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Statement of the Investment Company Institute at Senate Finance Committee Hearing on “Retirement Savings 2.0: Updating Savings Policy for the Modern Economy”

By Brian Reid

This statement was given on behalf of ICI by Brian Reid, chief economist, at the Senate Finance Committee’s hearing on “Retirement Savings 2.0: Updating Savings Policy for the Modern Economy.” For more information, see ICI’s full written testimony.

Thank you, Chairman Wyden and Ranking Member Hatch, for this opportunity to testify.

I am Brian Reid, chief economist of the Investment Company Institute, the world’s leading association of regulated funds. ICI’s U.S. members manage assets of more than $17 trillion and serve more than 90 million shareholders.

To the point of today’s hearing, mutual funds manage about half of defined contribution plan and individual retirement account assets. ICI has devoted years of research and considerable resources to making and communicating an accurate assessment of America’s retirement system.

Today, such an assessment must recognize three key facts:

1. America’s retirement system is working to build retirement security for a majority of Americans.
2. The tax incentives for retirement saving—based in deferral of taxes, not in tax exclusion or tax deduction—are key to the successes and strengths of that system.
3. While there are opportunities to improve our retirement system, changes should build on our current structure—and not put today’s retirement system at risk.

Those statements may contradict much of what you often hear—so let me explain.

Not only does Social Security cover nearly all working Americans, but 80 percent of near-retiree households in 2013 had accrued pension benefits. And a wide range of government, academic, and industry research demonstrates that the American retirement system has become stronger in the past half century.

The poverty rate among the elderly has fallen since 1966 from nearly 30 percent to 9 percent—the lowest among all age groups. And since 1975, the amount of assets earmarked for retirement per household has increased seven-fold, after adjusting for inflation; the share of retirees receiving private-sector pension income has increased by more than 60 percent; and the median private-sector pension income that retirees receive after adjusting for inflation has increased by nearly 40 percent.

These statistics speak to the impact of Congress’s bipartisan efforts that transformed Social Security into a strong foundation for America’s retirement system, and that created a framework of laws and tax incentives on which voluntary private employer plans and IRAs have grown and thrived.

As important as the tax incentives are in encouraging employers to offer plans and employees to participate in them, the nature and role of these incentives is often misunderstood.

The incentives take the form of *tax deferrals,* because contributions and earnings to traditional retirement plans *are* taxed when a retiree withdraws income. This is fundamentally different from tax deductions or exclusions, where the initial tax reduction is never recovered.

In economic terms, it is the after-tax rate of return that is the incentive to save. Tax deferral effectively taxes investment income at a zero tax rate for retirement savers in all income groups. Thus, rather than creating a so-called “upside-down incentive” for saving, tax deferral *equalizes* the incentive to save across retirement savers in all income groups and encourages support for employer-sponsored pension plans among a wide range of workers.

The American people overwhelmingly support today’s defined contribution retirement plans, including the tax incentives. In a fall 2013 survey, 86 percent disagreed with the idea of eliminating the tax advantages of defined contribution plans, and 83 percent opposed any reduction in employee contribution limits.

Now, despite the strengths and successes of our system, it can be improved. But changes to the current system should build upon the existing system—not put it at risk. ICI supports measures to:

- promote retirement savings;
- put Social Security on a sound financial footing as a universal, employment-based, progressive plan for all Americans;
- foster innovation and growth in the voluntary retirement savings system;
- help smaller employers by offering simpler plan features and easier access to multiple employer plans; and
- provide flexible approaches to retirement income.

What is central to these ideas is that they *build upon*—and do not undermine or replace—our current retirement system. This system depends critically on the tax incentives that Congress has provided for retirement saving.

Proposals to reduce the tax benefits of employer-sponsored retirement plans would *not* merely affect upper-income workers and reduce their desire to participate in such plans. Instead, they would undoubtedly *reduce* the number of employers that sponsor a retirement plan, depriving workers of all ages and incomes the many benefits of plan participation.

In short, our retirement system has many strengths and successes, and building upon our strong voluntary system will enhance Americans’ retirement security for generations to come.

Thank you, and I look forward to your questions.

Brian Reid was Chief Economist of the Investment Company Institute.
