Current Retirement Issues: Preparedness and Tax Proposals

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Summary (Part I): ICI Retirement Summit, April 4, 2014

- *A Close Look at Retirement Preparedness in America* (see www.ici.org/events/retirement_summit) convened an array of top researchers with a variety of viewpoints.

ICI's interpretation of the evidence:

- The conventional wisdom that the U.S. is facing a retirement crisis is overstated.
- Policy changes should build on the success of the U.S. retirement system and target those at risk.

Summary (Part II): Tax Reform and Deficit Reduction Plans Hit Employer Plans

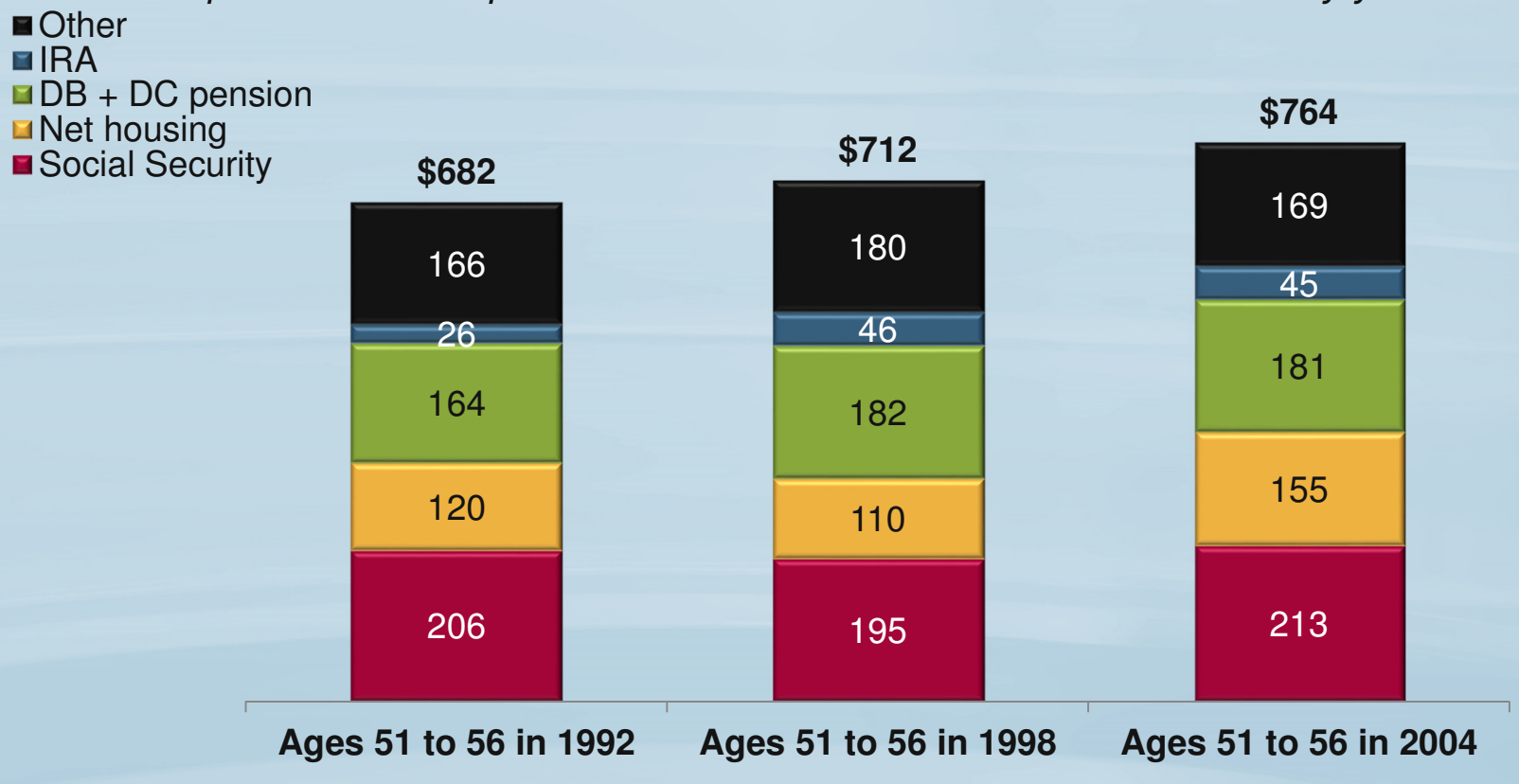
- Proposals target DC plans—the most successful employer-sponsored retirement plan design—and would disproportionately impact private-sector workers.
- Tax code changes should not include further restrictions on tax deferral and should ensure equal treatment of employer plan designs (DB vs. DC, employee vs. employer contributions).
- Vast majorities of Americans have favorable views on 401(k) plans and believe that policymakers should not reduce the tax incentives for those plans.

Empirical Evidence at Odds with Pessimism about Retirement

- Wealth of households approaching retirement has increased.
- Poverty rate of retirees has declined dramatically.
- Assets earmarked for retirement have increased.
- Most working households are properly preparing for retirement.
- Some households are at risk.

Near Retiree Wealth Has Increased for Successive Cohorts

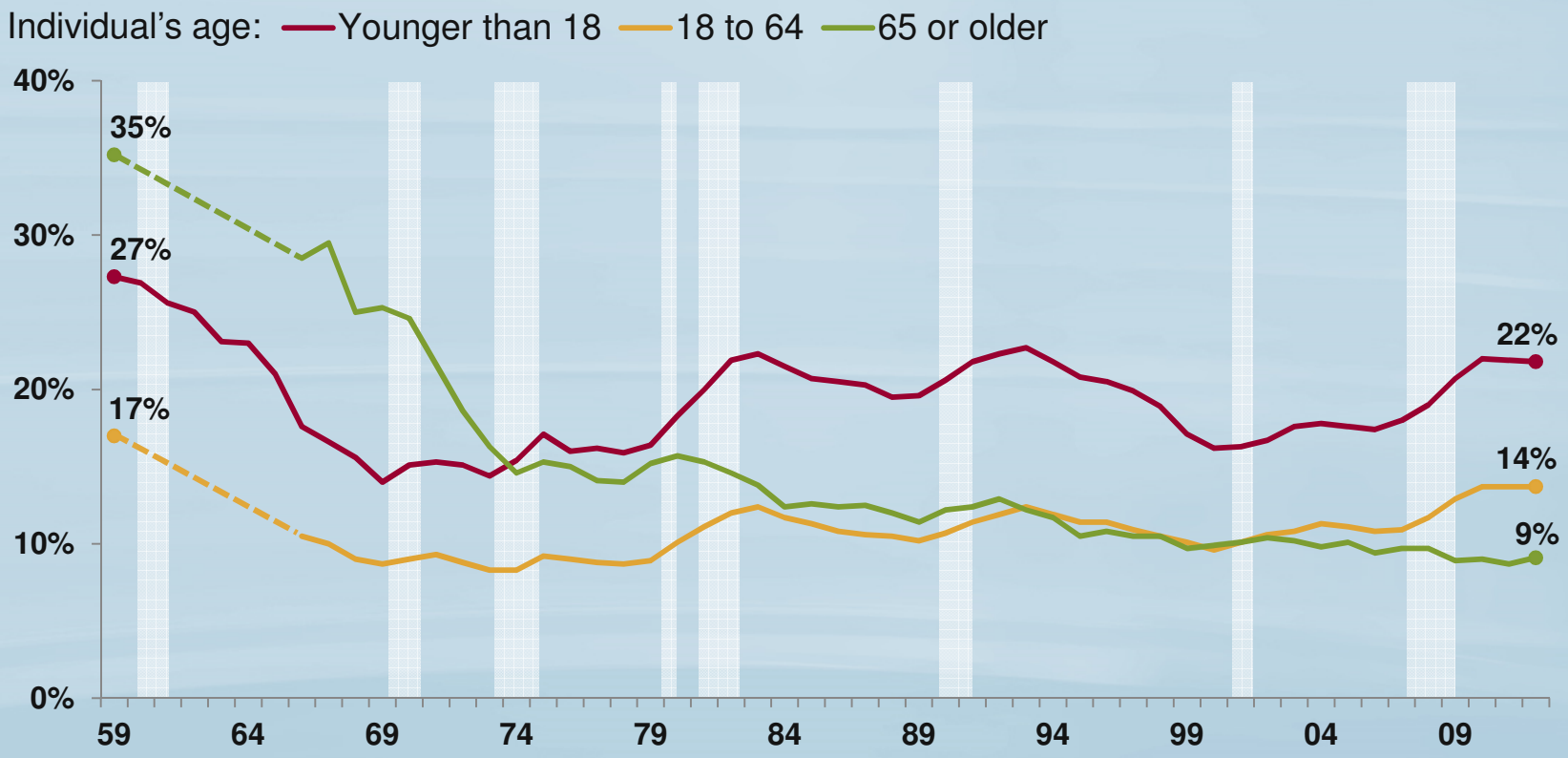
Comparison of average household wealth by cohort, thousands of constant 2010 dollars. Excludes top and bottom 1 percent of the wealth distribution in each survey year.



Source: Gustman, Steinmeier, and Tabatabai (2010)

Poverty Rates Among People Aged 65 or Older Have Fallen over Time

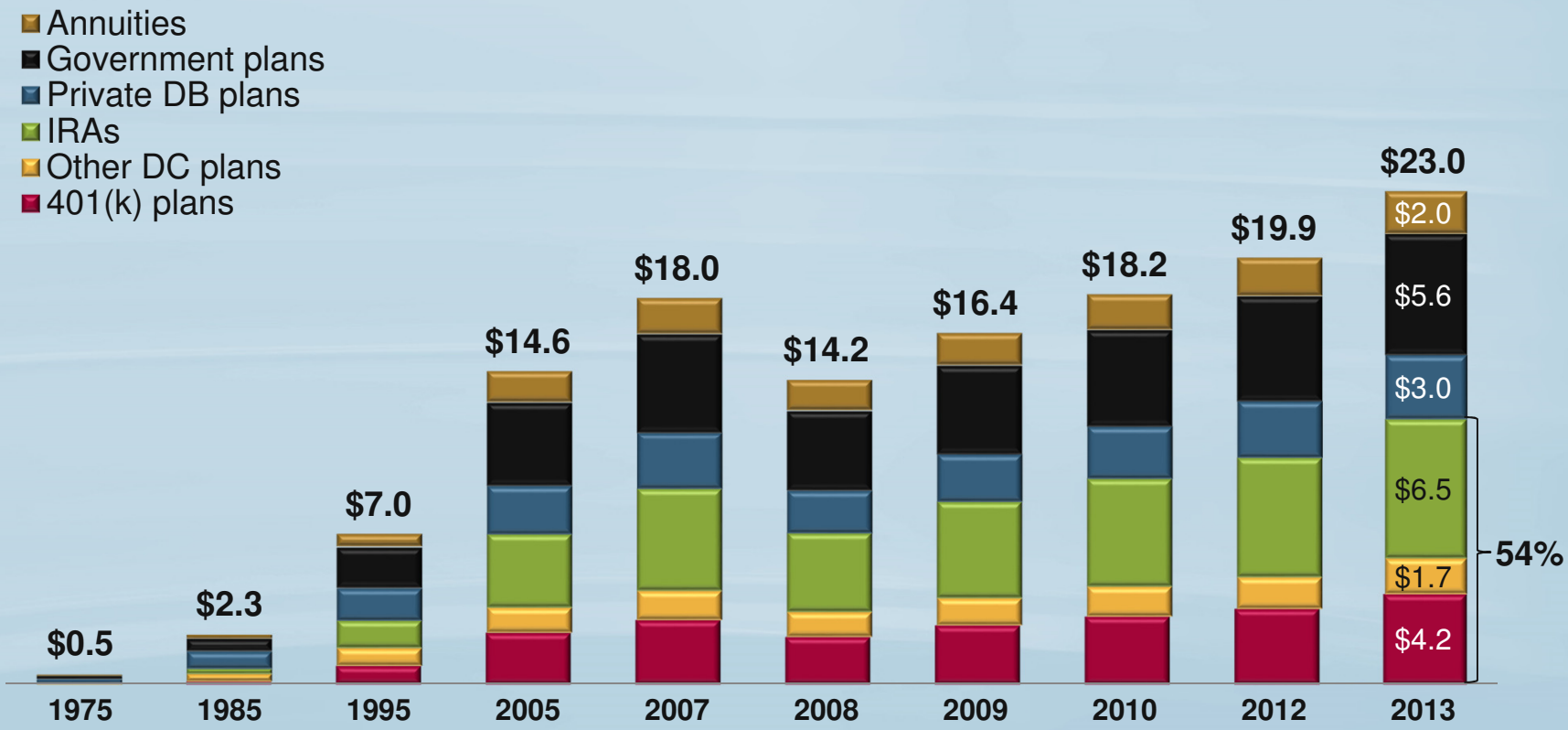
Poverty rates by age, percentage of individuals in age group, 1959–2012



*Note: The data points are placed at the midpoints of the respective years. Shaded bars represent recessions as dated by the National Bureau of Economic Research. Between 1959 and 1966, poverty rates are not available for the 18 to 64 or the 65 or older age group.
Sources: U.S. Census Bureau and National Bureau of Economic Research

Assets Earmarked for Retirement Are at a Record Level

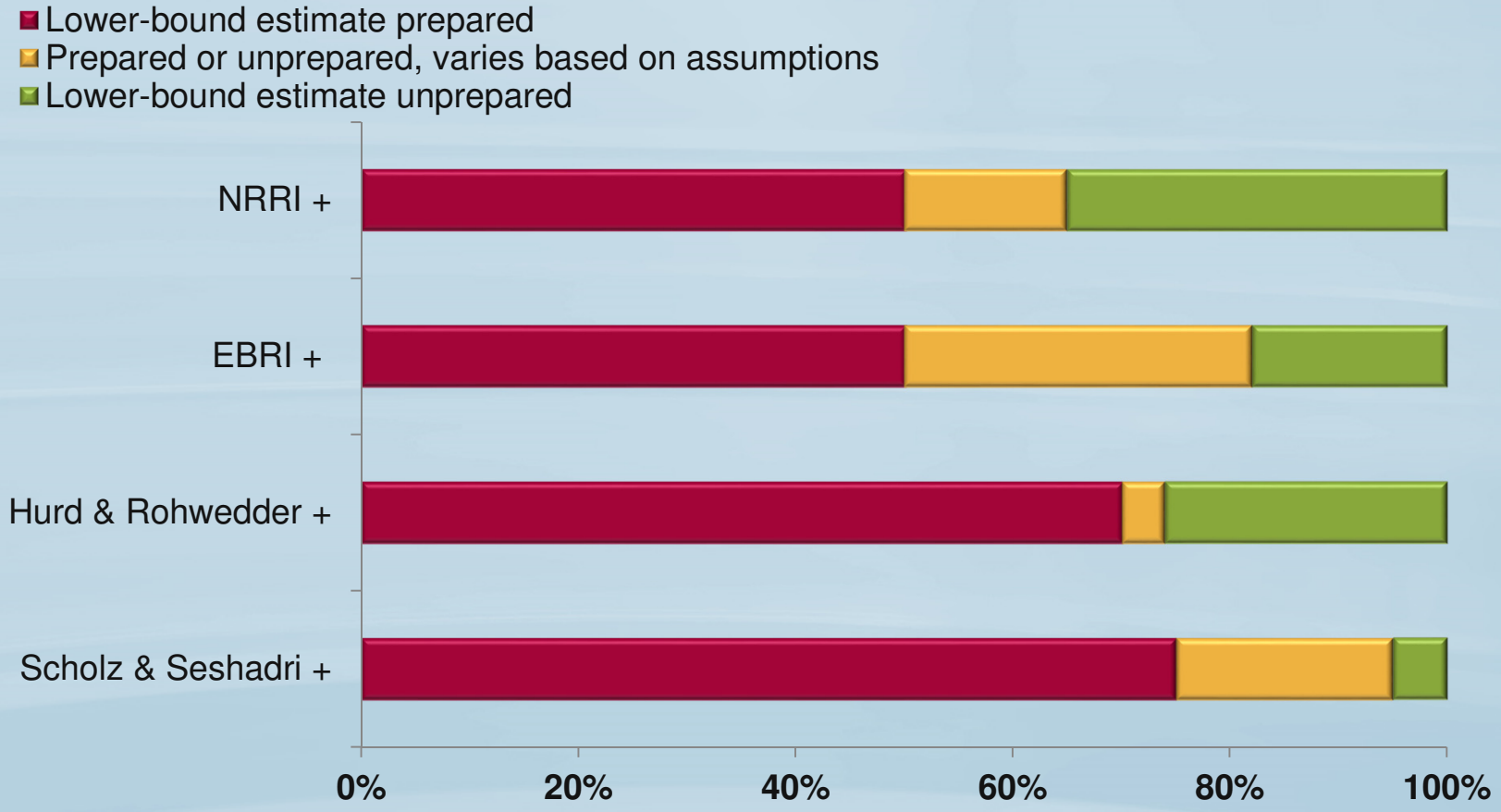
Trillions of dollars, end of period, selected dates



Note: For definitions of plan categories and a complete list of data sources, see Tables 1 and 4 in "The U.S. Retirement Market, Fourth Quarter 2013." Some data are estimated.

Source: Investment Company Institute, *The U.S. Retirement Market, Fourth Quarter 2013* (March 2014)

Majority of Americans Are Preparing Adequately for Retirement



Source: Estimates with rounding (calculations); see Utkus, "Four Views of Retirement Preparation" (April 2014)

Which Households Are at Risk?

- Early retirement due to poor health
- Limited work histories
  - "… vulnerability to inadequate resources in working life appears to persist into retirement." (Haveman, et al. 2007, p. 36)
- Individuals who are single entering retirement, with single females at greater risk than single males
- Mixed evidence on education and race
- Focus should be on helping households at risk.

Two Proposals to Cut Retirement Tax Incentives

- President Obama's budget would:
  - "Cap" the upfront tax benefit of tax-deferred employee contributions (DC or IRA) at 28%
  - Limit on total retirement benefits (DB, DC, and IRA) an individual can accrue
- Camp discussion draft would:
  - Impose 10 percent surtax on tax-deferred contributions (both employer and employee) to defined contribution (DC) plans
  - Freeze retirement plan limits for 10 years
  - Limit tax-deferred employee contributions to half the employee contribution limit (Roth contributions allowed for the rest)

Obama and Camp Proposals Would Discourage Employers from Sponsoring Plans

- Employers voluntarily choose to offer retirement plans
- Employers provide retirement benefits because their workers value them
- If further limits are placed on plans, some employers will find that the benefits their employees receive no longer justify the expense of maintaining a plan

Deferral Isn't Deduction or Exclusion

- Deductions and exclusions are straightforward
  - Reduce taxes in the year they are taken
  - Have no impact on future tax liability
  - Benefit is the one-year reduction in tax liability
- Tax deferral is more complex
  - Benefit of deferral is *not* the upfront reduction in tax liability
    - Reduces taxes in the year of the contribution
    - Reduces taxes during the deferral period
    - Increases taxes when funds are distributed
  - Instead, benefit of deferral is roughly equivalent to getting a zero rate of tax on investment income

"Cap" or "Surtax" Would Reduce Tax Benefits Substantially, Particularly for Older Workers

- Cap or surtax on deferral imposes fixed upfront penalty
  - Pay cap tax or surtax upfront
  - Withdrawals remain subject to tax
- Taxpayers nearing retirement could be better off contributing to a taxable account
  - With 10 percent surtax, worker with bond portfolio needs 8 years for contribution to catch up with taxable account
  - For stock portfolio: 13 years
- Tax benefits reduced substantially for younger workers
  - After 20 years, bond portfolio is 40% behind fully deferred account
  - Stock portfolio lags by 68 percent after 20 years

"Cap" and "Surtax" Proposals Target DC Plans, Introduce Unequal Treatment

- Under the current tax code, all tax-deferred retirement plan contributions—to both DB plans and DC plans, by both employers and employees—provide the same tax benefit: no taxation of deferred compensation until funds are distributed to employees.
- Obama proposal would apply cap only to tax-deferred employee contributions to DC plans and IRAs.
- Camp plan would impose surtax only on DC plan employer contributions and tax-deferred employee contributions.

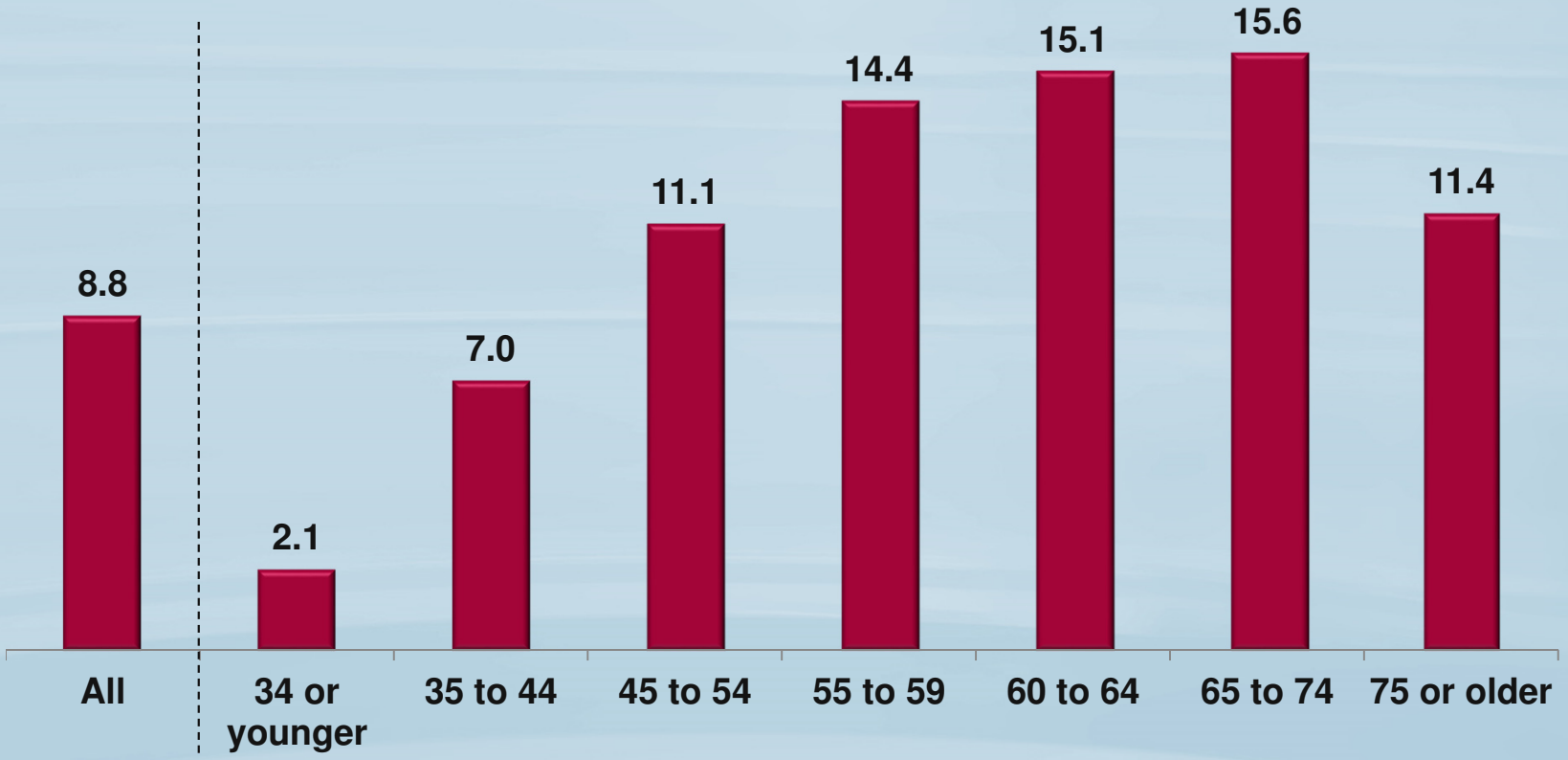
Freeze Projected to Cut Retirement Plan Limits by Roughly 20 Percent

	DC employee contribution limit	DC total contribution limit	DB plan annual benefit limit
Projected 2024 limits under current law	22,000	65,000	260,000
Projected 2024 limits under Camp 10-year freeze	17,500	53,000	210,000
Projected reduction in 2024 limits relative to current law			
Dollars	-4,500	-12,000	-50,000
Percent	-20.5%	-18.5%	-19.2%

Note: Projections use CBO inflation forecast
Source: Investment Company Institute

Freeze on Limits Most Likely to Impact Workers Approaching Retirement

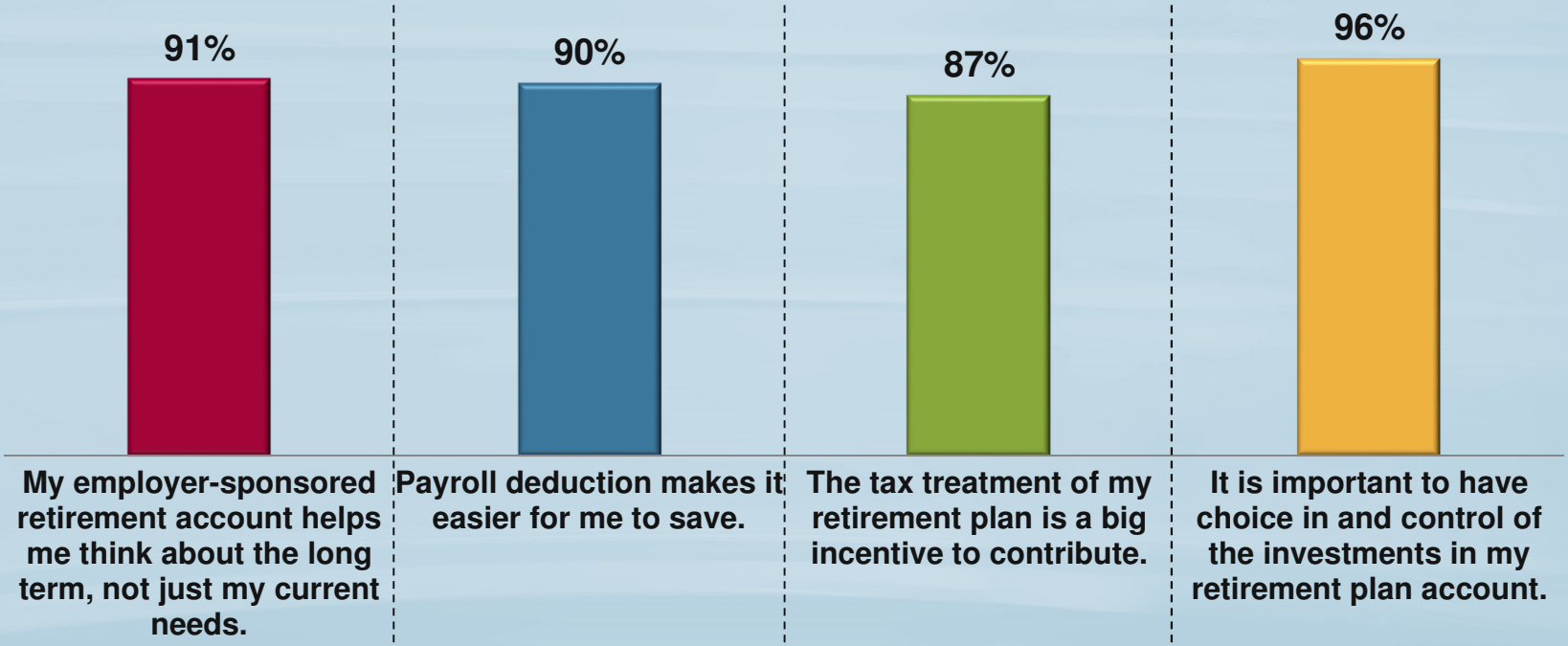
Percent of W-2 workers with employee contributions to DC plan who contribute at the limit, by age, 2010



Source: Internal Revenue Service Statistics of Income Division

Workers Like Their DC Plans

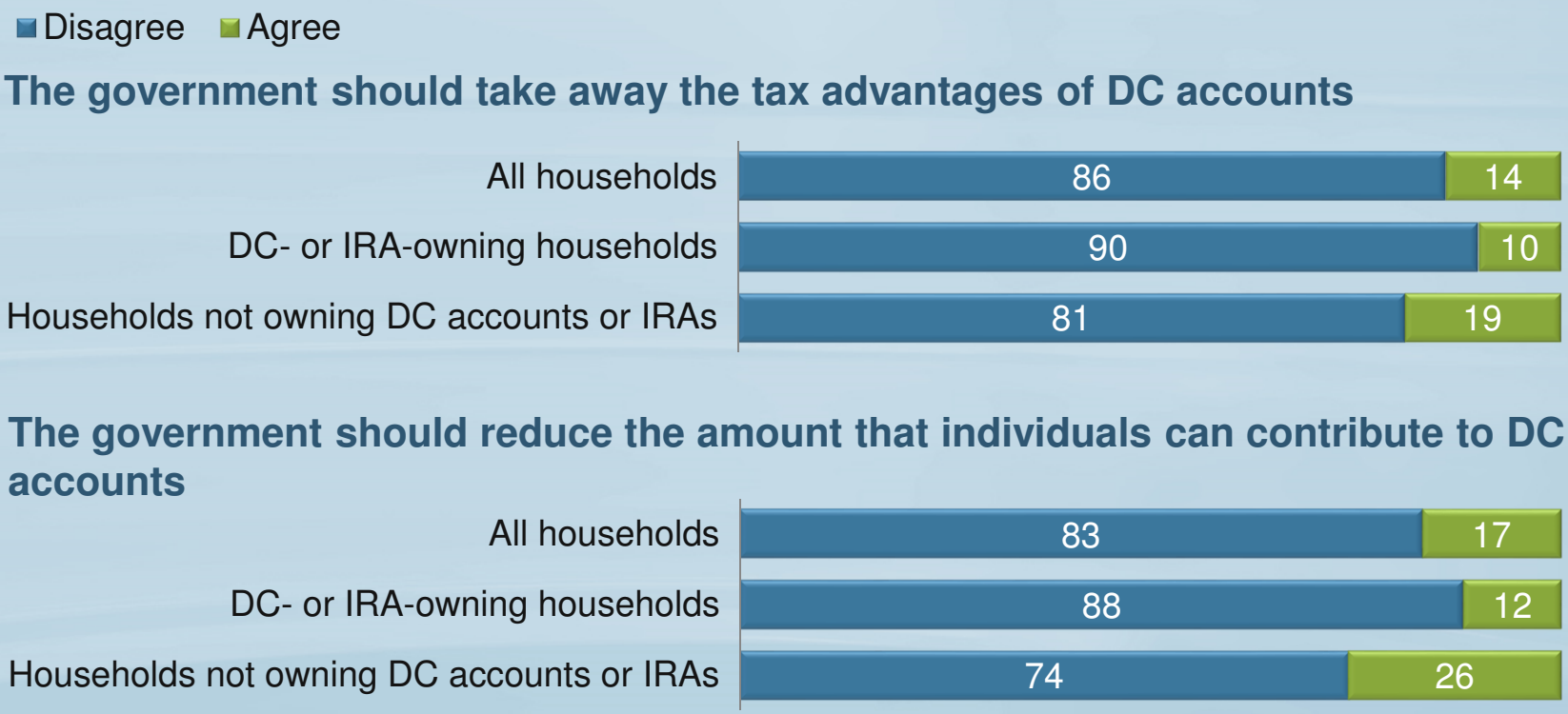
Percentage of DC-owning households agreeing with each statement, November 2013–December 2013



Note: Figure reports the percentage of DC-owning households who "strongly agreed" or "somewhat agreed" with the statement.
Source: ICI tabulation of GfK OmniTel survey data (November 2013–December 2013); see Burham, Bogdan, and Schrass, "Americans' Views on Defined Contribution Plan Saving," *ICI Research Report* (January 2014)

Large Majorities of Americans Want to Keep DC Plan Tax Features

Percentage of U.S. households agreeing or disagreeing, fall 2013



Source: ICI tabulation of GfK OmniTel survey data (November 2013–December 2013); see Burham, Bogdan, and Schrass, "Americans' Views on Defined Contribution Plan Saving," *ICI Research Report* (January 2014)

Key Takeaways

- The conventional wisdom that the U.S. is facing a retirement crisis is overstated.
- Policy changes should build on the success of the U.S. retirement system and target those at risk.
- Current tax proposals target DC plans—would reduce the incentive for employers to offer a plan disproportionately impact private-sector workers.

References

Burham, Kimberly, Michael Bogdan, and Daniel Schrass. 2014. "Americans' Views on Defined Contribution Plan Saving." *ICI Research Report*. Washington, DC: Investment Company Institute (January). www.ici.org/pdf/ppr_14_dc_plan_saving.pdf

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Utkus, Steve. 2014. "Four Views of Retirement Preparation," presented at the *2014 ICI Retirement Summit: A Close Look at Retirement Preparedness in America* (April). www.ici.org/pdf/ppt_14_summit_utkus.pdf