Statement of
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SUBMITTED TO THE
Committee on Finance
U.S. Senate
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Retirement Savings 2.0: Updating Savings Policy for the Modern Economy

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The Savings Coalition was established in 1991 to support incentives to increase personal savings in the United States. The Coalition's main objective is to enhance savings opportunities for all Americans. There are approximately 45 member organizations of the Savings Coalition representing a wide variety of private interests including banking, securities, financial services, consumer groups, engineering, home-building, realtors, tangible assets, trust companies, health care industry, insurance, education and business groups.

The Coalition commends the Committee for its efforts to make it easier for Americans to save for their retirements. Tens of millions of Americans are saving for retirement and benefitting from the enhancements and simplifications made to retirement savings vehicles. The Coalition believes that more people will save for retirement if the eligibility rules for these vehicles are easier to understand.

In thinking about updating savings policy for the modern economy, the Coalition has three key points:

- **First, there are many components to Americans' retirement resources, which draw from government programs, homeownership, compensation deferred until retirement, and other savings.** Social Security provides a nearly universal base. Complementing Social Security are employer-sponsored retirement plans—defined contribution (DC) plan accounts or defined benefit (DB) plan accumulations, and individual retirement accounts (IRAs). The assets that are specially earmarked for retirement are a key component to Americans' retirement resources and any policy changes should strive to build on this strong system.

- **Second, it is important to recognize that tax deferral is not the same as a tax exclusion or tax deduction; taxes are paid on distributions from retirement accounts and plans.** Reducing contribution limits would hurt workers across all incomes. In addition, Americans support the tax treatment of DC plans and want to preserve the key features of DC plans.

- **Third, the role of individual retirement accounts (IRAs) could be strengthened by simplifying the contribution rules and delaying required minimum distributions (RMDs).** Complex eligibility rules for IRA contributions deter IRA contribution activity; making IRA contributions universally available would encourage saving through IRAs. With growing life expectancies and an age to start RMDs that has not been updated in decades, raising the RMD age would help American workers preserve their IRAs to later in their retirements.

BACKGROUND

The U.S. retirement system is a comprehensive structure where private savings play a fundamental role for ensuring Americans an adequate retirement. The U.S. retirement system taken in its entirety is strong.[1] Rather than a three-legged stool, retirement resources are best thought of as a pyramid.[2] Social Security forms a strong foundation for the pyramid of retirement resources. Social Security provides retirement income for almost all working Americans, with higher replacement rates for lower-earning households, reflecting the highly progressive Social Security benefit formula. As lifetime earnings increase, Social Security benefits are a smaller and smaller share of workers' earnings. To maintain their standard of living in retirement, workers with higher earnings need to save more of their income to supplement Social Security benefits. Homeownership is another important layer of the pyramid, and some households have other assets. It is important to note that this structure is effective for Americans of all income levels, although the importance of each layer of the pyramid will vary across households.

MAJORITY OF AMERICANS HAVE RETIREMENT SAVINGS

As of March 31, 2014, retirement assets have grown to $23.0 trillion.[3] According to the *2014 Investment Company Institute Fact Book*, *"sixty-seven percent of U.S. households (or 82 million households) reported that they had employer-sponsored retirement plans, IRAs, or both in May 2013."*[4] Such resources represent an important component of Americans' retirement resources.

Despite the growth in retirement assets and in the number of households with retirement accumulations, there are some Americans who are not on track to be prepared for retirement. As a result, retirement policies should identify those individuals who are not making use of existing

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[1] See American Council of Life Insurers, American Benefits Council, and Investment Company Institute, *Our Strong Retirement System: An American Success Story* (December 2013), available at www.ici.org/pdf/ppr_13_strong_retirement.pdf.

[2] See Brady, Burham, and Holden, "The Success of the U.S. Retirement System," *ICI White Paper* (December 2012), available at www.ici.org/pdf/ppr_12_success_retirement.pdf.

[3] See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2014" (June 2014), available at www.ici.org/info/ret_14_q1_data.xls.

[4] See Chapter 7 in Investment Company Institute, *2014 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry* (2014), available at www.icifactbook.org/fb_ch7.html.

retirement vehicles and be targeted to helping such individuals overcome the barriers that are keeping them from getting on the path to a financially secure retirement. Moreover, any policy initiatives considered in the context of tax reform or deficit reduction should be carefully vetted to ensure that they won't have the unintended negative consequence of reducing retirement preparedness.

TAXES ARE DEFERRED

The Joint Committee on Taxation (JCT) estimates that tax benefits for retirement savings represent one of the largest tax expenditures in the Internal Revenue Code. As a result, some have argued that these tax incentives should be reduced or eliminated in the context of deficit reduction or comprehensive tax reform. However, it is important to recognize that tax incentives for retirement merely represent a *deferral* of tax. American savers receive tax benefits when accumulating retirement savings, but they pay tax – at ordinary income tax rates – when amounts are withdrawn during retirement. A recent study by the American Society of Pension Professionals & Actuaries (ASPPA) found that revenue estimates from the JCT and the Treasury Department's Office of Tax Analysis (OTA) overstated the true cost of retirement tax incentives by as much as 77 percent. According to the ASPPA study, "*The one-year present value tax expenditure estimates are 34 percent lower than the JCT estimates and 54 percent lower than the Treasury one-year estimates. Similarly, the one-year present-value tax expenditure estimates are lower than the Treasury one-year present-value estimates by approximately 77 percent.*"[5]

Moreover, a reduction in retirement tax incentives could reduce plan formation and negatively impact retirement savings for Americans at all income levels, which could lead to increased reliance on Federal safety net programs.

DECREASING TAX BENEFITS WILL HARM LOWER-INCOME AMERICANS

In December 2010, the National Commission on Fiscal Responsibility and Reform released its report on federal deficit reduction. The report provided several illustrative examples of options for reducing the deficit through tax reform. One of the options included in the report would consolidate retirement accounts and cap annual tax-preferred total (employer and employee) contributions to DC plans to the lower of $20,000 or 20% of income – an option that has come to be called the "20/20 plan."[6]

A recent study by the Employee Benefit Research Institute (EBRI) found that capping the tax benefit for retirement savings, as proposed under the 20/20 plan would reduce retirement security

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[5] See Xanthopoloulos and Schmitt, *Retirement Savings and Tax Expenditure Estimates,* American Society of Pension Professionals & Actuaries (May 2011), available at www.asppa.org/Portals/2/APerspectiveOnTaxPolicyToPromoteRetirementSavingsMay2011.pdf.pdf.

[6] See page 31 in The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth* (December 2010), available at www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

for workers at all income levels.[7] According to the study, those in the lowest-income quartile (of all but the oldest age group) will experience the second highest average percentage reduction in retirement savings.[8]

Lower-income workers would be especially harmed by proposals that would reduce retirement tax incentives and discourage small businesses from offering retirement plans. In her written testimony submitted to this Committee, Judy Miller, testifying on behalf of ASPPA, stated that, *"Reducing the maximum contribution from the current $49,000 to $20,000 would mean the qualified retirement plan no longer makes financial sense for many small business owners. The result would be less access to retirement savings opportunities at work for rank and file employees. In a survey of "cross-tested" plans conducted by the American Society of Pension Professionals and Actuaries (ASPPA), 65% of plan sponsors indicated they were likely to terminate the cross-tested plan if the plan design were no longer available. A dramatic reduction in the limit would effectively make not only a cross-tested plan, but most other qualified defined contribution plans, unattractive to small business owners."*[9]

INVESTORS WANT AND VALUE RETIREMENT SAVINGS TAX INCENTIVES

A wide range of research demonstrates that Americans value and want to retain retirement savings tax incentives and that changes in the tax incentives could negatively impact savings behaviors.

- 83 percent of Fidelity retail customers indicated that retirement savings is an important tax benefit that they want Congress to protect.[10]
- A fall 2013 survey of more than 3,000 U.S. households found that 86 percent of all households do not want the government to take away DC tax benefits and 83 percent rejected the idea that the amount individuals can contribute to DC accounts should be reduced.[11]
- In the fall of 2013, 87 percent of DC account–owning households indicated the tax treatment of their DC plan was a big incentive to contribute.[12]

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[7] See VanDerhei, "Tax Reform Options: Promoting Retirement Security," *EBRI Issue Brief* (November 2011), available at www.ebri.org/pdf/briefspdf/EBRI_IB_11-2011_No364_RetTaxRfm.pdf.

[8] *Ibid*, Figure 2.

[9] See page 14 in Miller, "Testimony Submitted by Judy A. Miller on behalf of the American Society of Pension Professionals and Actuaries, Senate Finance Committee Hearing: Tax Reform Options: Promoting Retirement Security" (September 15, 2011), available at www.finance.senate.gov/imo/media/doc/Testimony%20of%20Judy%20Miller.pdf.

[10] March 2011 Fidelity Survey – Online Survey of Fidelity Retail customers using the Customer Advisory Panel fielded March 9 to March 22, 2011

[11] See Figure 3 in Burham, Bogdan, and Schrass, "Americans' Views on Defined Contribution Plan Saving," *ICI Research Report* (January 2014), available at www.ici.org/pdf/ppr_14_dc_plan_saving.pdf.

[12] *Ibid*, Figure 2.

- The 2011 EBRI Retirement Confidence Survey (RCS) found that lower-income workers are more likely to reduce the amount of contributions made to their retirement savings accounts if the tax deduction were to be eliminated.[13]

INDIVIDUAL RETIREMENT ACCOUNTS

The Savings Coalition of America has actively supported the expanded Individual Retirement Account (IRA) provisions that increased contributions to spousal IRAs from $250 to $2000 in 1996; the establishment of the SIMPLE IRA in 1996; the increased income limits for IRAs and the establishment of the Roth IRA in 1997; and the increase in contribution limits for IRAs and the creation of catch up contributions in the 2001 tax bill and making these provisions permanent in 2006. Retirement savings is a key component of economic policy, and IRAs, which had $6.6 trillion in assets at the end of March 2014,[14] are a vital part of retirement savings.

In 2001, the Congressional Joint Committee on Taxation made recommendations for tax simplification in which it discussed the elimination of income limits on all IRAs and the elimination of the age requirement for required minimum distributions and described the complexity surrounding these sections of the tax code.[15] The Coalition shares the view that these sections of the tax code are complex and confusing and urges the Committee on Finance to review them.

Universally Available IRAs

Currently the tax code includes a number of income limits for eligibility to contribute to IRAs. In addition to different income limits for single and married Americans, there are different income eligibilities for the traditional, deductible IRA, the Roth IRA, and the nondeductible IRA. The lesson that we learned in the early 1980s, when IRAs were universally available to all Americans, is that more Americans contributed to IRAs.[16] The universal eligibility led to mass marketing of these savings vehicles, which increased participation and saving in IRAs. When income limits were imposed after the Tax Reform Act of 1986, there was a precipitous drop in

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[13] See Figure 4 in VanDerhei, "The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results from the 2011 Retirement Confidence Survey," *EBRI Notes* (March 2011), available at www.ebri.org/pdf/notespdf/EBRI_Notes_03_Mar-11.K-Taxes_Acct-HP.pdf.

[14] See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2014" (June 2014), available at www.ici.org/info/ret_14_q1_data.xls.

[15] See Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification Pursuant to Section 8022 (3)(B) of the Internal Revenue Code of 1986, Volume II: Recommendations of the Staff of the Joint Committee on Taxation to Simplify the Federal Tax System* (April 2001), available at www.jct.gov/s-3-01vol2.pdf.

[16] See Holden, Ireland, Leonard-Chambers, and Bogdan, "The Individual Retirement Account at Age 30: A Retrospective," *Investment Company Institute Research Perspective* (February 2005), available at www.ici.org/pdf/per11-01.pdf.

contributions to IRAs.[17] The 1986 experience teaches us that limiting IRA eligibility based on income confuses people and scares them away from establishing a pattern of savings that IRAs would otherwise promote. One of the most important effects of the IRA cutbacks in the Tax Reform Act of 1986 is the fact that IRA contributions for those who continued to be eligible for deductible IRAs dropped by more than 40% in the first year and have since dropped by over 65%.

Members of the Savings Coalition believe that eliminating income limits and creating a universally available IRA will help more Americans save. An IRA that is universally available to all American workers would leave no doubt to their understanding of their eligibility. Universally available IRAs will be marketed and advertised on a massive scale and this advertising will have an ancillary benefit of educating people about the need to save. History demonstrates that the simpler it is to save for retirement, the more Americans are inclined to do so.

Under current law, deductible IRA and Roth IRA contribution eligibility is determined based on whether a taxpayer falls under or between certain income thresholds, and for deductible IRAs, whether the taxpayer or the spouse, has access to an employer-sponsored retirement plan – a so called active participant.[18] The 2014 income thresholds for the deducting IRA contributions are $60,000 - $70,000 for single taxpayers and $96,000 - $116,000 for married couples filing a joint return. If the taxpayer does not have access to a plan but the spouse does, the phase-out range is $181,000 - $191,000 for joint filers. Roth eligibility thresholds are $114,000 - $129,000 for single individuals and $181,000 - $191,000 for married couples filing a joint return. No income limits apply to single taxpayers and married couples where neither spouse is an active participant for deductible IRAs. Taxpayers making excess contributions are subject to penalties.

Another area of confusion for joint filers is that eligibility for making deductible contributions also depends on participation in an employer-sponsored plan in addition to income. If one spouse is covered by an employer plan and the other is not, as long as their income is below $181,000, the non-covered spouse is eligible to make a fully deductible traditional IRA contribution. The deductibility of the contribution is phased out between $181,000 and $191,000. If they are both covered, then the phase out in place is between $96,000 and $116,000. Income is also considered for making a Roth IRA contribution. If income exceeds the limits, the person simply cannot make a contribution. Also, if a person is not covered, or neither spouse is covered by an employer plan, then there is no income limit to making a traditional deductible IRA contribution. Again, this adds a layer of complexity and confusion to already complex eligibility requirements which can discourage Americans from making use of these important savings vehicles.

Simplifying IRAs would encourage more participation. Then, participants could take advantage of direct deposit and other tools that have been shown to facilitate saving. The confusing array of income limits discourages many workers from establishing and contributing to IRAs. This

[17] *Ibid*, Figure 3.

[18] For IRA contribution eligibility rules, see Internal Revenue Service, *Publication 590,* available at www.irs.gov/pub/irs-pdf/p590.pdf.

simplification will lead to less confusion for taxpayers and likely encourage more marketing of IRAs by financial institutions, which in turn will lead to greater awareness.

Members of the Savings Coalition of America feel that any changes to the retirement system should encourage Americans to take more responsibility for their retirement preparedness. One way in which this can be achieved is to promote values that we all share; such as savings and thrift. When it comes to savings, our tax code should encourage Americans to save for their futures and make it easier to do so. The variety of income limits for current tax-favored IRAs are cumbersome and confusing and we encourage the Committee to recommend substantial simplification in this area. Provisions that encourage individually responsible behavior such as savings should apply to all Americans. Our current tax-favored savings vehicles already limit the amount that can be saved. We should not limit eligibility of the people who can save through them. That just makes them more confusing.

Required Minimum Distributions

Under present law, Americans who reach age 70½ must begin taking required minimum distributions (RMDs) from their non-Roth IRAs.[19] One unintended consequence of the requirement is that individuals may be forced to take a distribution at a time when their investment has declined in value. Over the past several years, many retirees and workers about to retire have seen a drop in the value of their retirement nest eggs. Those subject to the requirement may be forced to realize losses on part of their investments at a time when they can least afford to do so. The RMD rules merely determine when taxes will be imposed on retirement savings, not if. When the IRA owner withdraws funds, it will be taxed as ordinary income.

In addition, tax reform should take into account such things as a longer life expectancy for most Americans. U.S. life expectancy rates have increased substantially since the RMD rules were first extended to all types of retirement plans. According to the Social Security Administration (SSA) Period Life Expectancy Table, the life expectancy of a person aged 65 in 2013 is four and a half years longer for men and nearly three years (2.8) longer for women than it was in 1974,[20] the year that IRAs were created. For 2013, SSA estimates that a man aged 65 can expect to live to age 83.0 and a woman aged 65 can expect to live to 85.5.[21] With such substantial increases in longevity, it is important that the RMD rules be updated to ensure that American workers are not forced to take distributions prematurely.

Critics also overlook recent trends in the numbers of seniors working past the age of 65 and into their seventies. According to the U.S. Bureau of Labor Statistics, in 2012 the civilian labor force

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[19] For this purpose, "non-Roth IRAs" includes traditional IRAs, SEP IRAs and SIMPLE IRAs.

[20] See *2014 OASDI Trustees Report,* Table V.A3. Period Life Expectancy, Social Security Administration, available at www.ssa.gov/oact/TR/2014/lr5a3.html#hist.

[21] *Ibid*.

participation rate of people aged 65 or older was 18.5 percent.[22] The civilian labor force participation rate of people aged 65 or older is up more than 60 percent from 1992, when it was 11.5 percent of people aged 65 or older.[23] With the recent market downturn, many workers decided to put off their retirement. According to a fall 2010 survey of 3,000 U.S. households, 16 percent of households delayed retirement or increased their expected retirement age in response to the financial stresses of the prior three years,[24] which will contribute further to the numbers of seniors in the workforce. It is shortsighted policy to force distributions from retirement accounts when seniors are pushing back retirement dates to ensure they will have enough to live comfortably throughout their retirement years. As Americans live longer, the RMD rules need to be changed to reflect gains in life expectancy.

CONCLUSION

Workplace retirement plans, which combine tax incentives for retirement savings with employer matches and other features, such as auto enrollment and auto escalation, are extremely effective tools for increasing retirement saving and enhancing retirement security. The tax deferral that these plans offer is different from a tax deduction or tax exclusion; taxes are paid when distributions are taken from the plans. The system can be further strengthened through financial literacy and education about the existing programs and incentives, small business retirement plan enhancements and IRA reforms. The Savings Coalition supports the Committee on Finance's goal toward financially secure retirements for Americans and offers its assistance in this effort. We look forward to working with you to build on the strong U.S. retirement savings system.

[22] See Table 3 in Toossi, "Labor force projections to 2022: the labor force participation rate continues to fall", *Monthly Labor Review* (December 2013), available at www.bls.gov/opub/mlr/2013/article/labor-force-projections-to-2022-the-labor-force-participation-rate-continues-to-fall.htm.

[23] *Ibid*.

[24] See Holden, Bass, and Reid, "Commitment to Retirement Security: Investor Attitudes and Actions," *ICI Research Report* (January 2011), available at www.ici.org/pdf/ppr_11_com_ret.pdf.