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The Role of IRAs in Americans' Retirement Preparedness

Key Findings

- **IRAs and employer-sponsored retirement plans are the two main types of tax-advantaged savings vehicles available to Americans:** About 70 percent of American households either have retirement plans through work or own IRAs.
- **Households that invest in IRAs can accumulate sizeable balances in these accounts:** In 2005, households that owned IRAs for 10 or more years and contributed to them in tax-year 2004 had average IRA assets of $116,000. By comparison, three-quarters of all U.S. households had total household financial assets of less than $100,000 in 2001.
- **Despite the boost IRAs can give to retirement savings, the majority of U.S. households currently do not take advantage of them:** Only 41 percent of U.S. households own IRAs. Furthermore, most households do not make annual contributions to IRAs. Less than two out of every 10 U.S. households contributed to IRAs in tax-year 2004, and very few eligible households made "catch-up" contributions.

Retirement Savings is a Primary Financial Goal for Americans

Americans frequently rank preparing for retirement as one of their primary financial goals.[1] In the United States, two main types of formal retirement savings arrangements are available to help individuals and families attain that goal: Individual Retirement Accounts (IRAs) and employer-sponsored retirement plans, which include traditional pension plans as well as defined contribution plans, such as 401(k) and 403(b) plans. This issue of *Fundamentals* summarizes the results of an ICI survey of Americans' use of IRAs.[2]

History of the IRA	
Traditional IRA	1974 (Employee Retirement Income Security Act)
SEP IRA	1978 (Revenue Act)
SAR-SEP IRA	1986 (Tax Reform Act)
SIMPLE IRA	1996 (Small Business Job Protection Act)
Roth IRA	1997 (Taxpayer Relief Act)

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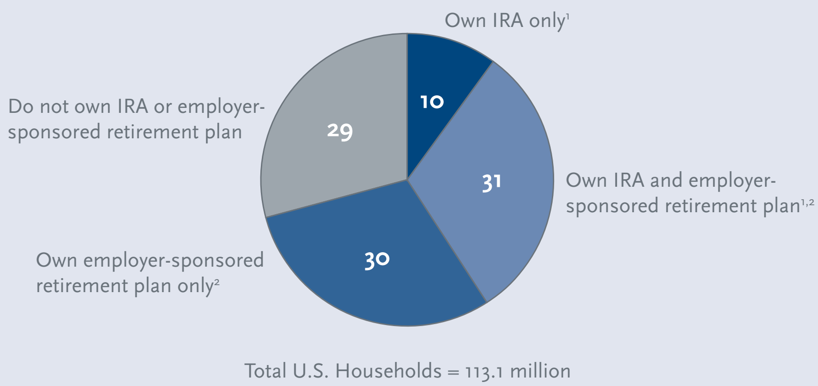
About Four in 10 Households Own IRAs

About 70 percent of all U.S. households have some type of formal, tax-advantaged retirement savings (Figure 1). More than 60 percent have employer-sponsored retirement plans. Only 41 percent, or 46.8 million U.S. households, own IRAs (Figure 2), even though most households are eligible to make contributions to them. Households most frequently own traditional IRAs—the first type of IRA created by Congress. Roth IRAs are the second most frequently owned type of IRA, followed by employer-sponsored IRAs, which include SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.

Figure 1

Many U.S. Households Have Tax-Advantaged Retirement Savings

Percent of U.S. households with IRAs and employer-sponsored retirement plans, 2005



[1]IRAs include traditional IRAs, Roth IRAs, SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.
[2]Employer-sponsored retirement plans include defined contribution and defined benefit retirement plans.
sources: Investment Company Institute and U.S. Bureau of the Census

Figure 2

U.S. Households Most Frequently Own Traditional IRAs

Millions of U.S. households owning IRAs, 2005

	Any type of IRA[1]	Traditional IRA	Roth IRA	Employer-sponsored IRA[2]
Percent of U.S. Households	41.4%	33.2%	14.2%	7.8%

[1]Households may own more than one type of IRA.
[2]Employer-sponsored IRAs include SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.
sources: Investment Company Institute and U.S. Bureau of the Census

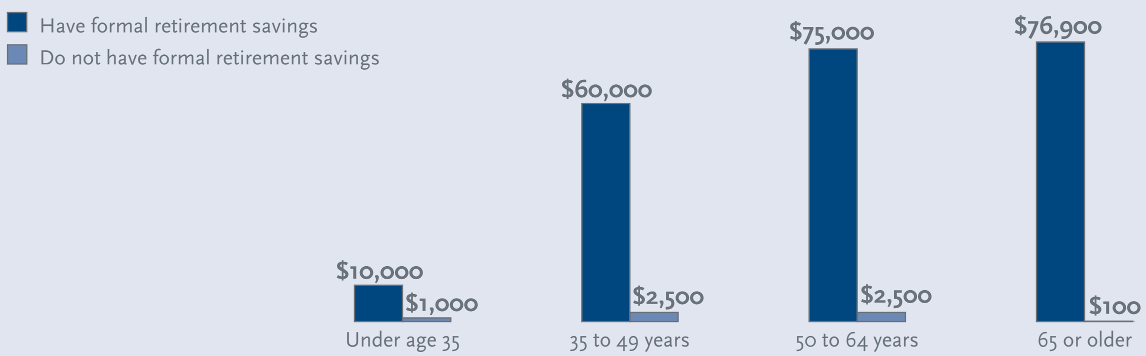
Households With IRAs Have More Savings than Other Households

Both employer-sponsored retirement plans and IRAs provide opportunities for U.S. workers to set aside assets for retirement in tax-advantaged vehicles. Households with these formal retirement savings arrangements typically have accumulated more financial assets than those who have not taken advantage of these accounts (Figure 3). In 2005, for example, median financial assets of households owning IRAs were six times greater than the financial assets of households that do not own IRAs (Figure 4).

Figure 3

Households With Formal Retirement Savings[1] Have Greater Total Financial Assets

Median total household financial assets, by age of head of household and formal retirement savings, 2005



[1]*Formal retirement savings include IRAs, employer-sponsored retirement plans, or both.*

source: Investment Company Institute

IRA owners typically exhibit the characteristics of individuals who are most likely to save. An individual's propensity to save increases with age, educational attainment, and income; and married people tend to save more than single people.[3] Following this pattern, the financial decisionmakers of households with IRAs tend to be older and are more likely to be married, employed, and have college or postgraduate degrees than those without IRAs.

IRAs help households build their savings over time. For example, in 2005, households owning IRAs for less than five years had median IRA holdings of $7,000, while households owning IRAs for 20 years or more had median IRA holdings of $35,300 (Figure 5). Mean IRA holdings, while considerably higher than the median values, follow a similar pattern.

Figure 4

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

Characteristics of U.S. households, by ownership of IRAs, 2005

	Households Owning IRAs[1]	Households Not Owning IRAs
Median Per Household		
Age of household sole or co-decisionmaker for investing	52 years	45 years
Household income	$70,000	$34,000
Household financial assets[2]	$150,000	$25,000
Household financial assets in IRAs	$30,000	NA
Share of household financial assets in IRAs	25%	NA
Percent of Households		
Household sole or co-decisionmaker for investing:		
Married	62	44
College or postgraduate degree	59	28
Employed full- or part-time	71	62
Retired from lifetime occupation	26	25
Household has defined contribution plan account or defined benefit plan coverage (total)	73	51
Defined contribution retirement plan account	67	43
Defined benefit plan coverage	45	28

NA=not applicable

[1]IRAs include traditional IRAs, Roth IRAs, SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.

[2]Household financial assets include assets in employer-sponsored retirement plans but exclude primary residence.

note: Number of respondents varies. Data for households owning IRAs are from ICI's May 2005 survey of U.S. households owning IRAs. Data for households not owning IRAs are from ICI's June 2005 Mutual Fund Shareholder Tracking Survey.

source: Investment Company Institute

Even more striking is how effective IRAs can be in building assets over time for investors who make ongoing contributions. Among households that have owned IRAs for at least 10 years and contributed to them in tax-year 2004, the average IRA balance in 2005 was $116,000 and the median balance was $60,000. Most U.S. households have not saved nearly this much. According to the Federal Reserve Board's *2001 Survey of Consumer Finances*, three-quarters of all U.S. households have total financial assets below $100,000, including IRA assets.[4]

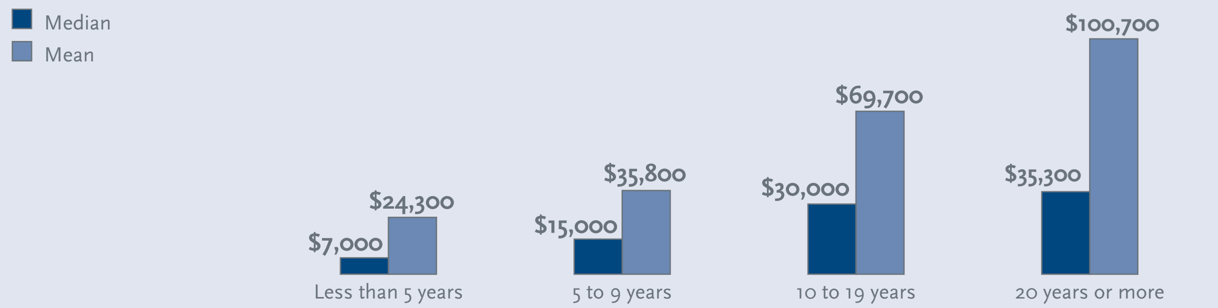
Traditional IRAs' Rollover Feature Preserves Retirement Savings

Traditional IRAs were designed with a dual purpose: to provide individuals not covered by retirement plans at work with the opportunity to save for retirement, and to give retiring workers or individuals changing jobs a means to preserve the tax-advantaged status of employer-sponsored retirement plan assets by allowing transfers, or "rollovers," of plan balances into IRAs.

Figure 5

IRA Assets Increase With Length of Ownership

Median and mean household financial assets in IRAs, by length of ownership, 2005



source: Investment Company Institute

The rollover feature has helped many Americans sustain their retirement savings. In 2002, households transferred about $200 billion from employer-sponsored retirement plans to IRAs.[5] In 2005, more than 16 million U.S. households, or 43 percent of all U.S. households owning traditional IRAs, had traditional IRAs that included rollover assets.[6] During their most recent rollovers, the vast majority of these households transferred their entire retirement plan balances into traditional IRAs.

The rollover feature is especially beneficial to individuals who change jobs during their careers or leave the work force for reasons other than retirement. In 2005, nearly two-thirds of households with traditional IRAs that include rollover assets said their rollovers were due to jobs changes, lay-offs, or employment terminations. About one-third conducted rollovers at retirement.

A comparison of the traditional IRA assets of households that have and have not conducted rollovers demonstrates the positive effect of the rollover feature on retirement savings. Median traditional IRA holdings that include rollovers were $50,000 in 2005, while median traditional IRA holdings that did not include rollovers were $20,000 (Figure 6).

Figure 6

Traditional IRAs Preserve Assets from Employer-Sponsored Retirement Plans

Traditional IRA assets, by employer-sponsored retirement plan rollover activity, 2005

	Traditional IRA Includes Rollover from Employer-Sponsored Retirement Plan[1]	Traditional IRA Does Not Include Rollover from Employer-Sponsored Retirement Plan[2]
Traditional IRA Assets		
Mean	$107,000	$46,500
Median	$50,000	$20,000
Household Financial Assets[3]		
Mean	$325,000	$257,200
Median	$200,000	$146,000

[1]Forty-three percent of households owning traditional IRAs have traditional IRAs that include rollovers from employer-sponsored retirement plans.
[2]Fifty-seven percent of households owning traditional IRAs have traditional IRAs that do not include rollovers from employer-sponsored retirement plans.
[3]Household financial assets include assets in employer-sponsored retirement plans but exclude primary residence.
source: Investment Company Institute

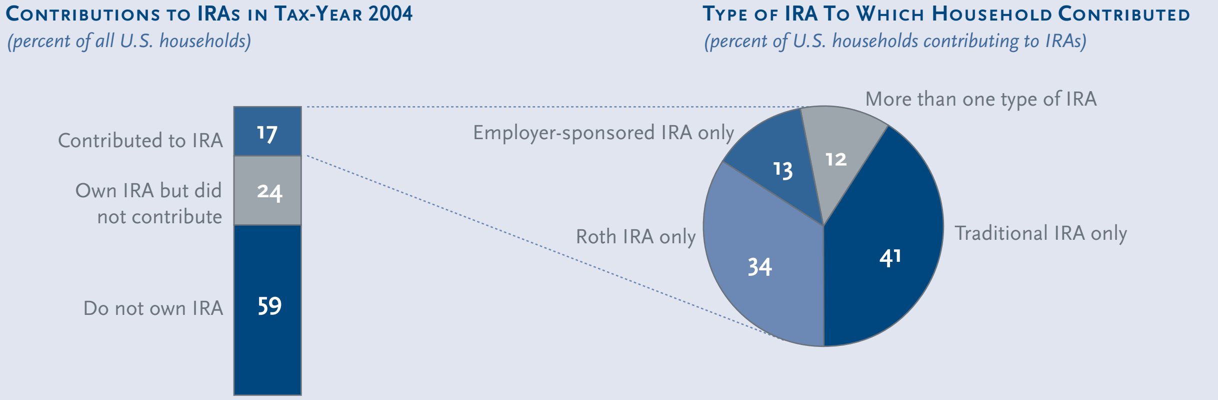
Most Households Do Not Contribute to IRAs

Although IRAs can help Americans build their retirement savings, the majority of U.S. households do not contribute to them. In tax-year 2004, only 17 percent of all U.S. households made IRA contributions (Figure 7). Because there are many more traditional IRA owners than owners of other types of IRAs, contributors to traditional IRAs represent the largest share of all households making IRA contributions.

When contributions to IRAs are examined by the type of IRA owned, however, traditional IRA owners are less likely than owners of other types of IRAs to

Figure 7

Few Households Contribute to IRAs



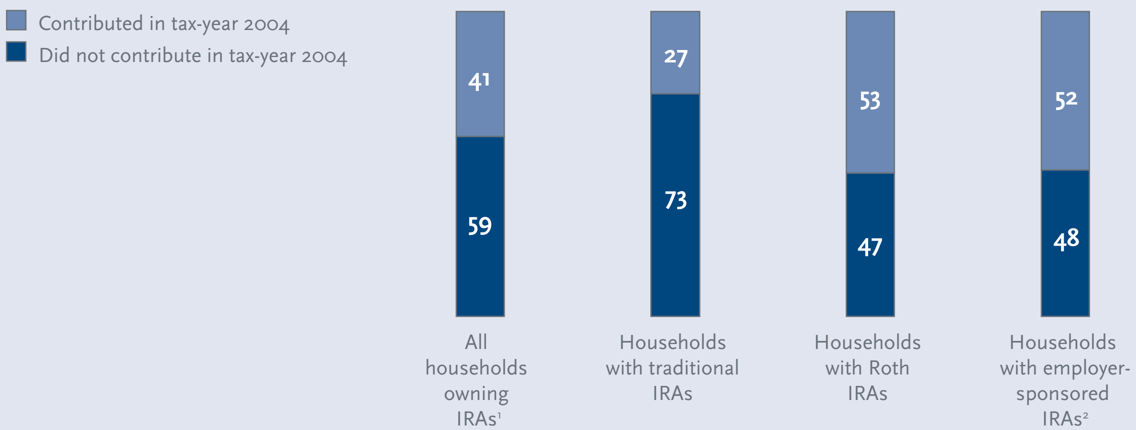
sources: Investment Company Institute and U.S. Bureau of the Census make contributions. For example, more than half of households owning Roth IRAs or employer-sponsored IRAs contributed to these IRAs in tax-year 2004 (Figure 8). In contrast, only 27 percent of traditional IRA-owning households contributed to their traditional IRAs in tax-year 2004. The lower contribution rate to traditional IRAs is likely due to tax deductibility restrictions.

In addition, the typical household contribution to each type of IRA varies, partly because IRA contribution limits are not uniform. The median contribution among households contributing to Roth IRAs was $3,000 in tax-year 2004, while the typical contribution to traditional IRAs was $2,300 per household. For employer-sponsored IRAs, which generally have higher contribution limits, the median household contribution was $5,000.

Figure 8

Contribution Activity to Roth, Employer-Sponsored IRAs Outpaces Contribution Activity to Traditional IRAs

Percent of households owning each type of IRA, by contribution status in tax-year 2004



	All households owning IRAs[1]	Households with traditional IRAs	Households with Roth IRAs	Households with employer-sponsored IRAs[2]
Median contribution per household to type of IRA indicated	$3,000	$2,300	$3,000	$5,000

[1]IRAs include traditional IRAs, Roth IRAs, SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.
[2]Employer-sponsored IRAs include SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.
source: Investment Company Institute

"Catch-Up" Contributions Infrequent Among Eligible Households

Very few households with individuals age 50 or older make catch-up contributions to IRAs, which were first permitted in tax-year 2002. Only 6 percent of all U.S. households with individuals eligible to make catch-up contributions did so in tax-year 2004 (Figure 9).

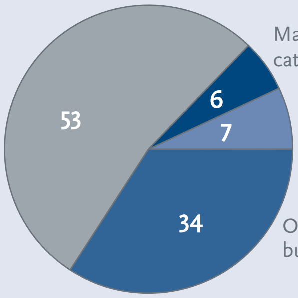
Nonetheless, the share of IRA owners making catch-up contributions has increased slightly since tax-year 2002. Nearly one-third of households owning Roth IRAs that qualified to make catch-up contributions did so in tax-year 2004, up from 16 percent in tax-year 2002 (Figure 10).[7] Among households with traditional IRAs that were eligible to make catch-up contributions, the share making additional contributions has also increased from 11 percent in tax-year 2002 to 16 percent in tax-year 2004.[8]

Although few eligible households are making catch-up contributions, awareness of the catch-up contribution feature is widespread. Among traditional and Roth IRA owners age 50 or older who did not make catch-up contributions in 2005, nearly three-quarters said they knew about the provision.

Figure 9

Traditional and Roth IRA Catch-Up Contributions Are Infrequent

Percent of U.S. households with individuals age 50 or older, by contribution status in tax-year 2004



source: Investment Company Institute

Figure 10

Catch-Up Contribution Activity Is Increasing Among IRA Households

	Tax-Year 2002	Tax-Year 2003	Tax-Year 2004
Traditional IRA Households[1] *(percent of households owning traditional IRAs that qualified to make catch-up contributions)*			
Made a catch-up contribution	11	13	16
Contributed, but did not make a catch-up contribution	13	21	18
Did not contribute[2]	76	66	66
Roth IRA Households[3] *(percent of households owning Roth IRAs that qualified to make catch-up contributions)*			
Made a catch-up contribution	16	25	32
Contributed, but did not make a catch-up contribution	15	22	23
Did not contribute	70	53	45

[1]*Households that may make catch-up contributions to traditional IRAs are those in which a household member is at least age 50 but less than 70½ years old.*

[2]*This group may include households ineligible to make deductible contributions to traditional IRAs.*

[3]*Households that may make catch-up contributions to Roth IRAs are those with incomes within the limits to contribute to a Roth IRA and in which a household member is age 50 or older.*

note: Number of respondents varies.

source: Investment Company Institute

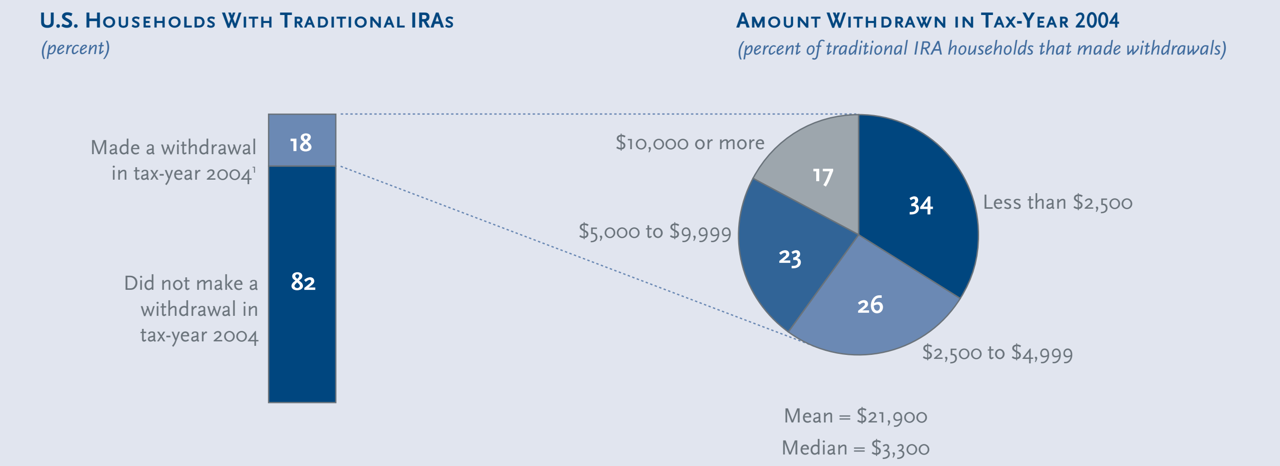
IRA Withdrawals Infrequent, Mostly Made by Older Owners

Very few households withdraw money from their IRAs in any given year. Less than one-fifth of households owning traditional IRAs took withdrawals from these IRAs in tax-year 2004 (Figure 11).[9] Among those who withdrew that year, most made modest-sized withdrawals. The typical amount withdrawn in tax-year 2004 was $3,300, a median of 8 percent of the account balance.

Withdrawals from traditional IRAs typically are made to meet minimum distribution requirements. About three-quarters of those who made withdrawals in tax-year 2004 were satisfying this requirement (Figure 12).

Figure 11

Withdrawals from Traditional IRAs Are Infrequent



[1]Households that made a withdrawal excludes those which closed and no longer own traditional IRAs.
note: Number of respondents varies.
source: Investment Company Institute

Traditional IRA owners who made withdrawals in tax-year 2004 have very different demographic characteristics from those who did not make withdrawals. Most notably, the traditional IRA owners who took withdrawals generally were much older than those who did not. Because the traditional IRA owners who took withdrawals were older, they were also much more likely to be retired, widowed, and have lower household incomes and financial assets.

FIGURE 12

MOST TRADITIONAL IRA WITHDRAWALS ARE MADE TO MEET MINIMUM DISTRIBUTION REQUIREMENTS

Characteristics of U.S. households owning traditional IRAs, by withdrawal status in tax-year 2004

	Made a Withdrawal from a Traditional IRA in Tax-Year 2004[1]	Did Not Make a Withdrawal from a Traditional IRA in Tax-Year 2004[2]
Median Per Household		
Age of household sole or co-decisionmaker for investing	72 years	52 years
Household income	$44,300	$73,900
Household financial assets[3]	$166,400	$200,000
Household financial assets in all types of IRAs	$30,000	$22,500
Percent of Households		
Household sole or co-decisionmaker for investing:		
Married	60	63
Widowed	21	7
Retired from lifetime occupation	75	22
Reasons for Withdrawal(s):[4]		
Take a required minimum distribution	76	NA
Pay bills or other living expenses	16	NA
Pay for travel	8	NA
Pay for an unexpected medical illness	7	NA
Make a large purchase	6	NA
Purchase investments outside of an IRA	4	NA
Other reasons	14	NA

NA=not applicable

[1]Eighteen percent of households owning traditional IRAs withdrew money from them in tax-year 2004. The sample size is small. This group excludes households that closed and no longer own traditional IRAs.

[2]Eighty-two percent of households owning traditional IRAs did not withdraw money from them in tax-year 2004.

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

[4]Multiple responses are included.

note: Number of respondents varies.

source: Investment Company Institute

Notes

[1] See "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin,* January 2003, p. 6 (www.federalreserve.gov/pubs/bulletin/2003/0103lead.pdf) and Investment Company Institute Research Series, *Profile of Mutual Fund Shareholders,* 2004, p. 10 (www.ici.org/pdf/rpt_profile04.pdf).

[2] Data presented in this issue of *Fundamentals* on the number and percentage of households owning IRAs are based on an annual survey conducted in June 2005 of 3,000 randomly selected, representative U.S. households (the standard error for the total sample is ± 1.8 percentage points at the 95 percent confidence level). The demographic and financial characteristics of IRA owners are derived from a separate May 2005 survey of 595 randomly selected, representative U.S. households owning IRAs, including traditional IRAs, Roth IRAs, SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs (the standard error for the total sample is ± 4.0 percentage points at the 95 percent confidence level). IRA ownership does not include ownership of Coverdell Education Savings Accounts (formerly called Education IRAs).

Additional data on household ownership of IRAs are available in an Appendix on ICI's website (www.ici.org/pdf/fmv15n1_appendix.pdf). For a brief history of IRAs and a discussion of the various features of different IRA types, see Sarah Holden, Kathy Ireland, Vicky Leonard-Chambers, and Michael Bogdan, "The Individual Retirement Account at Age 30: A Retrospective," *ICI Perspective*, Vol. 11, No. 1, February 2005 (www.ici.org/pdf/per11-01.pdf) (to be referenced as ICI (February 2005) in the remainder of this publication).

For the rules governing IRAs, see IRS *Publication 590, Individual Retirement Arrangements* (www.irs.gov/pub/irs-pdf/p590.pdf) (to be referenced as IRS *Publication 590* in the remainder of this publication).

[3] See ICI (February 2005) for a discussion of the relationship between demographic characteristics and the propensity to save.

[4] Federal Reserve Board, *2001 Survey of Consumer Finances,* tabulations by ICI.

[5] See Figure A8 in "Appendix: Additional Data on Mutual Funds and the U.S. Retirement Market in 2004," *ICI Fundamentals,* Vol. 14, No. 4A, August 2005 (www.ici.org/pdf/fm-v14n4_appendix.pdf).

[6] Roth IRAs are not eligible for direct rollovers from employer-sponsored retirement plan accounts (see IRS *Publication 590*). See the online appendix for additional data on households with IRAs that include rollover assets.

[7] Households that may make catch-up contributions to Roth IRAs are those with incomes within the limits to contribute to a Roth IRA and in which a household member is age 50 or older (see IRS *Publication 590*).

[8] Households that may make catch-up contributions to traditional IRAs are those in which a household member is at least age 50 but less than 70½ years old (see IRS *Publication 590*). Some of these households may be ineligible to make deductible contributions to traditional IRAs.

[9] Data exclude households that closed and no longer own traditional IRAs.

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