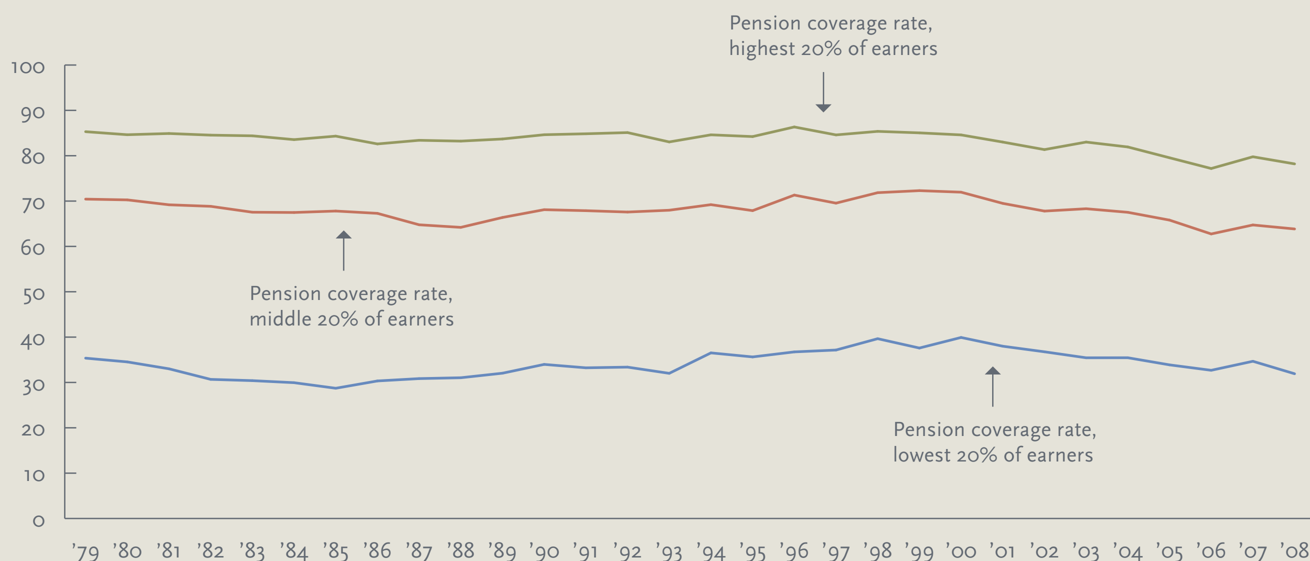
The SCF data are available at www.federalreserve.gov/pubs/oss/oss2/scfindex.html.

The trend from DB to DC plans has likely led to increased rollovers into IRAs for a few reasons. The growth in DC plans was largely driven by 401(k) plans, which allow employees to make voluntary contributions to the plan and often involve employer matching contributions. In a 401(k), employee contributions vest immediately, and the vesting period currently allowed by law for employer contributions is shorter than for other types of retirement plans. Thus,

Figure 7

Pension Coverage Has Been Steady Across Income Groups

Percentage of full-time workers[1] aged 21 to 64 by income[2] quintile, 1979–2008



[1] Pension coverage is for full-time private-sector and government workers who have worked more than 25 weeks during the year indicated (which is the year prior to the survey year).
[2] Income is wage and salary income in year indicated (which is the year prior to the survey year).
Source: ICI tabulations of the Current Population Survey, 1980–2009

ICI's Annual Mutual Fund Shareholder Tracking Survey

ICI conducts the Annual Mutual Fund Shareholder Tracking Survey each spring to gather information on the demographic and financial characteristics of households in the United States. The May 2008 survey was based on a sample of 4,100 U.S. households selected by random digit dialing. All interviews were conducted over the telephone with the member of the household who was the sole or co-decisionmaker most knowledgeable about the household's savings and investments.

For more information about the survey, see Holden, Bogdan, and Bass 2008.

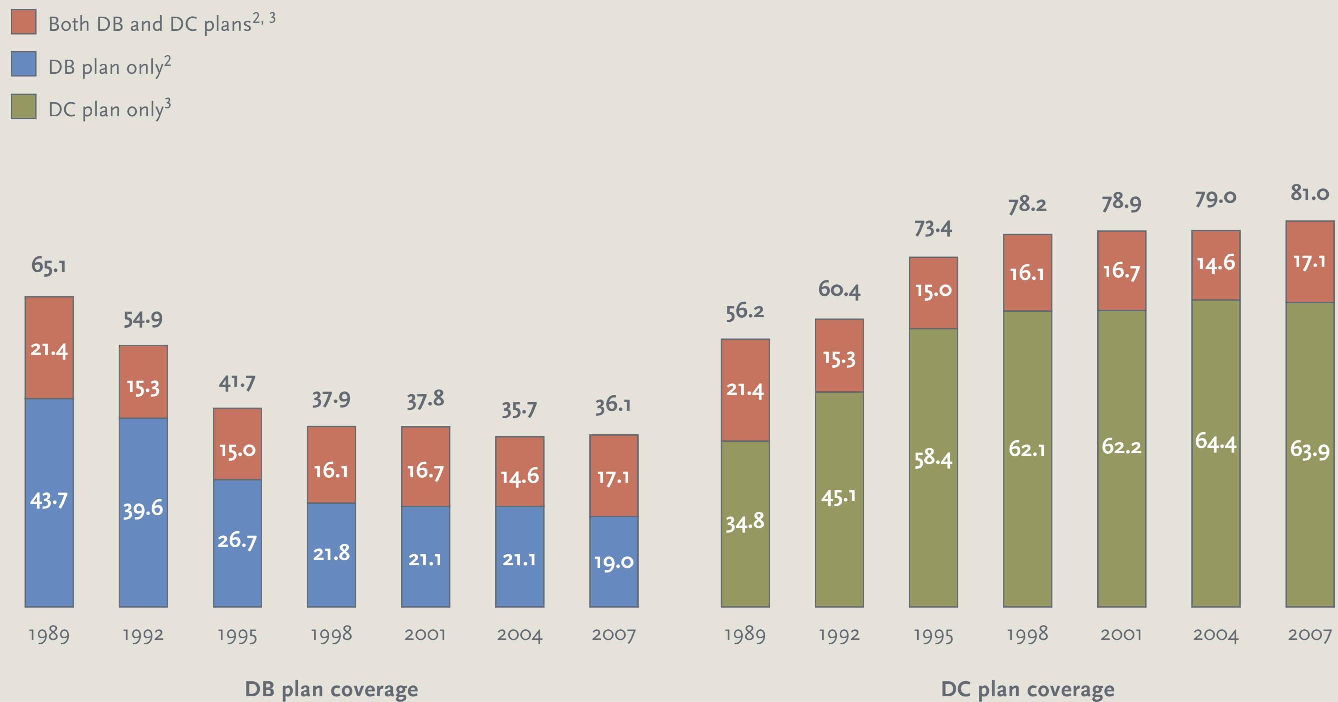
even short-tenured workers with a 401(k) plan are likely to have assets available to roll into an IRA at job separation or retirement. Finally, as noted earlier, most lump-sum distributions from DC plans are rolled over into IRAs.

Other trends in employer-sponsored retirement plans have added to the increase in rollovers to IRAs. For example, traditional DB pensions were much more likely to offer a lump-sum distribution in 2005 than they were in 1997.[15] There has also been a shift within the DB system toward cash balance (CB) plans that probably increased the prevalence of lump-sum distributions. In 2006, 26 percent of active private-sector DB plan participants were in CB plans, which generally define an employee's benefits by reference to a hypothetical "account" balance and offer a lump-sum distribution of that account balance, similar to a DC plan.[16]

Figure 8

Coverage Has Been Shifting from Defined Benefit to Defined Contribution Plans

Percentage of covered, full-time workers with a DB or DC plan at their current job,[1] 1989–2007



[1] Coverage is for full-time private-sector and government workers who have worked more than 25 weeks during the year.
[2] DB plan coverage includes individuals with traditional DB plans at their current jobs.
[3] DC plan coverage includes individuals with account-based retirement plans at their current jobs.
Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances, 1989–2007

Job turnover trends: The other key characteristic of the U.S. economy that directly affects IRA ownership is a high rate of job turnover. Although typical employee tenure with their current employer rises predictably with age, about half of people near the end of their careers (people aged 55 to 64 and 65 or older) as of 2008 have worked for their current employer for 10 or fewer years (Figure 9).[17] Low tenure is the flip side of high rates of job turnover, and high turnover is associated with distributions from employer-sponsored retirement plans to traditional IRAs.[18] In addition, mobility of the American workforce has increased slightly over time, as evidenced by the modest decline in median tenure over the past 25 years. This trend reinforces the importance of IRAs as a destination for rollovers of employer-sponsored retirement plan accumulations.

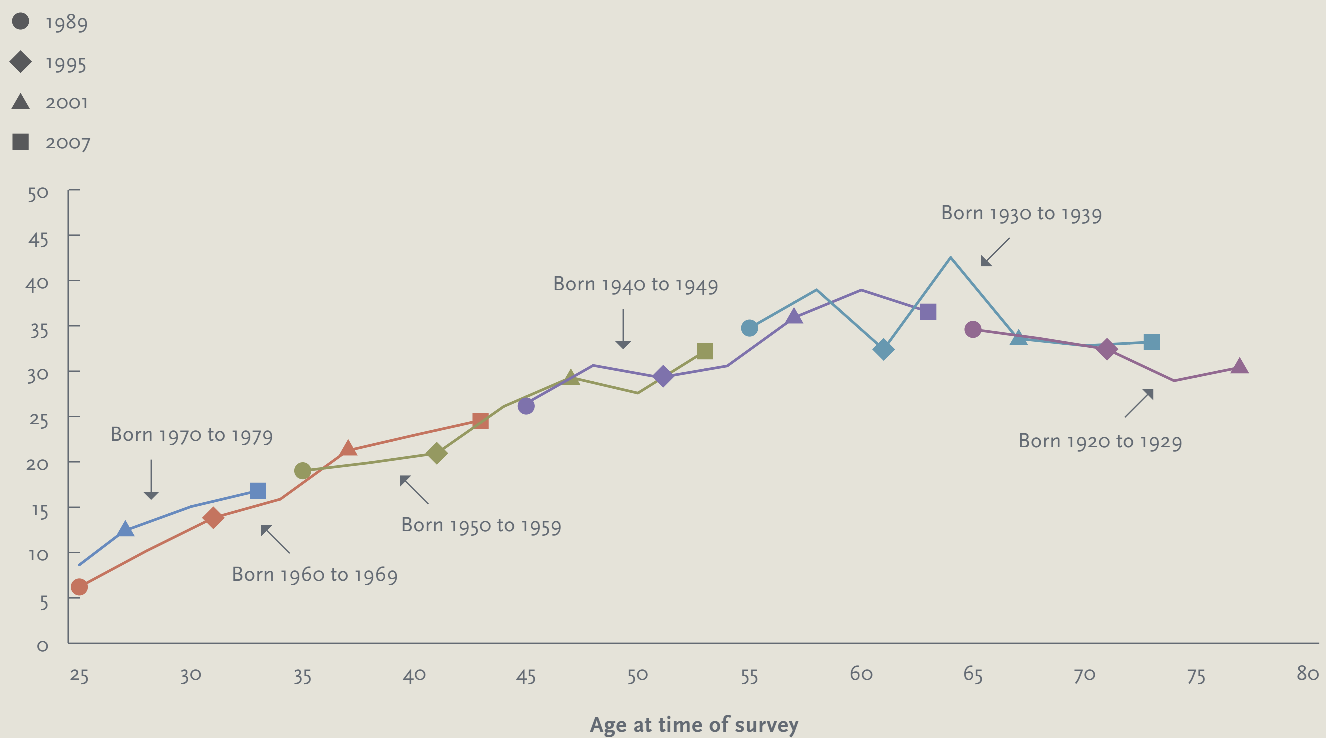
Trends Lead to Predictable Patterns of IRA Participation

Trends in employer-sponsored retirement plan coverage and high rates of job turnover have led to a predictable and stable pattern of IRA participation and accumulation across cohorts and time. As people enter the full-time labor force (generally in their twenties), some begin to contribute to IRAs directly, but even more become exposed to the cycle of employer-sponsored retirement plan accumulation, job transition, and lump-sum rollovers to IRAs that leads to an increasing fraction of IRA owners as each cohort ages (Figure 10).[19] The available cohort-level data (1989 through 2007) show that the oldest cohort tracked over time (born between 1920 and 1929) had fairly low rates of IRA ownership when they entered retirement because they were less likely to have been exposed to

Figure 10

IRA Ownership by 10-Year Birth Cohorts

Ownership of IRAs; percentage of individuals by 10-year birth cohorts, 1989–2007*



**IRAs include traditional or Roth IRAs or both.*
Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances, 1989–2007

IRAs or lump-sum distributions from employer-sponsored plans.[20] Younger cohorts are much more likely—during their prime working and saving years—to have been exposed to some combination of the universal IRA deductibility period (1981 to 1986) and the secular trend toward lump-sum distributions from employer-sponsored retirement plans.

For example, the cohort born between 1950 and 1959, which entered the workforce concurrently with the spread of DC plans, saw an increase in IRA ownership from 19 percent when they were (on average) 35 years old in 1989 to 32 percent when they were (on average) 53 years old in 2007 (Figure 10). The next youngest cohort, born between 1960 and 1969, saw an increase in IRA ownership from 6 percent when they were (on average) 25 years old in 1989 to 24 percent when they were (on average) 43 years old in 2007. The fact that the ownership rates for these two cohorts lie on top of each other during the ages for which they overlap indicates that the younger cohort is basically following the same life-cycle pattern of IRA ownership, which makes sense because the two groups have been exposed to basically the same employer-sponsored retirement plan and regulatory environment.

The powerful correlation between rollovers from employer-sponsored retirement plans and IRA balances is evident when one considers IRA balances in the same cohort-by-age framework used to analyze ownership rates. Growth in median IRA balances (among IRA owners) rises with age and across cohort groups, with the steepest increases generally occurring around retirement age when lump-sum distributions from employer-sponsored retirement plans are most likely to occur (Figure 11). Median IRA balances generally grow with age, and the balances for successively younger cohorts (who have had higher earnings and are more likely to be in a retirement plan that pays benefits through a lump-sum distribution at any given age) lie above the older cohorts at the same age. The balances for the two cohorts who entered retirement

during the period covered by the SCF surveys—those born between 1940 and 1949 and between 1930 and 1939—show the steepest increases right around retirement age, between their late fifties and mid-sixties.[21]

Employer-Sponsored IRAs Are a Relatively Small and Stable Share of the Overall IRA Market

Although much of the growth in IRA ownership and aggregate IRA balances has been fueled by rollovers from employer-sponsored retirement plans, a noticeable and stable fraction has occurred directly through employer-sponsored IRAs. Employer-sponsored IRAs were created and modified by several acts of Congress, with the intent to make it easier for smaller firms to implement workplace saving.[22] The Revenue Act of 1978 created the Simplified Employee Pension (SEP) IRA; the Tax Reform Act of 1986 created the Salary Reduction SEP (SAR-SEP) IRA; and the Small Business Job Protection Act (SBJPA) of 1996 created the Savings Incentive Match Plan for Employees (SIMPLE) IRA.[23, 24]

The overall fraction of U.S. households owning any type of IRA has risen modestly, from 35.7 percent in 2000 to 40.5 percent in 2008 (Figure 12).[25] The growth of employer-sponsored IRA ownership went in the same direction, from 6.8 percent to 8.6 percent of U.S. households. Another way to put employer-sponsored IRAs in perspective is to consider how aggregate balances in the three main types of IRAs have varied over time. In 1998, employer-sponsored IRAs accounted for $119 billion out of the $2,150 billion total, or 5.5 percent (Figure 13). In 2008, that share was little changed: $224 billion out of $3,572 billion total, or 6.3 percent.

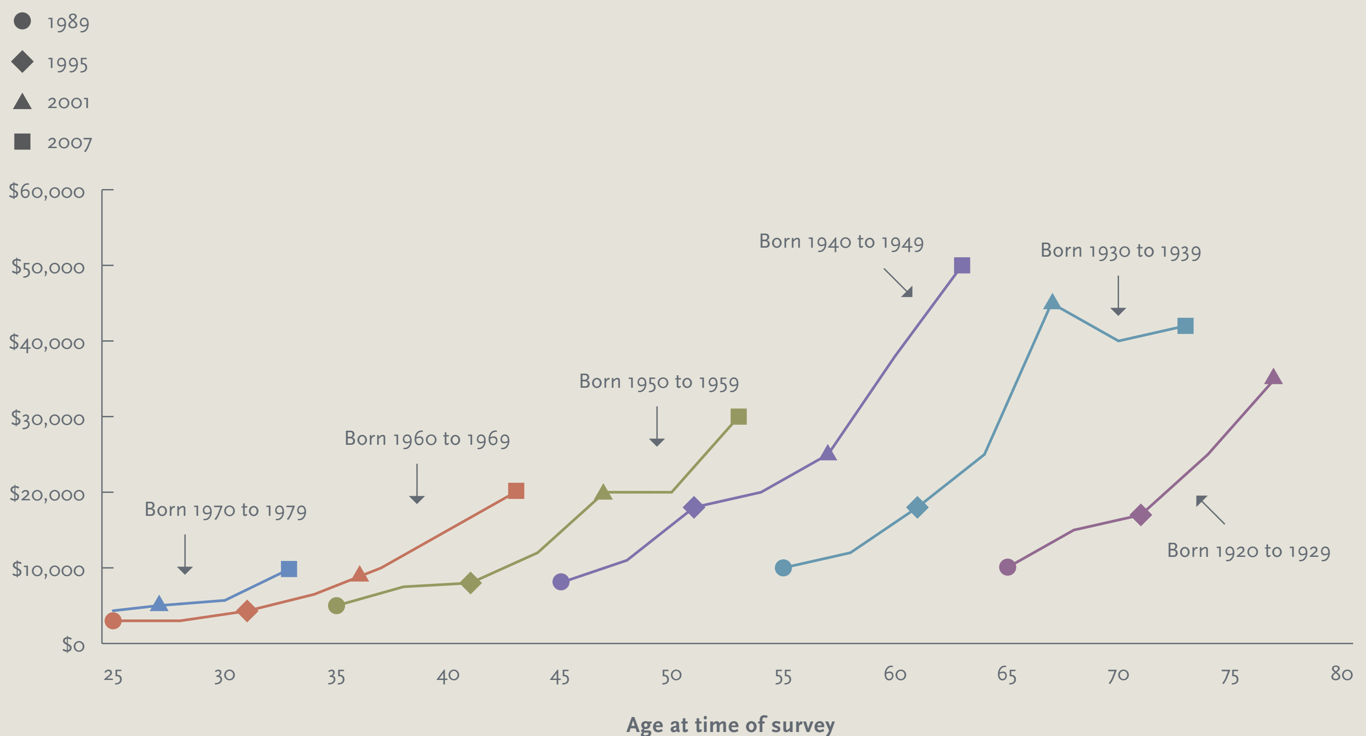
IRA Withdrawals Are Rising, but Not as Fast as IRA Assets

Just as IRAs have become an increasingly important vehicle for retirement wealth accumulation, they are also becoming an increasingly important source of retirement income. Withdrawals from IRAs have grown dramatically in both absolute dollar terms and relative to other sources

Figure 11

Median IRA Balances by 10-Year Birth Cohorts

Median IRA balances for individuals owning IRAs by 10-year birth cohorts, 1989–2007*



**IRAs include traditional or Roth IRAs or both.*
Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances, 1989–2007

Figure 12

U.S. Households' Ownership of IRAs

Employer-sponsored IRAs*
Roth IRA
Traditional IRA
Any type of IRA

Percentage of U.S. households owning type of IRA, 2000–2008

Millions of U.S. households owning type of IRA, 2000–2008

**Employer-sponsored IRAs include SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.*

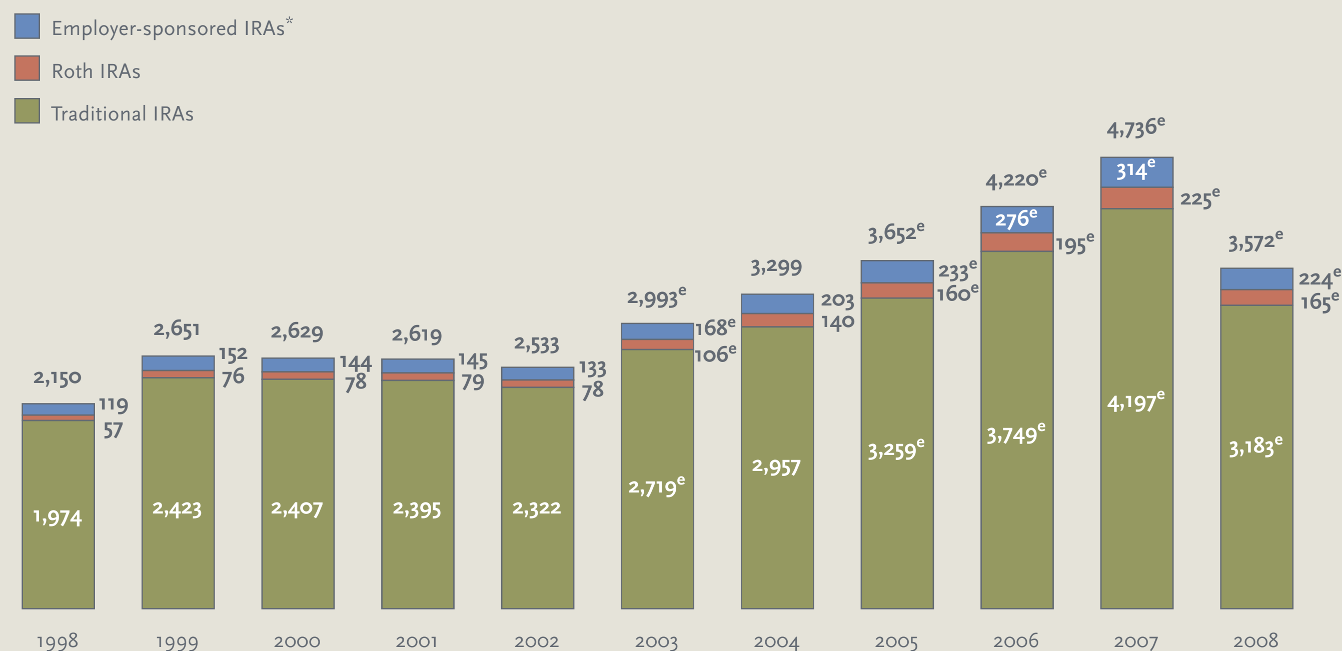
Note: Households may hold more than one type of IRA.

Source: Investment Company Institute Annual Mutual Fund Shareholder Tracking Survey, 2000–2008

Figure 13

Most IRA Assets Held in Traditional IRAs

Billions of dollars, year-end, 1998–2008



**Employer-sponsored IRAs include SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.*
e Data are estimated.
Sources: Investment Company Institute and Internal Revenue Service Statistics of Income Division

of retirement income. However, the percentage of IRA balances withdrawn each year is in fact lower now than it was 20 years ago. That is because the growth of IRA assets has been faster than the growth of IRA withdrawals.

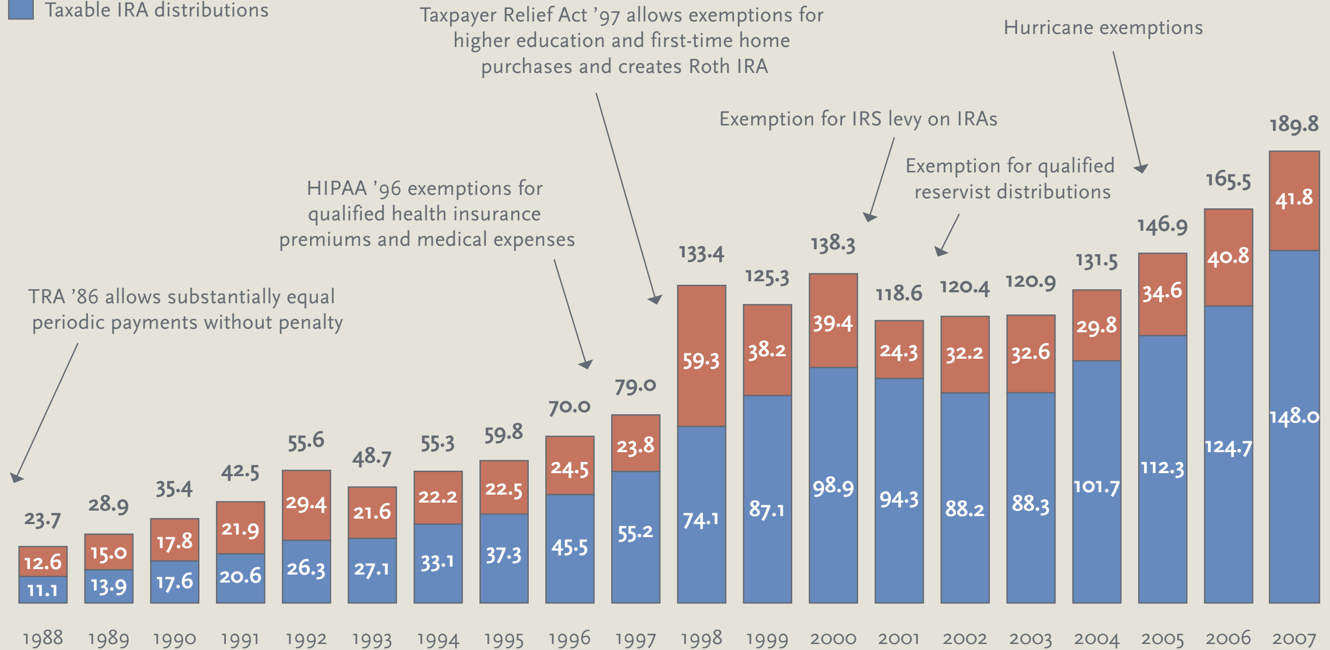
Total IRA withdrawals have risen dramatically in the past two decades, from $23.7 billion in 1988 to $189.8 billion in 2007 (Figure 14). The pattern of withdrawals over time shows that changes in tax provisions (for example, allowing withdrawals for education or health expenses, or for conversions from traditional to Roth IRAs) had short-term effects on withdrawal rates, but the dominant trend one sees is a strong secular rise. The same basic upward trend is visible in taxable IRA distributions, rising from $11.1 billion in 1988 to $148.0 billion by 2007. The ratio of taxable to total IRA distributions has generally risen over time, with the notable exception of 1998 when Roth IRAs were introduced and amounts converted from traditional to Roth IRAs in that year were allowed to be included in taxable income ratably over a four-year period.

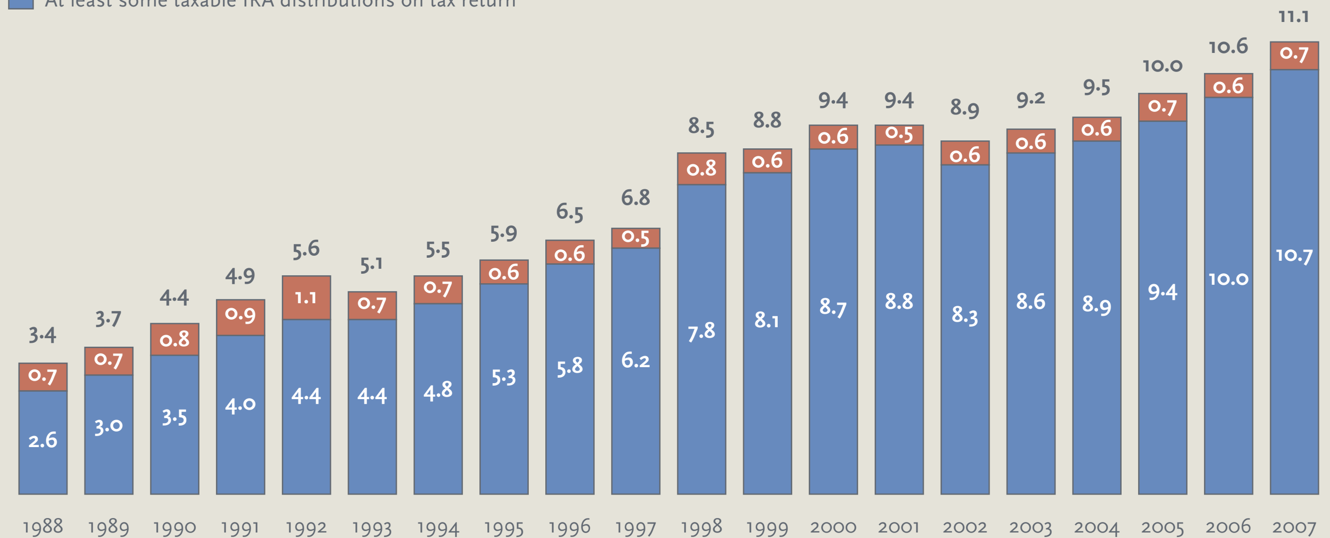
There are several possible reasons why taxable withdrawals are less than total distributions in any given year, but unfortunately, the available data from tax returns do not allow us to distinguish between the explanations. In any given year, taxpayers are instructed to report any IRA distribution that has been reported to them on IRS Form 1099-R. In some cases, however, those amounts are simply being rolled over from the IRA to another tax-deferred account, and are therefore not taxable.[26] Thus, in the general case of nontaxable rollovers from IRAs to another account, the taxable distributions concept is the preferred income measure. One notable exception to the general rule that rollovers are nontaxable is the conversion of assets from a traditional IRA to a Roth IRA. For example, in 1998, 1.4 million taxpayers converted $39.3 billion in traditional IRAs to Roth IRAs when that option became available.[27] Traditional to Roth conversions are similar to rollovers in the sense that they move the assets from one type of retirement account to another, but unlike a typical rollover, they can be reported as a taxable distribution.[28]

Figure 14

IRA Distributions*

1988–2007





**IRA distributions reported on IRS Form 1040 include taxable and nontaxable amounts. Nontaxable amounts include amounts converted to Roth IRAs, withdrawals of after-tax contributions, and indirect rollovers from IRAs to other IRAs or qualified plans (not trustee-to-trustee).*

Note: Components may not add to the total because of rounding.

Sources: Internal Revenue Service Statistics of Income Division, Individual Tax Returns, Publication 1304, *various years; and summary of legislative changes*

In addition, some IRA distributions are nontaxable for other reasons, and it makes sense to include those withdrawals when measuring retirement income available to fund consumption. IRA distributions are nontaxable to the extent they represent withdrawals of after-tax (nondeductible) contributions, withdrawals from Roth IRAs, or Qualified Charitable Distributions (QCDs). As noted, the available (published) tax return data do not allow one to distinguish these types of nontaxable withdrawals from other possibilities, but these components of nontaxable distributions should certainly be included in income. In the end, the choice of an income measure probably comes down to whether or not the households receiving the distributions think of the transaction as a true withdrawal (income-generating) event, and in that sense, the best available survey data on withdrawals (from the Federal Reserve Board's Survey of Consumer Finances [SCF] and ICI's IRA surveys, described in detail below) are closer, at least in aggregate, to the lower taxable distributions measure reported in the tax return data.

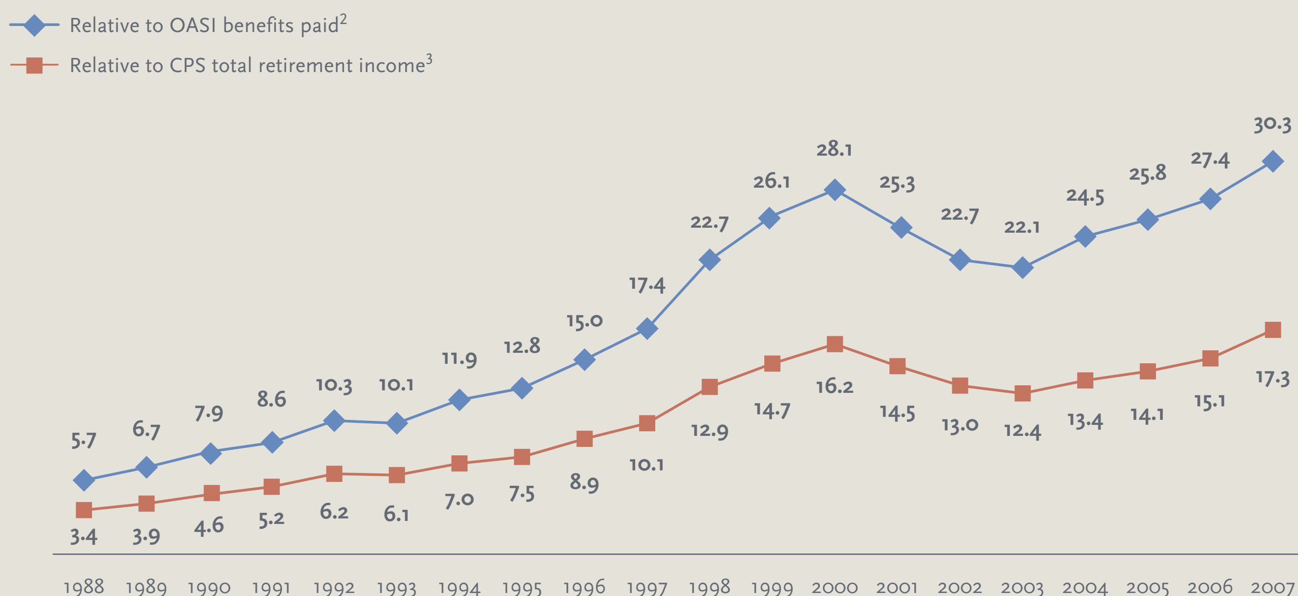
Considering the growth of IRA withdrawals relative to other sources of retirement income reinforces the impression that IRAs are becoming increasingly important, whether one uses a taxable or total distributions measure in the numerator. The taxable measure is the lower of the two and therefore less likely to overstate IRA withdrawals as a source of income. That measure is used for this relative-growth analysis.

The other part of the relative-growth analysis is specifying some income concept against which to benchmark the growth of IRA distributions over time; two such income concepts are considered here. The first benchmark compares aggregate taxable withdrawals from IRS Form 1040 over time against aggregate Social Security retirement benefits as reported by the Social Security Administration.[29] The second approach is to analyze growth in taxable IRA withdrawals from IRS Form 1040 relative to other reported sources of retirement income as measured in the Current Population Survey

Figure 15

Taxable IRA Distributions[1] Are a Rapidly Growing Source of Retirement Income

Percentage, 1988–2007



[1] Taxable IRA distributions reported on IRS Form 1040 (see Figure 14).

[2] OASI benefits include benefits paid to retired workers, their spouses and dependents, and to survivors of deceased insured workers.

[3] CPS total retirement income includes Social Security, private pensions, state and local employee pensions, federal civilian employee pensions, U.S. veterans benefits, federal military pensions, other pensions, annuities, and regular withdrawals from IRAs, Keoghs, and DC plans. See Figure 19 for 2006 retirement income information.

Sources: ICI tabulations using information from IRS Form 1040, Current Population Survey, and Social Security Administration

(CPS). Those other sources include all Social Security (including disability), pension benefits (private, federal, state, and local), veterans benefits, and reported "regular" withdrawals from IRAs and 401(k) plans.[30]

Relative to either measure of underlying retirement income, taxable IRA distributions have risen by a factor of about five (Figure 15). For example, taxable IRA distributions relative to Social Security retiree benefits in 1988 were 5.7 percent, but rose to 30.3 percent by 2007. Taxable IRA distributions relative to the CPS total retirement income measure in 1988 was 3.4 percent, but grew to 17.3 percent by 2007.

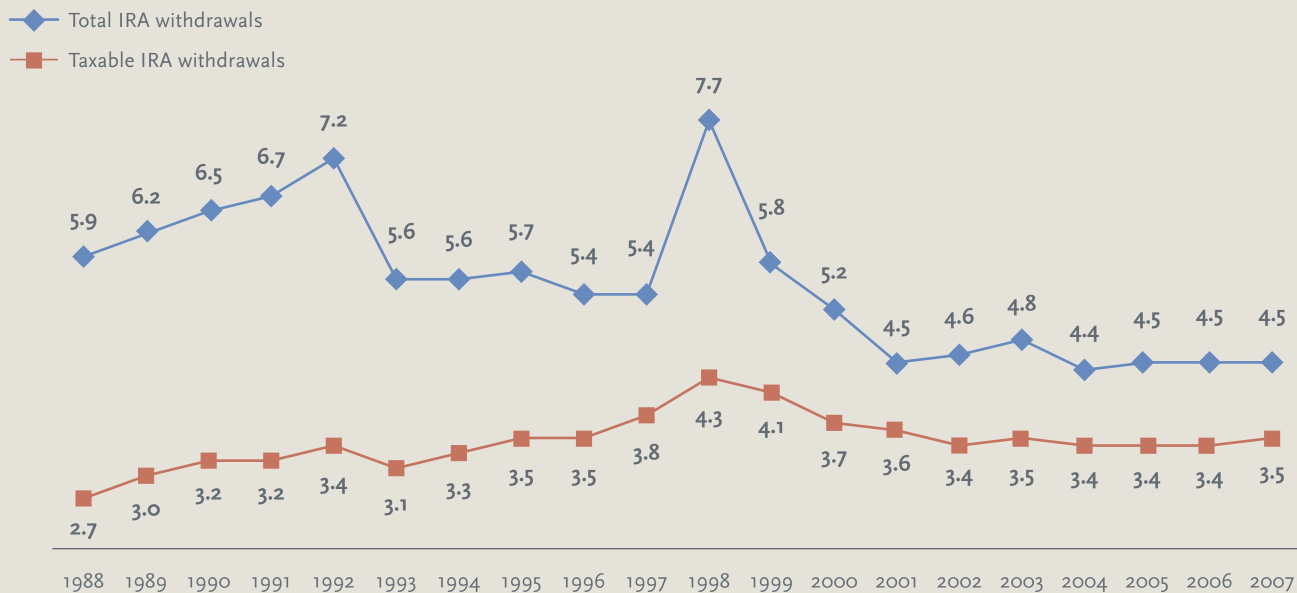
Nevertheless, the growth of IRA assets has outpaced the dollar increases in IRA withdrawals. The ratio of IRA withdrawals to previous year-end IRA assets in 2007 was 4.5 percent, below the withdrawal rate of 5.9 percent in 1988 (Figure 16). There are a variety of reasons why withdrawal rates have trended down over time and maintained relatively low levels. For example, some retired IRA owners appear reluctant to make withdrawals, and only do so when the required minimum distribution (RMD) rules for people aged 70½ or older begin to affect them.[31]

Reluctance to make withdrawals except in emergencies might explain the low level of withdrawals, but it does not explain the time pattern. The overall withdrawal rate at any point in time depends on the age distribution of balances and the propensity to take withdrawals by age. The age distribution of IRA balances more likely relates to the maturing of the IRA and employer-sponsored retirement plan systems and the movement of successive cohorts of American workers into the cycle of pension participation, job change, rollover, and IRA creation. Thus, one would expect that as IRA balances grow, withdrawals will also grow, but with a lag as the people who own the IRA balances get older and begin to access their accounts. That is, the age distribution of IRA balances is still maturing.

Figure 16

IRA Distributions* Are Small Relative to Assets

IRA distributions as a percentage of previous year's total IRA assets, 1988–2007



**IRA distributions reported on IRS Form 1040 include taxable and nontaxable amounts. Nontaxable amounts include amounts converted to Roth IRAs, withdrawals of after-tax contributions, and indirect rollovers from IRAs to other IRAs or qualified plans (not trustee-to-trustee).*

Sources: Investment Company Institute; Federal Reserve Board; American Council of Life Insurers; and Internal Revenue Service Statistics of Income Division, Individual Tax Returns, Publication 1304, *various years*

IRA Withdrawals Are Likely to Become an Even Larger Source of Retirement Income, but Their Importance May Be Mismeasured

The data presented on IRA ownership, contributions, balances, and withdrawals tell an important story about the evolution of IRAs since their inception in 1974. Yet the tremendous growth in IRA withdrawals relative to other sources of retirement income may only just be beginning because a significant fraction of accumulated IRA wealth is owned by households on the verge of retirement. Within a few years those households will enter retirement and begin drawing down their accumulated IRA balances, and those withdrawals will be an important source of funding for retirees' spending.

However, it is not clear that those withdrawals will be appropriately measured as a source of retiree income because traditional survey-based measures of retiree resources may be both statistically and conceptually flawed. The official U.S. annual household survey data that are used to measure income and poverty status capture only a small fraction of IRA withdrawals that actually occur in a given year. Thus, while IRA withdrawals have risen in importance as a source of retirement income, the most widely cited income measure has failed to capture that growth. Looking ahead, that trend is likely to continue.

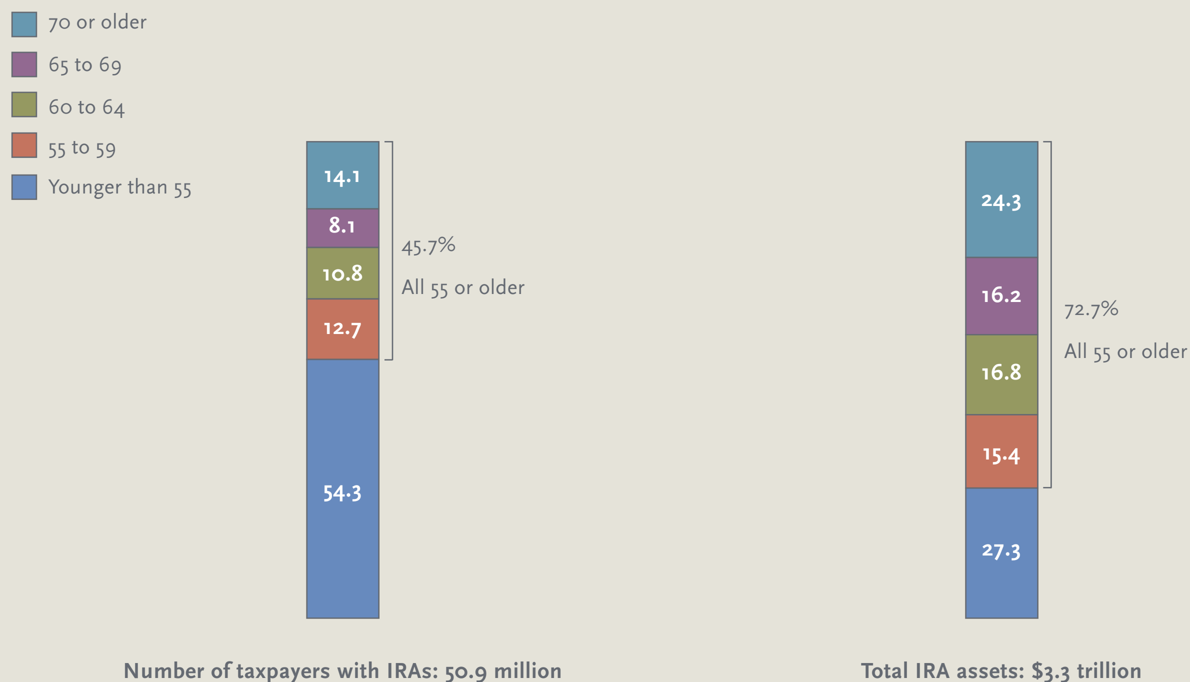
The Coming Boom in IRA Withdrawals

IRA withdrawals have grown much faster than other sources of retirement income, and it is straightforward to project that IRA withdrawals will continue growing at a rapid pace. One can examine the trends in employer-sponsored retirement plans and IRA ownership by age presented earlier to get some sense of where IRA withdrawals are headed, but it is even more instructive to look closely at IRA ownership and withdrawal rates for people in retirement compared with those on the cusp of retirement. In 2004, persons aged 55 or older represented 45.7 percent of the IRA-owning population, but held 72.7 percent of all IRA assets (Figure 17).

Figure 17

Most IRA Assets Are Held By Taxpayers Aged 55 or Older

Percentage of total by age, 2004



Note: Total IRA assets include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).
Source: ICI tabulations using information from Internal Revenue Service Statistics of Income Division

Current Population Survey Official Definition of Income

The Current Population Survey (CPS) collects income information for each person 15 years or older in the sample. Data are collected on the amount of income received in the preceding calendar year from each of the following sources: earnings, unemployment compensation, workers' compensation, Social Security, supplemental security income, public assistance, veterans payments, survivor benefits, disability benefits, pension or retirement income (including regular withdrawals from IRAs, Keoghs, and DC plans), interest, dividends, rents, royalties, estates, trusts, educational assistance, alimony, child support, and financial assistance from outside of the household.

The income of the household does not include amounts received by people who were members during all or part of the previous year if these people no longer resided in the household at the time of the interview. The survey collects income data for people who are current residents but did not reside in the household during the previous year.

In addition, the income data collected by the U.S. Census Bureau include money income received before payments for personal income taxes, Social Security, union dues, and Medicare deductions. Receipts of noncash benefits such as food stamps, health benefits, and subsidized housing are not included.

The propensity to take withdrawals tends to rise with age: 10.8 percent of IRA-owning taxpayers aged 55 to 59 had withdrawals, compared with 19.6 percent of IRA-owning taxpayers aged 60 to 64 and 28.6 percent of IRA-owning taxpayers aged 65 to 69 (Figure 18).[32] The percentage of IRA balances withdrawn also rises with age, and one need only mentally age the balances of the near-retiree cohorts forward in five-year increments—considering how their average withdrawal rates will rise by looking at the group five years older—the implication that aggregate IRA withdrawals are likely to soar becomes clear.

Current Population Survey IRA Data Collection

The CPS is the most widely used data source for measuring economic well-being across the U.S. population.[33] Every March, the CPS collects data on incomes (along with demographic, labor force, and other socioeconomic data) for a large sample of U.S. households, and those data are used to produce commonly used measures such as income and the official poverty rate. The CPS-based measures of economic well-being indicate that IRA withdrawals (and Keogh and DC plan withdrawals; the CPS lumps the three together in the survey questionnaire) are an insignificant source of income (Figure 19). However, a quick comparison of the CPS-reported IRA withdrawals for 2006 ($6.4 billion) with the values of withdrawals from tax returns ($165.5 billion total, $124.7 billion taxable; Figure 14, top panel) suggests there is a significant difference in what is being measured.

Figure 18

IRA Withdrawals Are Likely to Continue Growing Rapidly Because of Aging Population

Based on Internal Revenue Service tax and information returns, 2004

Age group	Percentage of IRA owners within age group making a withdrawal	Percentage of aggregate IRA balance withdrawn*
Younger than 55	9.6	3.0
55 to 59	10.8	2.5
60 to 64	19.6	3.8
65 to 69	28.6	3.9
70 or older	93.0	6.5

**The percentage of the aggregate IRA balance withdrawn is the aggregate withdrawal amount divided by the sum of the withdrawal amount and the aggregate IRA balance for each age group.*
Note: Total IRA assets include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).
Source: ICI tabulations of information from Internal Revenue Service Statistics of Income Division

Indeed, one crucial difference is that the CPS interview question asks the household whether they received any "regular" withdrawals from their IRAs, Keoghs, or DC plans. This may or may not be an appropriate measure of income, but it is important to note that asking about IRA withdrawals more generally (and perhaps more pointedly, while discussing IRA holdings with the respondent) leads to much higher estimates. For example, in the 2007 SCF and in ICI's 2007 IRA Owners Survey, respondents were asked about withdrawals at the point in the survey immediately following the questions about IRA ownership and balances. In both surveys, the values of reported withdrawals (SCF $95.2 billion, ICI $71.6 billion) were an order of magnitude above the CPS value, and closer to the tax return–based actual value (Figure 20).

Figure 19

IRA Withdrawals Appear Insignificant in the Current Population Survey

Retirement income source	Number of persons receiving (thousands)	Average annual receipt	Total annual receipts (billions)
Social Security	41,371	$11,473	$474.7
Private pensions and annuities	11,609	12,606	146.3
State and local employee pensions	4,245	20,562	87.3
Federal civilian employee pensions	1,611	23,070	37.2
U.S. veterans benefits	2,416	11,424	27.6
Federal military pensions	1,283	18,715	24.0
Other pensions	1,501	14,045	21.1
Regular withdrawals from IRAs, Keoghs, and DC plans	445	14,307	6.4

Source: ICI tabulations of March 2007 Current Population Survey data

Figure 20

The Importance of IRA Withdrawals Is Greatly Misstated in Household Income Surveys

IRA withdrawal measures,[1] various sources

	Number of persons receiving (thousands)	Average annual receipt	Total annual receipts (billions)
CPS persons with regular withdrawals from IRAs, Keoghs, and DC plans[1, 2]	445	$14,307	$6.4
SCF family basis, any withdrawals from IRAs[1]	6,992	13,621	95.2
ICI Tracking/IRA Survey family basis, any withdrawals from IRAs[1]	7,003	10,219	71.6
IRS tax return basis, taxable IRA distributions[1]			
All tax returns	9,965	12,514	124.7
Tax returns where primary taxpayer is younger than 55	1,872	10,142	19.0
Tax returns where primary taxpayer is 55 or older	8,093	13,063	105.7

[1] *IRA withdrawals include traditional and Roth withdrawals for the 2006 tax year.*

[2] *Keogh and DC plan withdrawals are from the 2006 tax year.*

Sources: ICI tabulations of Current Population Survey and Survey of Consumer Finances; Internal Revenue Service Statistics of Income Division, Individual Tax Returns, Publication 1304; *ICI Annual Mutual Fund Shareholder Tracking Survey; and ICI IRA Owners Survey*

Implications of the CPS Methodology

The implication of the CPS data collection strategy is clear: the CPS misses significant economic resources flowing to retired households. That means measures such as median income, the poverty rate, and other summary statistics may well be biased for older Americans. One way to quantify this omission is to use the SCF, which has the CPS-type "regular" income measure for most income sources but also has good estimates of DC plan and IRA withdrawals. The CPS-type "regular" per-capita income of people aged 65 or older was $5,792 in the lowest income decile, $17,874 for the fifth decile, and $156,051 for the highest decile (Figure 21, top panel).[34] The overall per-capita average of the "regular" income measure was $34,359 in 2006.

Adding appropriately measured IRA and DC retirement plan withdrawals raises average per-capita income by 6.5 percent because average withdrawals across all persons 65 or older were just over $2,000 per year (average income is $36,583 including IRA and DC retirement plan withdrawals versus $34,359 using the "regular" income measure; Figure 21, top panel). In addition, IRA and DC plan withdrawals affect incomes across the income distribution. Incomes among persons in the lowest income decile increase by 7.2 percent over the "regular" income concept when IRA and DC plan withdrawals are included.

The undermeasured impact of IRA and retirement plan withdrawals on retiree incomes becomes even more noticeable when one focuses on those persons who had DC plan or IRA withdrawals during the year, as opposed to spreading out withdrawals across all persons regardless of whether they made withdrawals (Figure 21, lower panel). Estimated income for persons who had IRA or retirement plan withdrawals in the survey year are biased down even further under the "regular" income measure when one takes this approach. The overall impact on annual income for this group jumps to 21.7 percent, and the effect is strongest for persons in the two lowest income deciles. The implications for measuring economic well-being among the retired population are significant; for example, whether or not IRA and DC retirement plan withdrawals are counted appropriately could be the difference between whether or not a person is deemed to be below the official poverty threshold.

Figure 21

Defined Contribution Plan and IRA Withdrawals Significantly Increase Average Per-Capita Income of Retirees

Average per-capita income within income deciles for individuals aged 65 or older, tax year 2006

Income decile[1]	Income excluding DC plan and IRA withdrawals[2]	Income including DC plan and IRA withdrawals[2]	Percent difference
Lowest	$5,792	$6,209	7.2%
2nd	9,647	10,053	4.2
3rd	11,764	12,835	9.1
4th	14,808	15,898	7.4
5th	17,874	19,245	7.7
6th	21,615	22,896	5.9
7th	26,215	27,698	5.7
8th	32,924	35,770	8.6
9th	46,931	48,701	3.8
Highest	156,051	166,537	6.7
All	34,359	36,583	6.5

Average per-capita income within income deciles for individuals aged 65 or older that had DC plan or IRA withdrawals, tax year 2006

Income decile[1]	Income excluding DC plan and IRA withdrawals	Income including DC plan and IRA withdrawals	Percent difference
Lowest	$5,502	$8,061	46.5%
2nd	11,135	15,848	42.3
3rd	14,300	17,496	22.4
4th	17,390	22,087	27.0
5th	20,909	26,964	29.0
6th	24,943	30,748	23.3
7th	30,517	41,174	34.9
8th	37,255	41,432	11.2
9th	53,410	60,258	12.8
Highest	190,169	229,003	20.4
All	40,574	49,363	21.7

[1] Income includes wages and salaries, income from a sole proprietorship or farm, businesses or investments, interest and dividends, Social Security, and other pensions (excluding withdrawals from IRAs and DC plans, unemployment or worker's compensation, welfare assistance, child support, and alimony).

[2] Figures include individuals who do not have DC plan or IRA withdrawals.

Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances, 2007

Reporting of IRA Withdrawals in the SCF: An Example of How Question Placement Affects IRA Withdrawal Reporting

The table below shows that reported IRA withdrawal rates in the SCF were not always much higher than in the CPS. Like most surveys, the SCF balances improvements in the survey against maintaining consistent measures of income and wealth over time. There is a significant jump in IRA withdrawal rates that can be traced back to a deliberate change in the SCF survey design. Up to and including the 2001 survey, the SCF questions about IRA withdrawals were included in the income section of the survey, under the "other income" category. This approach is comparable to the way the CPS and other income-oriented surveys collect the data. However, the Federal Reserve Board realized that this approach was failing to capture most of the withdrawal activity that was actually going on, so in 2004, those questions were shifted to the section of the survey that covered IRAs. In particular, the respondent is now asked to focus on all of the aspects of their IRAs at one time, including things like account balance(s), types of investments in the account(s), and withdrawals. As the results below indicate, withdrawal rates and aggregate withdrawals rose significantly after the SCF change was implemented.

IRA-Owning Households Taking Withdrawals by Survey Year
Percent

Year	Percent
1998	0.5
2001	1.7
2004	17.4
2007	19.9

Aggregate IRA Withdrawals by Survey Year
Billions of dollars

Year	Billions of dollars
1998	4.9
2001	13.0
2004	58.9
2007	95.2

Note: IRA withdrawals occurred in the tax year prior to the survey year.
Source: ICI tabulations of Federal Reserve Board Survey of Consumer Finances, 1998–2007

Regulation of IRAs

The tax treatment of IRAs is governed by the Internal Revenue Code and Internal Revenue Service (IRS) regulations. The Code and IRS regulations also spell out various disclosure requirements for IRA providers, including providing the owner with information on the fees and expenses of the IRA, explanations of the applicable tax rules, and certain annual reports (e.g., IRS Forms 1099-R and 5498).

Entities that serve as custodians to IRAs also are regulated depending on the type of entity. The Federal Deposit Insurance Corporation (FDIC) regulates bank custodians, and the IRS regulates nonbank custodians. Any entity that is not a bank must be approved by the IRS to serve as a nonbank trustee or custodian for IRAs or other types of retirement accounts.

Investment products (such as mutual funds) used within IRAs may be subject to other specific regulation. In addition, when an IRA owner consults a financial planner, adviser, or broker in investing the assets of an IRA, the planner, adviser, or broker may have fiduciary obligations or be subject to other rules of practice. For example, investment advisers are regulated and subject to fiduciary obligations to clients under the Investment Advisers Act of 1940 or state adviser laws or both.

Additional Reading

"The Individual Retirement Account at Age 30: A Retrospective," Investment Company Institute Perspective. *Provides a summary of the growth and development of the IRA market. Available at www.ici.org/pdf/per11-01.pdf.*

"The Role of IRAs in U.S. Households' Saving for Retirement, 2008," Investment Company Institute Fundamentals. *Available at www.ici.org/pdf/fm-v18n1.pdf.*

Figure A1

IRA Assets Represent a Growing Share of Retirement Assets and Household Financial Assets

Year-end, 1975–2008

	Total IRA assets (billions)	Total U.S. retirement assets (billions)	IRA assets as a percentage of total U.S. retirement assets	Total U.S. household financial assets (billions)	IRA assets as a percentage of total U.S household financial assets
1975	$3	$469	0.6%	$3,664	0.1%
1976	6	539	1.1	4,149	0.1
1977	9	598	1.5	4,428	0.2
1978	14	704	2.0	4,959	0.3
1979	20	819	2.4	5,685	0.4
1980	25	995	2.5	6,561	0.4
1981	38	1,101	3.5	6,953	0.5
1982	68	1,355	5.0	7,540	0.9
1983	107	1,639	6.5	8,316	1.3
1984	159	1,860	8.5	8,827	1.8
1985	241	2,321	10.4	9,964	2.4
1986	329	2,643	12.4	11,082	3.0
1987	404	2,890	14.0	11,738	3.4
1988	469	3,181	14.7	12,873	3.6
1989	546	3,694	14.8	14,198	3.8
1990	636	3,923	16.2	14,570	4.4
1991	776	4,582	16.9	16,124	4.8
1992	873	4,988	17.5	16,967	5.1
1993	993	5,581	17.8	18,244	5.4
1994	1,056	5,921	17.8	18,921	5.6
1995	1,288	6,978	18.5	21,524	6.0
1996	1,467	7,821	18.8	23,426	6.3
1997	1,728	9,012	19.2	26,750	6.5
1998	2,150	10,336	20.8	30,249	7.1
1999	2,651	11,833	22.4	34,822	7.6
2000	2,629	11,696	22.5	33,423	7.9
2001	2,619	11,280	23.2	32,170	8.1
2002	2,533	10,543	24.0	30,231	8.4
2003	2,993[e]	12,543	23.9	35,307	8.5
2004	3,299	13,783	23.9	39,236	8.4
2005	3,652[e]	14,863	24.6	43,268	8.4
2006	4,220[e]	16,761	25.2	48,025	8.8
2007	4,736[e]	18,034	26.3	50,703	9.3
2008	3,572[e]	14,061	25.4	41,957	8.5

[e] *Data are estimated.*

Note: Total IRA assets include traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs).

Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

Notes

1 The aggregate data presented in this section are taken from ICI's ongoing reporting of U.S. retirement market data. For the most recent releases see Brady, Holden, and Short 2009 and Investment Company Institute 2009.

2 If one looks at the wealthiest 5 percent of families in the SCF in 2007, that group owned 82 percent of the outstanding directly held equities, but only 50 percent of all IRA balances. This is one way to show that, although IRA holdings are skewed, they are not as concentrated as other financial holdings such as directly held equities.

3 The data on IRA owner characteristics presented in this section are largely taken from the IRA Owners Survey conducted by ICI annually since 2000 (except in 2006). See Holden and Schrass 2009 for the most recent report based on those surveys. Although the ICI IRA Owners Survey is useful for tracking the characteristics of the IRA-owning population, the data in this Perspective on the number and percentage of households owning IRAs are based on ICI's Annual Mutual Fund Shareholder Tracking Survey. For further discussion, see Holden, Bogdan, and Bass 2008.

4 See Holden et al. 2005 for additional discussion.

5 In 2004, contributions to Roth IRAs were $14.7 billion, while contributions to traditional IRAs were $12.6 billion. See Bryant 2008.

6 Rollover activity to IRAs from DC plans are reported for new retirees in Sabelhaus, Bogdan, and Holden 2008. Estimates of account disposition for all separating employees can be found in The Vanguard Group 2009. The Vanguard study shows that 48 percent of separating employees—accounting for 50 percent of account balances—leave their accumulated assets in the DC plan. Another 42 percent of assets were rolled over, thus 92 percent of assets were retained in some type of retirement account when employees separated.

7 See Bryant 2008.

8 The same vesting rules typically apply to both DB and DC plan benefits. Maximum vesting periods were first restricted by ERISA in 1974 and later by the Tax Reform Act of 1986 (TRA '86). In 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) instituted more restrictive maximum vesting periods for employer matching contributions in a 401(k) plan.

9 Plans can also use "graded" vesting—that is, employees are entitled to a portion of the benefits that increases over time. Under ERISA, the maximum allowable graded vesting period was 15 years, where vesting phased in starting at five years and reached 100 percent at 15 years. TRA '86 restricted graded vesting to seven years, with vesting phasing in from three to seven years.

10 The maximum graded vesting period for employer contributions in a 401(k) plan is six years, with vesting phasing in from two to six years. Some plan designs, referred to as "safe harbor" plans, require a more rapid vesting schedule.

11 Indeed, 87 percent of DB plan participants in 2005 were in plans with cliff vesting taking place at tenure of five years or more. By contrast, only 22 percent of workers in DC plans are exposed to cliff vesting of any duration. See U.S. Department of Labor, Bureau of Labor Statistics 2007, p. 70 and p. 83.

12 The CPS micro data used in this Perspective were downloaded from the CPS-IPUMS project at the University of Minnesota Population Research Center. For a description of the CPS files, see King et al. 2004. The observed differentials in coverage by earnings can be explained by a number of factors, including the fact that low earners get relatively higher replacement rates from Social Security, which suggests they may choose not to forego current compensation (by participating in a retirement plan) in order to increase future income. Firms with employees who are older (therefore, more likely to be focused on retirement saving rather than other savings goals), more highly compensated, and full-time workers, are more likely to sponsor retirement plans. Retirement plan sponsorship by these firms is at least in part because more of their employees are focused on saving for retirement and have enough resources to save. For a comprehensive analysis of differences in employer-sponsored retirement plan coverage across socioeconomic characteristics, see Brady and Sigrist 2008.

13 The data underlying Figure 7 are from the Federal Reserve Board's Survey of Consumer Finances (SCF), which is only available on a consistent basis beginning in 1989. If one looks back further in time using other data—for example, coverage data for private-sector employees from the Department of Labor's Form 5500 data series—the shift from DB to DC is even more dramatic. See U.S. Department of Labor, Employee Benefits Security Administration 2004.

14 Clark and Sabelhaus 2009 use the same SCF data to further explore the two trends reported in Figures 7 and 8. Higher earners have higher pension coverage rates in every year, and those differences are relatively stable over time (Figure 7). However, that does not necessarily imply that the shift from DB to DC (Figure 8) was equal across earnings groups—the shift could have been concentrated among low or high earners. Clark and Sabelhaus 2009 show that the shift was generally proportional across earnings groups, although slightly lower take-up rates for low earners under DC plans has led to a slight (relative) decline in their overall coverage.

15 A decade ago, 76 percent of DB plans offered by medium and large business establishments distributed plan proceeds at retirement only in an annuity. See U.S. Department of Labor, Bureau of Labor Statistics 1999, p. 107. By 2005, more than half of DB plans offered a full or partial lump-sum distribution option. See U.S. Department of Labor, Bureau of Labor Statistics 2007, p. 66.

16 U.S. Department of Labor, Employee Benefits Security Administration 2008 reports cash balance plans represented 8 percent of private-sector DB plans, 28 percent of DB plan assets, and 26 percent of active DB plan participants in 2006.

[17] For the complete reports, see U.S. Department of Labor, Bureau of Labor Statistics 2004 and 2008.

[18] Indeed, Clark and Sabelhaus 2009 discuss the fact that high rates of job turnover pose an important risk to workers in DB plans, whose rates of accumulation are generally back-loaded (that is, accrued pension benefits rise in a very nonlinear way with tenure). When one considers that risk alongside the investment risk that some observers identify as a drawback to DC plans, it is possible to see how the shift from DB to DC actually benefitted many workers. See Holden, Hadley, and Brady 2006 for a brief summary of research on the DB to DC changes.

[19] The rates of IRA ownership shown here are at the person level—instead of the usual household level—in order to emphasize how the cycle of DC accumulation and rollover to IRA affects individuals. The same basic pattern shows up in household-level data, which is the more traditional way to tabulate the SCF cohort-level data over time. For a description of the SCF data along with household-level tabulations of various types of wealth holdings by age and survey year, see Bucks et al. 2009.

[20] Recall, IRAs were first available in 1975, when this cohort was already 46 to 55 years old, and 401(k) plans were essentially first available in 1981, when this cohort was already 52 to 61 years old.

[21] One interesting observation in Figure 11 is that the median balances for the 1920 to 1929 cohort actually increased between 1995, when they were 71 years old on average, and 2001, when they were 77 years old on average. One would expect to see stabilization or even decumulation of IRA balances, as occurred for the next youngest cohort (born between 1930 and 1939) in the next period (2001 to 2007). There are two explanations for this apparent anomaly. First, stock market returns were high during this time period, so these older IRA owners may have been drawing money out but still saw their balances increase. Second, this cohort reached the age range where differential mortality—the empirical observation that high-wealth individuals tend to live longer than low-wealth individuals—begins to play a role when measuring changes over time. This is a common problem when using cross-section surveys at different points in time to compute some change for a given group. Basically, the sample of IRA owners born between 1920 and 1929 who were still alive in 2001 is not representative of the sample who were alive six years earlier—the survivor group is likely to be higher wealth, so the comparison of medians can be misleading. This does not affect the younger age groups because mortality rates are much lower. See Attanasio and Hoynes 2000 for empirical evidence on the extent of differential mortality and the implications for measuring wealth changes over time.

[22] Indeed, one of the distinguishing features of an employer-sponsored IRA is exemption from annual Department of Labor/Internal Revenue Service/Pension Benefits Guaranty Corporation Form 5500 filing, which generally is a requirement of DC plans under ERISA.

[23] SBJPA also prevented the formation of new SAR-SEP IRAs, although it grandfathered existing SAR-SEP IRAs.

[24] For a more complete description of the different types of IRAs and the evolution of IRA policy, see Holden et al. 2005.

[25] The incidence of ownership across different types of IRAs is based on ICI's Annual Mutual Fund Shareholder Tracking Survey. For further discussion of that survey, see Holden, Bogdan, and Bass 2008.

[26] Note that in most rollover events this is a nonissue because trustee-to-trustee transactions do not generate an IRS Form 1099-R filing.

[27] See Internal Revenue Service 2009.

[28] In 1998 taxpayers were allowed to spread the taxable distribution over four years when converting balances from traditional to Roth IRAs. That option was only available in 1998.

[29] The measure of Social Security retirement income here is Old Age and Survivor's Insurance (OASI) benefits, which are only payable to workers who have reached age 62 and their dependents. See U.S. Social Security Administration, Office of Retirement and Disability Policy 2009.

[30] Although the CPS's concept of retirement income includes some IRA, Keogh, and DC plan withdrawals, the data indicate that the bulk of withdrawals are not being captured by the survey (as described in the next section). Thus, it is appropriate to think of the denominator here as "retirement income other than withdrawals from IRAs and 401(k) plans." Also, the taxable withdrawal measure includes withdrawals by people of all ages, not just retirees. This is probably not too big of a problem because most taxable IRA withdrawals are made by people over age 59½. See Bryant 2008 and Holden and Schrass 2009.

[31] Among traditional IRA–owning households (surveyed in 2008) taking withdrawals in tax year 2007, 64 percent indicated the withdrawal amount was based on the required minimum distribution (RMD). Looking to possible future withdrawal activity, traditional IRA–owning households that did not take withdrawals in tax year 2007 were asked about their future withdrawal intentions. In 2008, 61 percent of these traditional IRA–owning households said it was unlikely they will take withdrawals prior to age 70½. See Holden and Schrass 2009. (For additional discussion of IRA withdrawal behavior, see Holden and Reid 2008.)

[32] The withdrawals shown in Figure 18 are total, not taxable, as in some of the other figures, because these are the only available measures for the five-year age groups.

[33] See U.S. Census Bureau and U.S. Department of Labor, Current Population Survey.

[34] The SCF values by decile are similar to the CPS except for the very highest decile because the SCF oversamples (then appropriately reweights) a subset of high-wealth families.

Glossary

cash balance (CB) pension plan: A type of DB plan where the benefit is defined as the value of a hypothetical "account." The employee can choose to receive benefits either in a lump sum equal to the value of the "account" or as an actuarially equivalent annuity. In a CB plan, each year the employee's "account" is credited with a set percentage of the employee's earnings and an "earnings" credit based on a stated rate of return. Because these DB plans have some characteristics of DC plans, they are often referred to as *hybrid plans*. Contrast **traditional DB plan**.

catch-up contribution: Individuals aged 50 or older are permitted to make contributions to an IRA or employer-sponsored retirement savings plan in excess of the annual contribution limit. In 2009, the catch-up limit was $1,000 for IRAs, $2,500 for SIMPLE plans, and $5,500 for 401(k) plans.

contribution limit: Federal law establishes limits for the amount an individual may contribute to an IRA, 401(k), or other retirement savings plan in any given year. In 2009, the annual employee contribution limit for 401(k)s and similar employer-sponsored retirement plans was $16,500; the annual limit for traditional and Roth IRAs was $5,000; and the annual limit for SIMPLE IRAs was $11,500. The limit on the sum of employee and employer contributions for DC plans in 2009 was $49,000. Individuals aged 50 or older can make additional "catch-up" contributions. These limits are unchanged for 2010. See also **catch-up contribution**.

defined benefit (DB) plan: An employer-sponsored pension plan where the amount of future benefits an employee will receive from the plan is defined, typically by a formula based on salary history and years of service. The amount of contributions the employer is required to make will depend on the investment returns experienced by the plan and the benefits promised. Contrast **defined contribution plan**.

defined contribution (DC) plan: An employer-sponsored retirement plan, such as a 401(k) plan or a 403(b) plan, in which contributions are made to individual participant accounts. Depending on the type of DC plan, contributions may be made by the employee, the employer, or both. The employee's benefits at retirement or termination of employment are based on the employee and employer contributions and earnings and losses on those contributions. See also **401(k) plan**. Contrast **defined benefit plan**.

401(k) plan: A type of DC plan that allows employees to choose to contribute a portion of their salaries into the plan, which defers income taxes on the amounts contributed. Like a traditional IRA, no taxes are due until distributions are taken from the account. In 2006, plans could choose to allow employees to make Roth contributions to a 401(k) plan. These contributions are claimed as taxable income in the year of the contribution, but no taxes are due on qualified distributions. Most 401(k) plans also allow employees to choose how they wish to invest their accounts. See also **defined contribution plan**.

individual retirement account (IRA): A tax-deferred or tax-free retirement account that allows contributions of a limited yearly sum. Congress initially designed IRAs to have two roles: (1) to give individuals not covered by a retirement plan at work a tax-advantaged retirement savings plan, and (2) to play a complementary role to the employer-sponsored retirement system by preserving rollover assets at job separation or retirement. The term IRA is also applied to *individual retirement annuities*, which receive similar tax treatment.

IRA distribution: Individuals may take distributions (that is, withdraw funds) from their IRAs prior to retirement, but distributions may be subject to federal income tax, tax penalty, or both. Withdrawals from traditional IRAs before age 59½ are subject to income tax and may be subject to a 10 percent early withdrawal penalty. The earnings portion of withdrawals from Roth IRAs made within five years of contribution or made before age 59½ are generally subject to income tax and may be subject to the 10 percent penalty (along with the after-tax contribution portion, in some circumstances). For both traditional IRAs and Roth IRAs, the 10 percent penalty does not apply to withdrawals made in cases of death or disability, or if

used for certain medical expenses, first-time homebuyer expenses, qualified higher-education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments made for the life or over the life expectancy of the individual. In addition, provided the five-year holding period is satisfied, the earnings portion of early withdrawals from a Roth IRA made in cases of death, disability, or first-time homebuyer expenses are not subject to income tax.

required minimum distribution (RMD): Minimum distribution rules require that beginning at age 70½, the entire amount of a traditional IRA be distributed over the expected life of the individual (or the joint lives of the individual and designated beneficiary). Distributing less than the required amount will result in a tax penalty. Roth IRAs are not subject to required minimum distributions during the account holder's lifetime.

rollover: The transfer of an investor's assets from one qualified retirement plan or account (IRA, 401(k), or other tax-advantaged, employer-sponsored retirement plan) to another—due to changing jobs, for instance—without a tax penalty.

Roth IRA: An individual retirement account, first available in 1998, that permits only after-tax (nondeductible) contributions. Earnings on investments in this IRA are not taxed. Distributions of both principal and earnings are generally not subject to federal income tax if taken after age 59½. Distributions of principal before age 59½ are not subject to tax, but investment earnings are generally subject to tax and a 10 percent penalty if taken before age 59½. There are no required distributions during the account holder's lifetime. See also **IRA distribution** and **required minimum distribution**.

SIMPLE (Savings Incentive Match Plan for Employees) IRA: A tax-favored retirement plan, created in 1996, that small employers can set up for the benefit of their employees. Both employer and employee contributions are allowed in a SIMPLE IRA plan.

Simplified Employee Pension IRA (SEP-IRA): A retirement program in which an employer makes contributions to the IRAs on behalf of employees. A *Salary Reduction SEP* (or "*SAR-SEP*") IRA is a SEP IRA that allows employees to contribute their own compensation into the IRA. When Congress created the SIMPLE IRA in 1996, it provided that an employer could not establish a new SAR-SEP plan after 1996. See also **SIMPLE IRA**.

traditional DB plan: Traditionally, DB plans calculated benefits in terms of an annual payment that commenced at retirement. Many plans calculated the annual payment amount as a percentage of final pay (or average pay over some number of years), with the percentage based on the number of years worked at the firm. Contrast **cash balance pension plan**.

traditional IRA: The first type of IRA, created in 1974. Individuals may make tax-deductible and nondeductible contributions to these IRAs. Taxes on IRA investment earnings are deferred until they are distributed. Upon distribution, both principal and earnings are subject to federal income tax. Generally, distributions before age 59½ are subject to income tax and a 10 percent penalty. See also **IRA distribution** and **required minimum distribution**.

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