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Managing the IRA in Retirement

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And

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Positioning, Investing, and Spending Assets”

Wharton Pension Research Council

Philadelphia, PA

Why Look at IRA Distribution Activity?

- IRAs represent a growing share of households' retirement accumulations.
- The bulk of lump-sum distributions at retirement is rolled over into IRAs.
- There is public policy concern over how individuals will spend down their retirement nest eggs.

Overview*

- History of IRAs
 - Contributions, Rollovers, Distributions/Withdrawals
- IRA Withdrawal/Distribution Rules
- Brief Literature Review
- Analysis of IRA Withdrawal Activity
 - FRB Survey of Consumer Finances (SCF)
 - IRS Statistics of Income (SOI) Data
 - ICI Household Survey Information
- Conclusions, Thus Far
- Future Work
- References

*Views expressed are those of the authors and not necessarily those of the Investment Company Institute or its members. Thanks to Michael Bogdan for data tabulations.

Millions of Households Own IRAs

	Year Created	Number of U.S. Households With Type of IRA, 2006 (percent of households)	Assets at Year-End 2005 (billions) ^e
Traditional IRA	1974 (Employee Retirement Income Security Act)	34.8 million (30.4%)	\$3,315
SEP IRA	1978 (Revenue Act)	7.9 million (6.9%)	\$207
SAR-SEP IRA	1986 (Tax Reform Act)		
SIMPLE IRA	1996 (Small Business Job Protection Act)		
Roth IRA	1997 (Taxpayer Relief Act)	14.4 million (12.6%)	\$145
Memo: Any IRA (total)		42.2 million (36.9%)	\$3,667

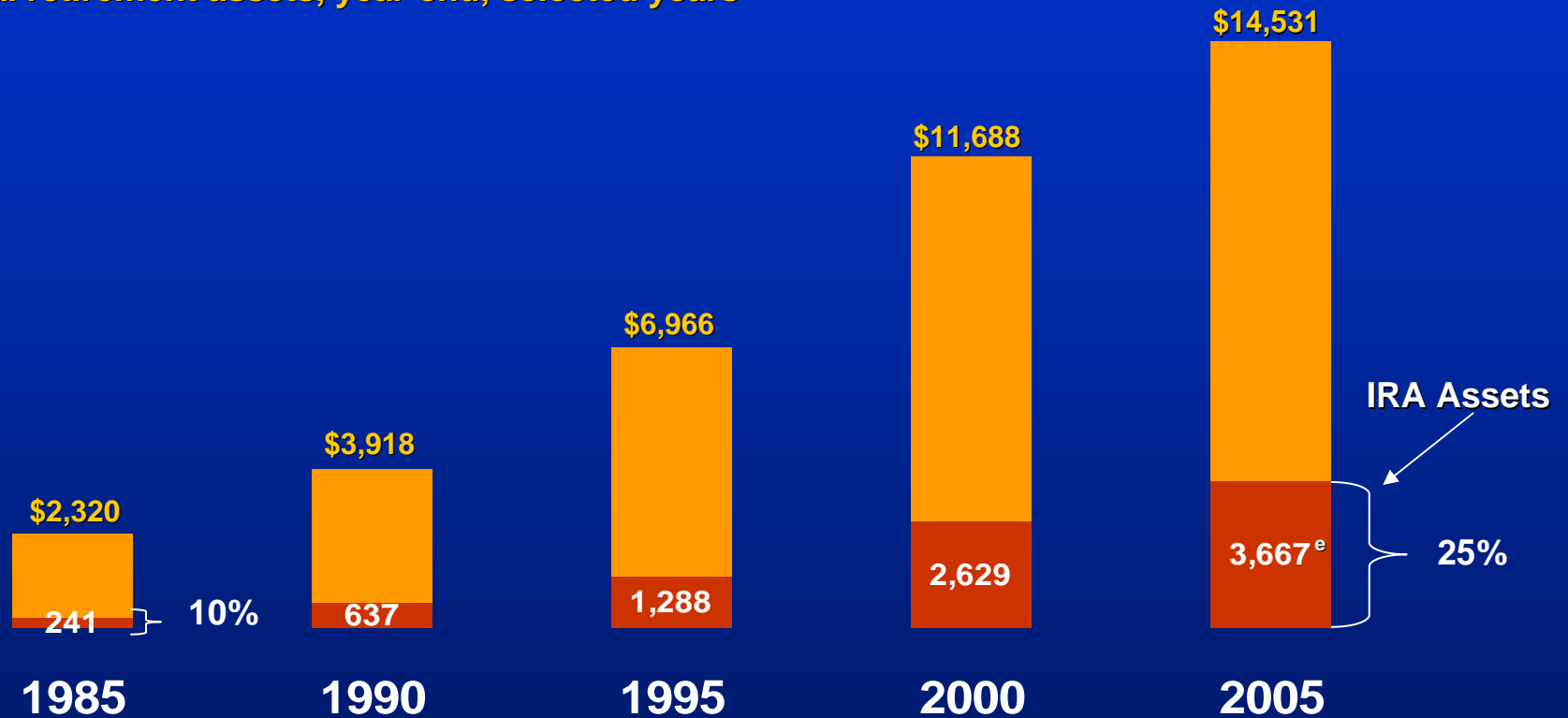
e = estimated

Note: Multiple responses included.

Sources: Investment Company Institute, U.S. Census Bureau, and Federal Reserve Board.

Role of IRAs in Retirement Accumulations Is Increasing

Total retirement assets, year-end, selected years

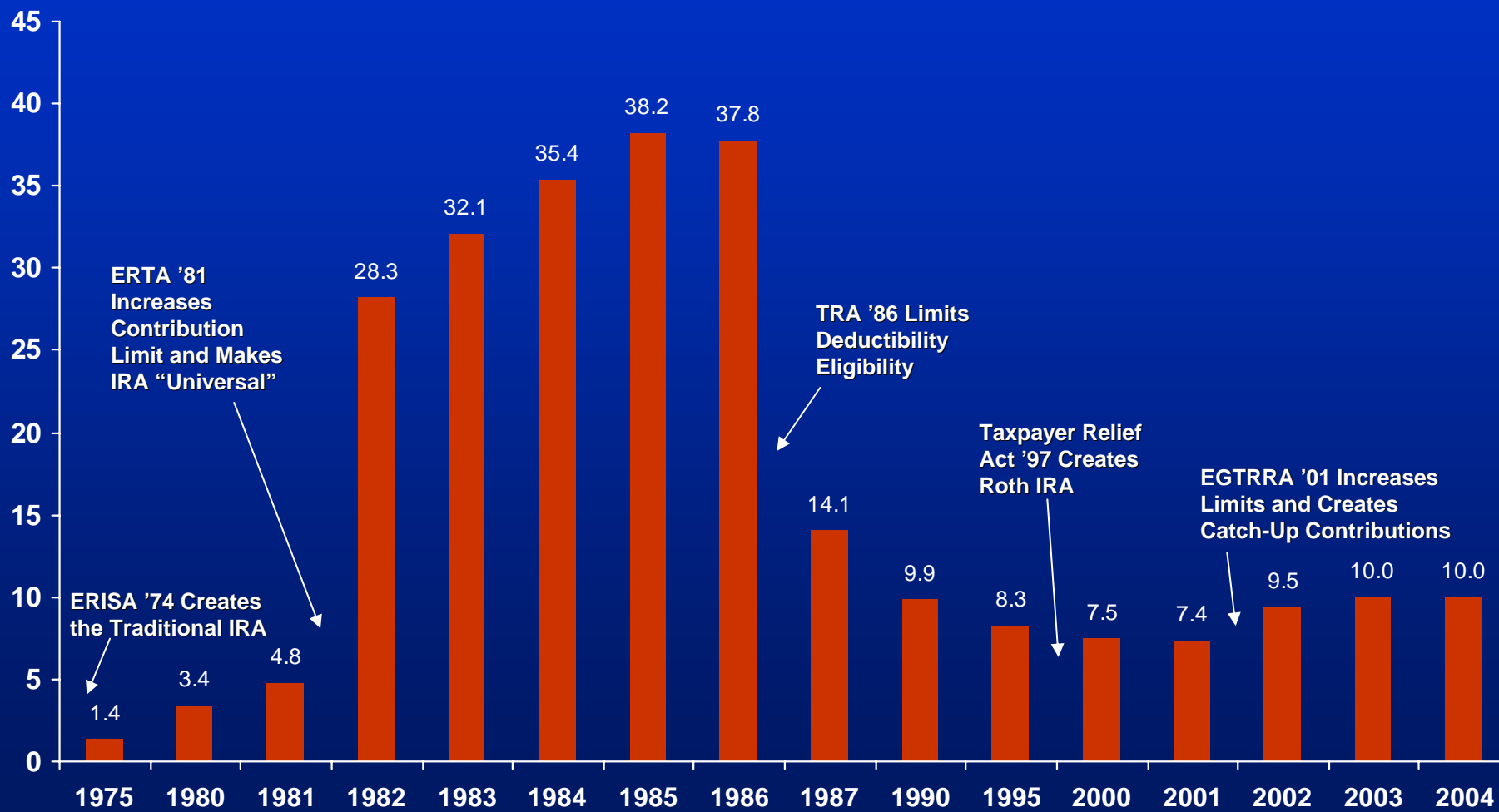


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Sources: Investment Company Institute, Federal Reserve Board, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division (See Brady and Holden (July 2006– Appendix))

Rules Affect Deductible Traditional IRA Contributions*

Billions of dollars, selected years

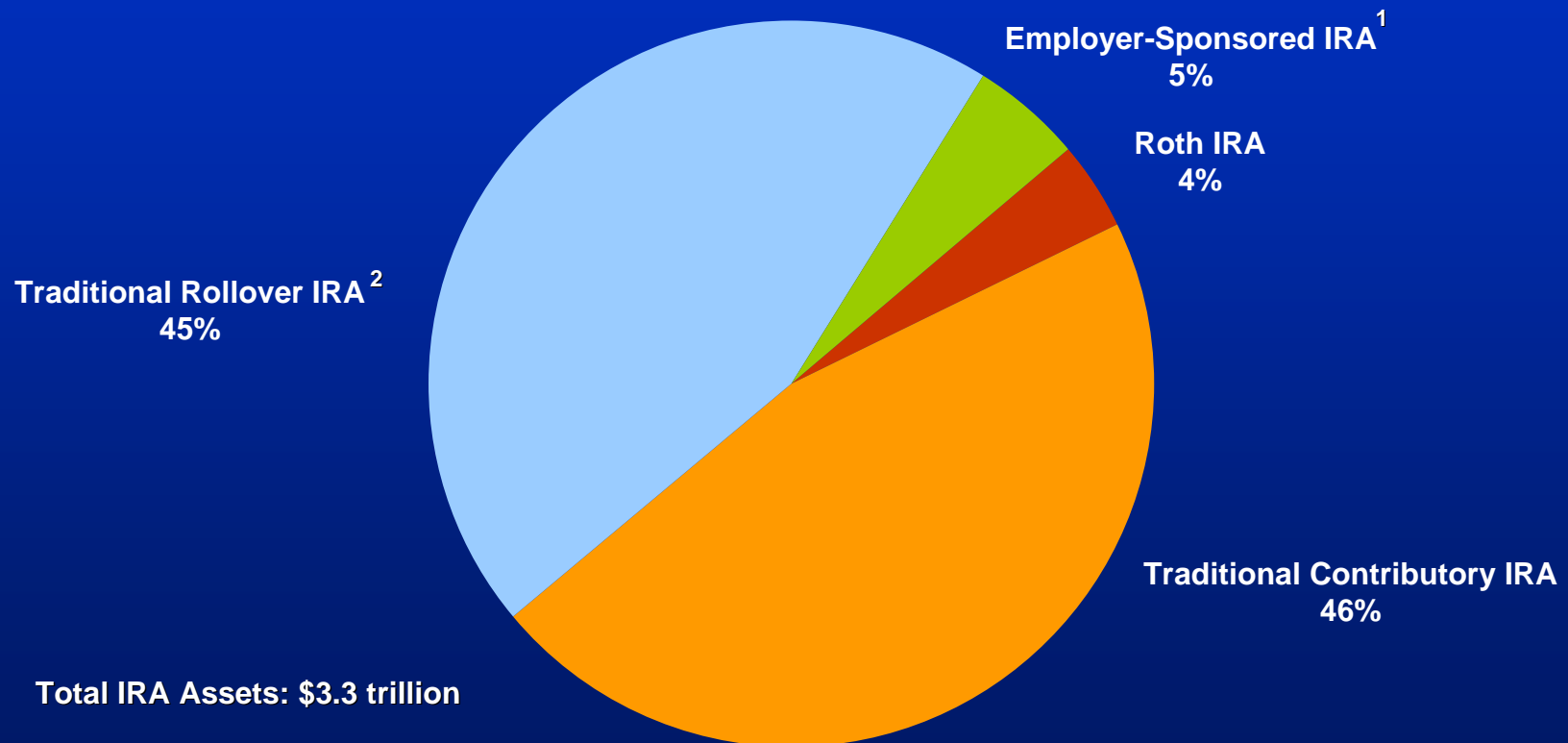


*Deductible IRA contributions reported on individual income tax returns (Form 1040)

Sources: IRS, Statistics of Income Division, *Individual Income Tax Returns, Publication 1304*, various years, and *SOI Bulletin*, various issues; and Authors' Summary of Legislative Changes (See Holden, Ireland, Leonard-Chambers, and Bogdan (February 2005))

Large Part of IRA Assets Originally Employer-Sponsored Plan Assets

Percent of total IRA assets at year-end 2004



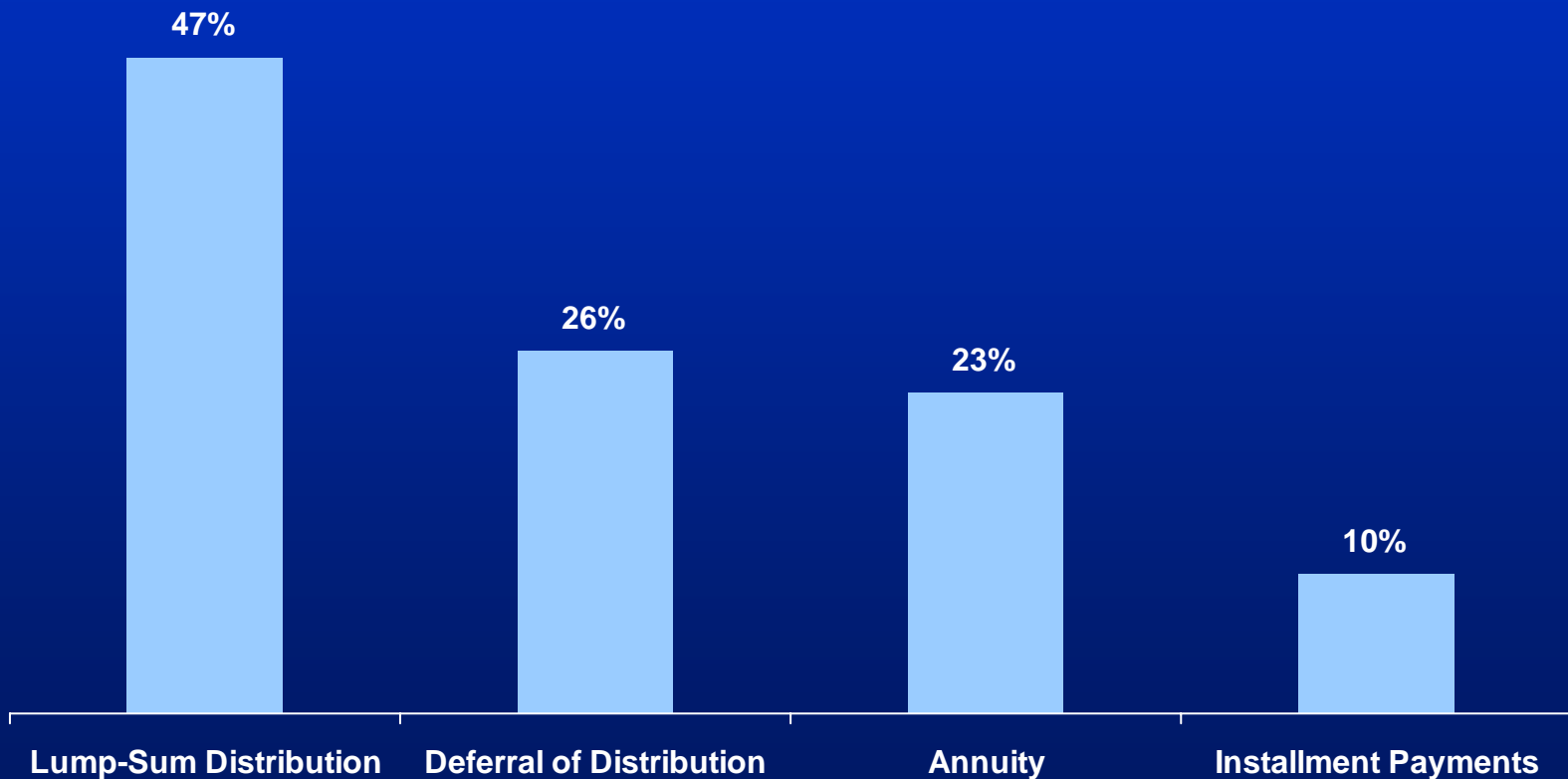
¹ Employer-sponsored IRAs include SEP, SAR-SEP, and SIMPLE IRA assets.

² Traditional rollover IRA assets include all assets contained in IRA accounts classified as rollover IRAs as estimated from the Survey of Consumer Finances.

Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, Internal Revenue Service Statistics of Income Division, and ICI Tabulation of Survey of Consumer Finances (See Brady and Holden (July 2006))

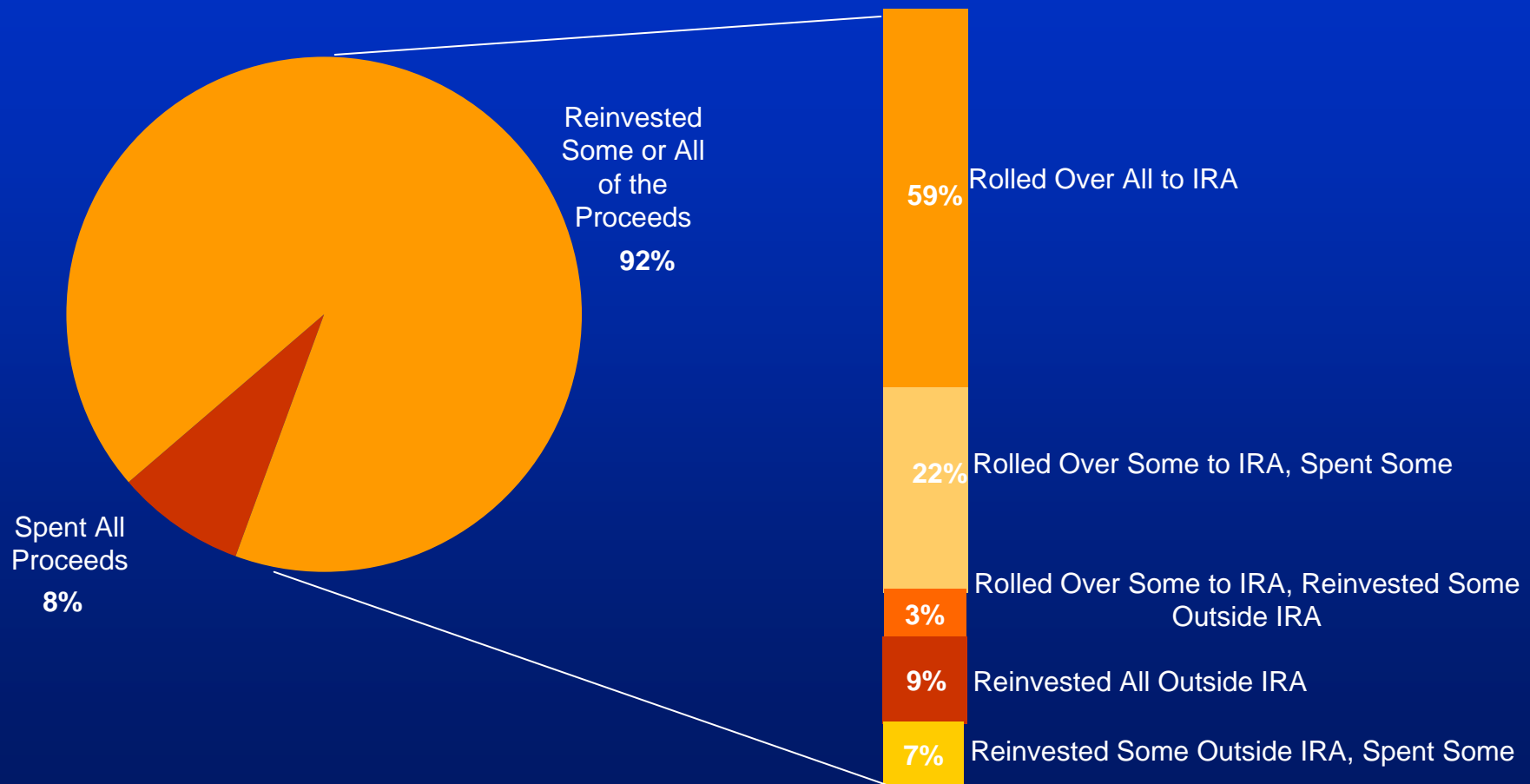
DC Plan Distribution Decision at Retirement

Distribution Options Selected at Retirement by Retirees Having More than One Option
(percent of respondents who had multiple options—multiple responses)



Note: Individuals retired from a defined contribution plan between 1995 and 2000. Data as of May 2000.
Source: Investment Company Institute, "Financial Decisions at Retirement," *ICI Fundamentals*, November 2000

Bulk of Lump-Sum Distributions at Retirement Is Rolled Over

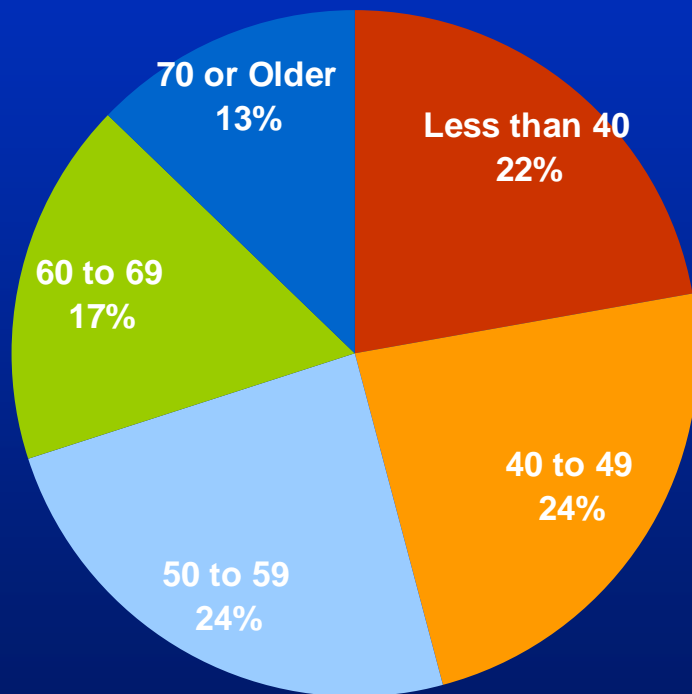


Note: Individuals retired from a defined contribution plan between 1995 and 2000. Data as of May 2000.
Source: Investment Company Institute, "Financial Decisions at Retirement," *ICI Fundamentals*, November 2000

Older Taxpayers Hold Bulk of IRA Assets

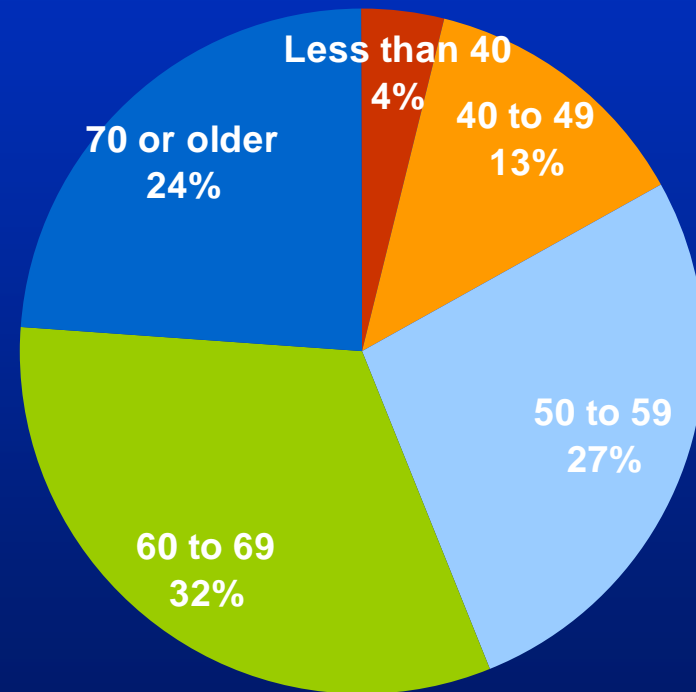
Taxpayers with any IRAs by age, 2002

Percent of Taxpayers



Total: 49.9 Million

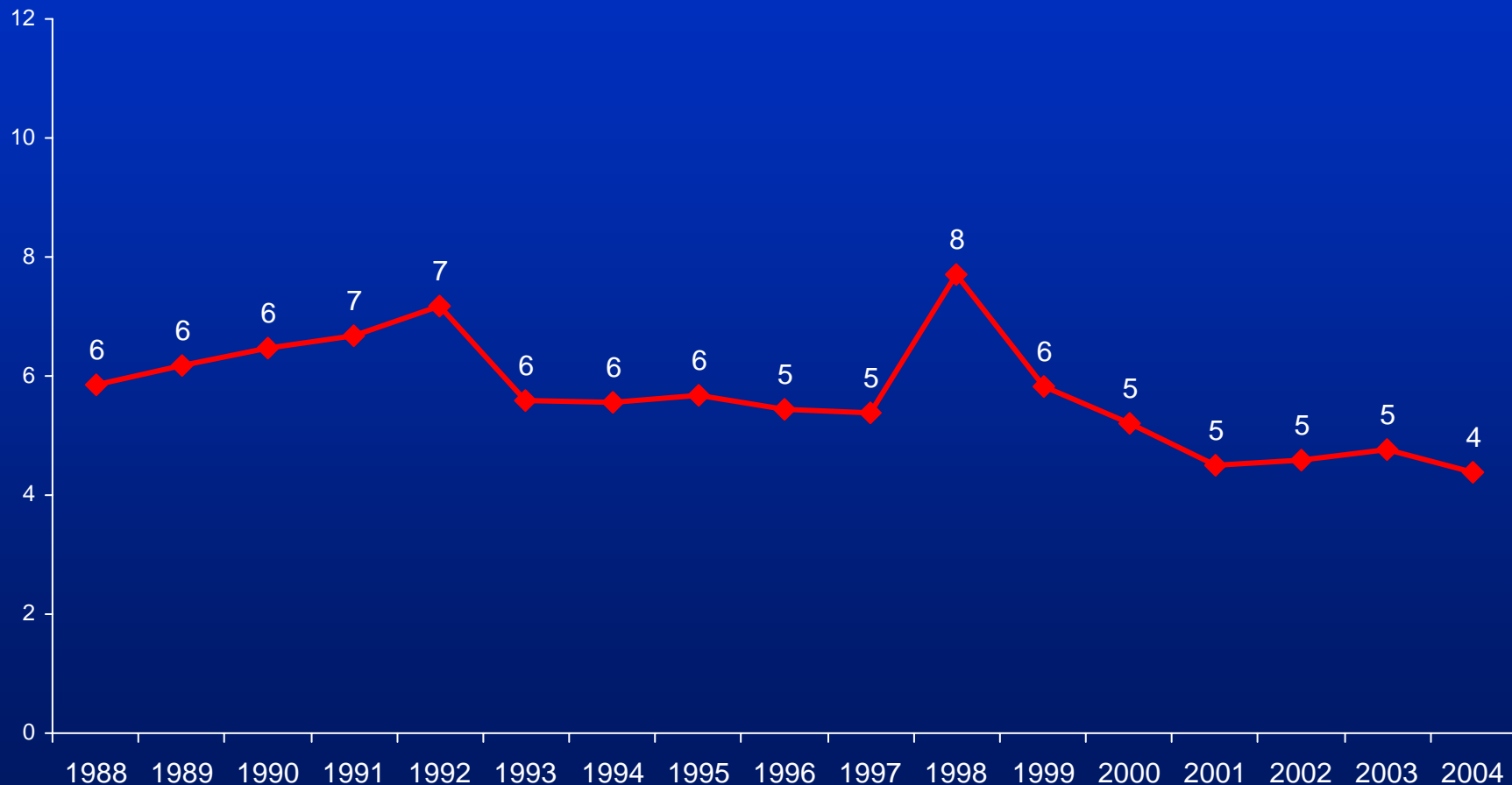
Percent of IRA Assets



Total: \$2,533 billion

IRA Withdrawals Are Small Relative to Assets

Total IRA withdrawal as a percent of previous year's total IRA assets, 1988–2004



Sources: IRS Statistics of Income Division, *Individual Tax Returns*, Publications 1304, Various Years; and Investment Company Institute, Federal Reserve Board, and American Council of Life Insurers

Traditional IRA Distribution Rules*

- If younger than age 59½, generally 10% penalty on taxable portion of withdrawal, unless exception for:
 - substantially equal periodic payments (SEPPs)
 - qualified medical expenses; health insurance premiums, if unemployed
 - qualified higher education expenses; 1st time home purchase (up to \$10,000)
 - IRS levy on IRA (after 1999)
 - reservists (called to active duty after 9/11/2001 and before 12/31/2007) making withdrawals
 - taxpayers with withdrawals in wake of Katrina, Rita, or Wilma

*For discussion purposes; not for legal, tax, or financial advice.

Source: Authors' Interpretation of Internal Revenue Code

Traditional IRA Distribution Rules,* cont.

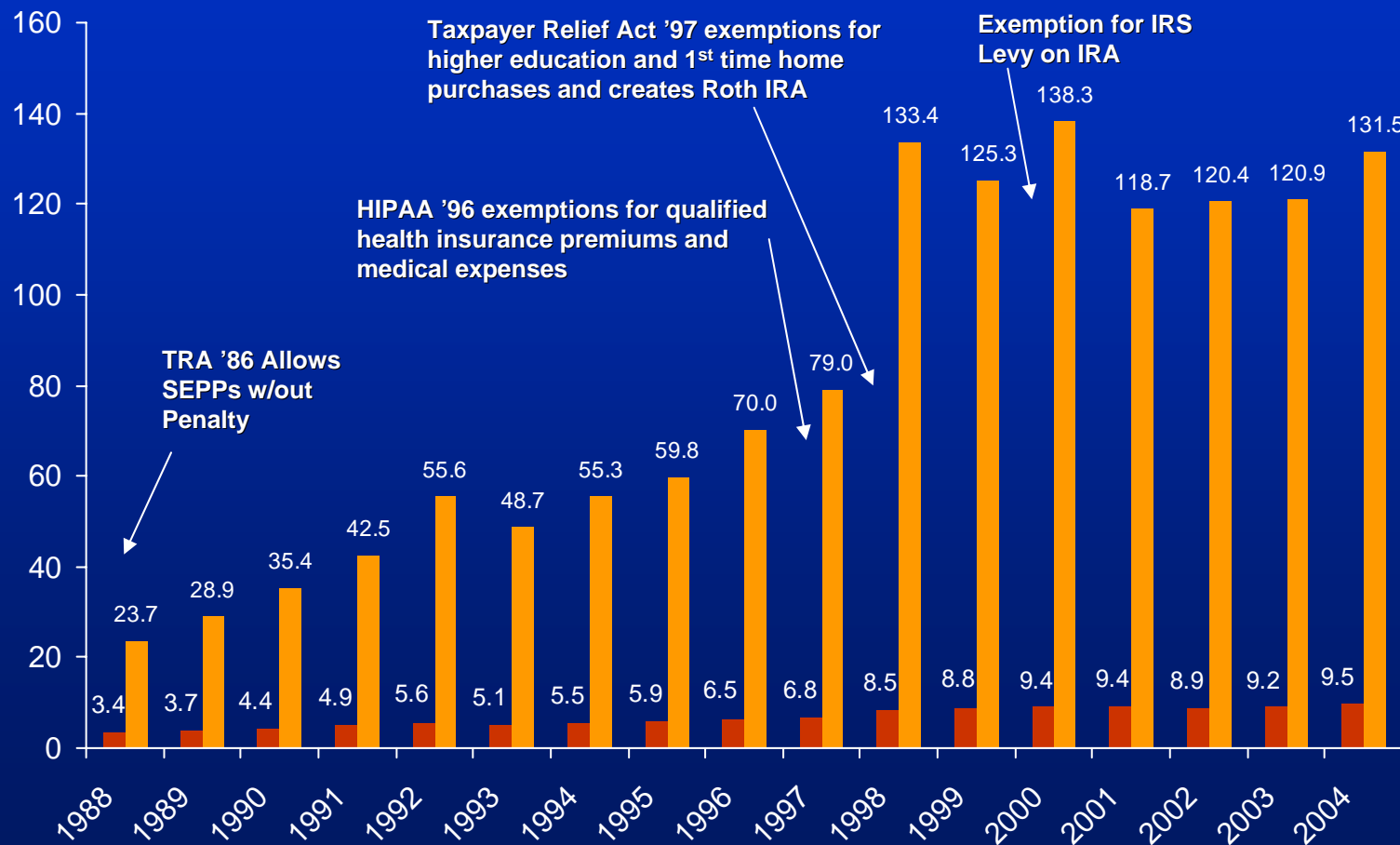
- If age 59½ to 70½, withdrawal generally not subject to penalty (still owe income taxes on taxable portion)
- If age 70½ or older, taxpayer must take required minimum distribution (RMD) based on life expectancy or may face a 50% excise tax on amount not withdrawn as required

*For discussion purposes; not for legal, tax, or financial advice.

Source: Authors' Interpretation of Internal Revenue Code

IRA Distributions*

■ Millions of Tax Returns ■ Billions of Dollars

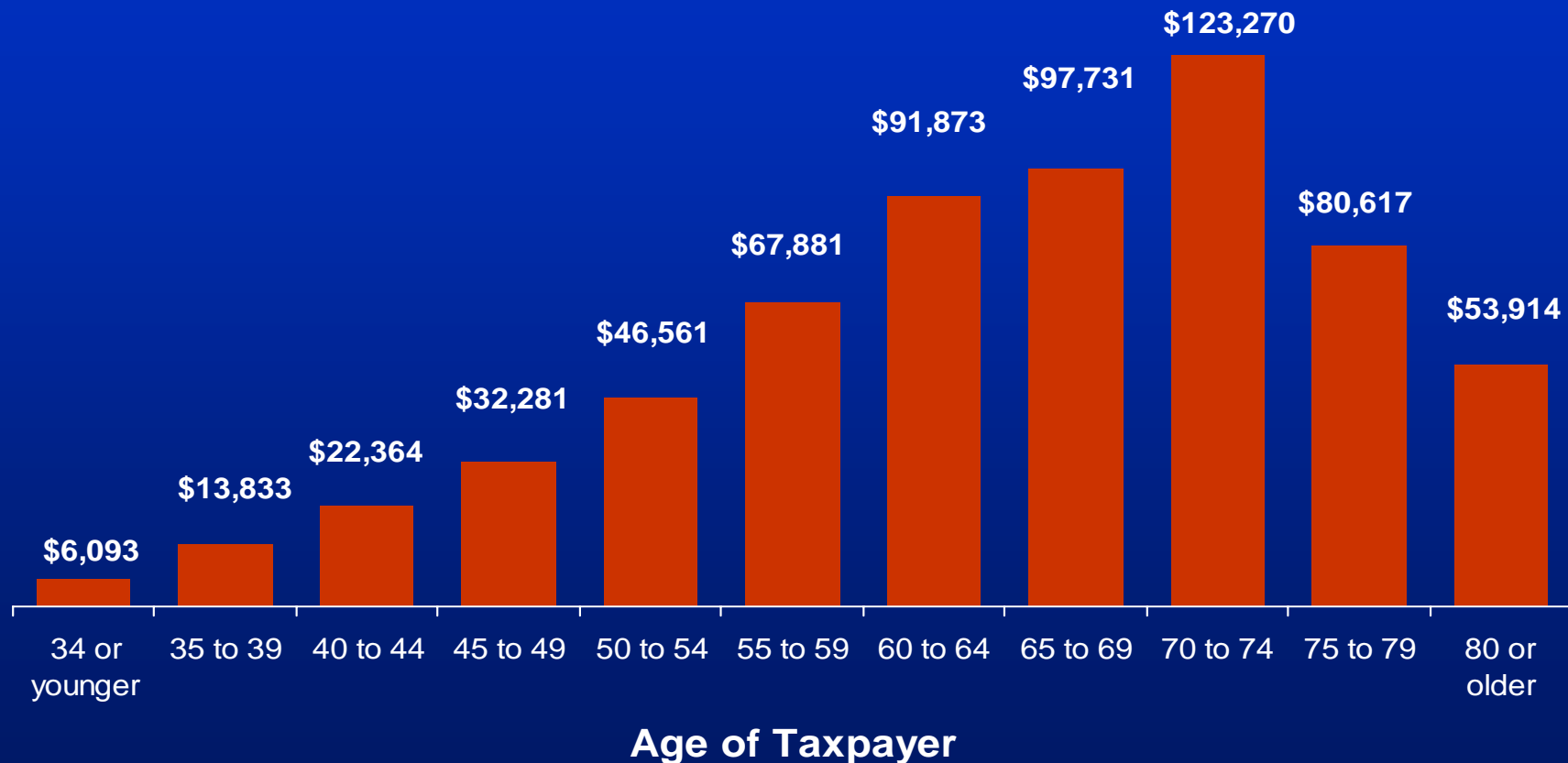


*Total IRA distributions reported on Form 1040. Data include amounts converted to Roth IRAs.

Source: IRS Statistics of Income Division, *Individual Tax Returns, Publications 1304, Various Years*; and *Authors' Summary of Legislative Changes*

IRA Average Account: Accumulation to Distribution

Average IRA assets by age, year-end 2002

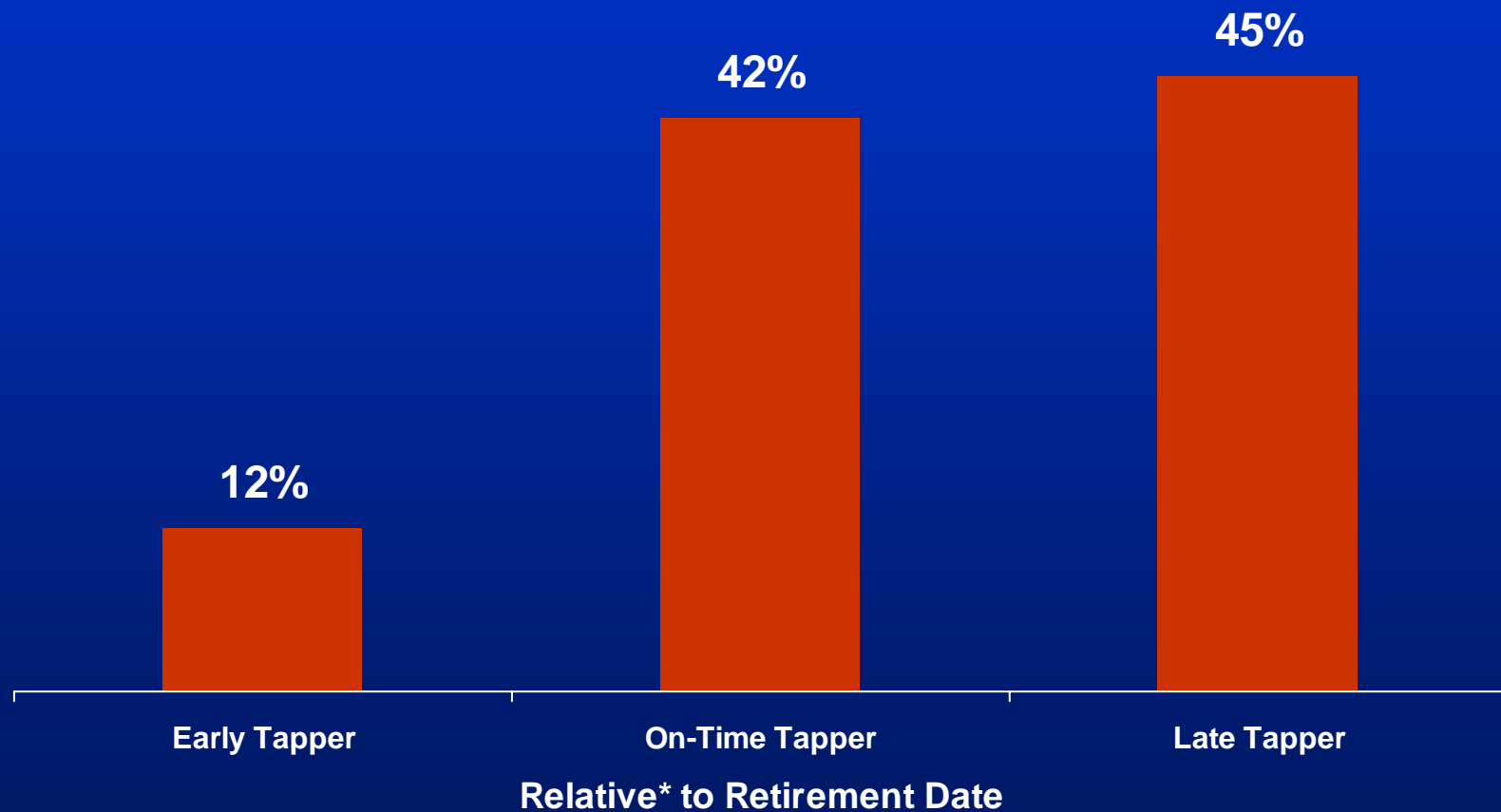


Prior Research on IRA Distributions

- Impact of Adverse Shocks
 - Lin (September 8, 2006)
 - HRS data
 - Amromin and Smith (September 2003)
 - IRS SOI Panel of taxpayers 1987–1996
- Pattern of Tapping IRAs Around Retirement
 - Bershader and Smith (2006)
 - IRS SOI Panel of taxpayers 1987–1996

Most IRA-Owning Taxpayers Are “On-Time” or “Late” Tappers

Percent of taxpayers age 57 to 63 in 1987, tracked over 1987–1996



*Retirement defined as first year with >50 percent drop in earnings. “On-time” defined as within two years of retirement.

Source: U.S. Treasury Department Panel Data Set of Individual Taxpayers 1987–1996 (See Bershadker and Smith (2006))

Income Composition of Tax Returns by Presence of Taxable IRA Distributions

Incidence of income category on tax return, tax-year 2002

	Return Has Taxable IRA Distributions	Return Does Not have Taxable IRA Distributions
Taxable IRA Distributions	100%	0%
Gross Social Security Income	55%	8%
Gross Pension and Annuity Income	60%	16%
Wages and Salary Income	48%	88%
Other Income	95%	66%
Memo:		
Number of Returns (millions)	8.3	121.8

Few Households Tap Traditional IRAs Prior to Retirement

Percent of traditional IRA owners,¹ withdrawals in 1999–2004

	All Households with Traditional IRAs	Age of Head of Household (Years)		
		Under 59	59 to 69	70 or older
All Withdrawals	17	6	18	57
Withdrew Some, But Not All, Money	14	4	15	52
Withdrew All Money	3	2	3	5

¹Seventeen percent of households either still holding traditional IRAs in the year of the survey and having withdrawn some of the assets (14 percent) or having liquidated (3 percent) their traditional IRA during the year prior to the survey are counted as having withdrawals.

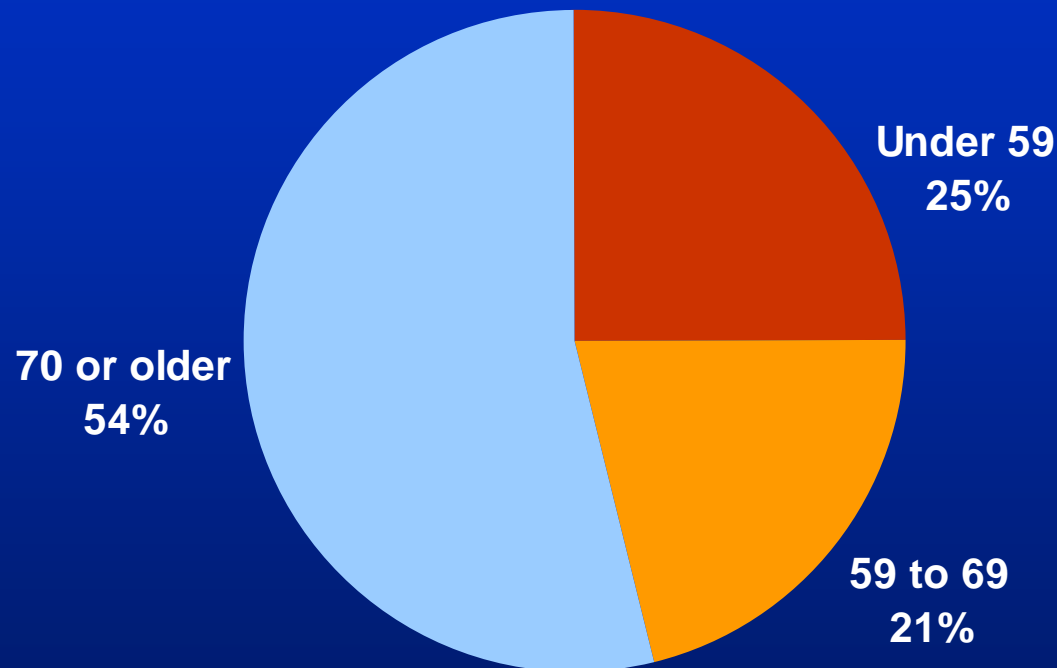
The denominator includes households still holding traditional IRAs and those households whose withdrawals in the previous year closed their traditional IRAs. Results are pooled over 2000 to 2005 survey years covering withdrawal activity in 1999 to 2004.

Note: Number of respondents varies.

Source: Investment Company Institute, Annual Tracking Survey (2000 to 2005)

Most Households with Traditional IRA Withdrawals Are Older

Percent of traditional IRA owners taking withdrawals by age of head of household¹



¹Seventeen percent of households either still holding traditional IRAs in the year of the survey and having withdrawn some of the assets (14 percent) or having liquidated (3 percent) their traditional IRA during the year prior to the survey are counted as having withdrawals.

The denominator includes households still holding traditional IRAs and those households whose withdrawals in the previous year closed their traditional IRAs. Results are pooled over 2000 to 2005 survey years covering withdrawal activity in 1999 to 2004.

Source: Investment Company Institute, Annual Tracking Survey (2000 to 2005)

Traditional IRA Withdrawal Activity by Age of Head of Household, 1999–2004

Percent of traditional IRA owners taking withdrawals^{1,2}

Reason for Withdrawal ²	Households with Traditional IRA Withdrawals	Age of Head of Household (years)		
		Under 59	59 to 69	70 or Older
To Take a Required Minimum Distribution (RMD)	46	10	12	75
To Pay Living Expenses	18	24	34	9
To Pay for Health Care	8	9	9	8
To Reinvest the Money ³	9	10	11	7
To Buy a Home	5	9	6	2
To Make a Large Purchase	8	9	16	5
To Pay for Education	4	11	3	1
Other Reason	16	22	23	11

¹Seventeen percent of households either still holding traditional IRAs in the year of the survey and having withdrawn some of the assets (14 percent) or having liquidated (3 percent) their traditional IRA during the year prior to the survey are counted as having withdrawals.

The denominator includes households still holding traditional IRAs and those households whose withdrawals in the previous year closed their traditional IRAs. Results are pooled over 2000 to 2005 survey years covering withdrawal activity in 1999 to 2004.

²Multiple responses included.

³Households indicating they were buying investments outside IRAs and/or buying another type of IRA.

Note: Number of respondents varies.

Source: Investment Company Institute, Annual Tracking Survey (2000 to 2005)

IRA Withdrawals Tend to Be Small

Amount Withdrawn	ICI Traditional IRA Withdrawals 1999–2004 ¹ (percent of households) ³	SOI Form 1040 Taxable IRA Distributions ² Data for 2002 (percent of tax returns) ³	SCF Data Traditional IRA Withdrawals for 2003 (percent of households) ³
Less than \$2,500	31	36	44
\$2,500 to \$4,999	15	19	12
\$5,000 to \$9,999	18	17	18
\$10,000 to \$24,999	20	17	15
\$25,000 to \$49,999	9	7	6
\$50,000 or more	7	4	5
Mean³	\$15,100	\$10,700	\$10,500
Median³	\$5,000	\$4,200	\$3,000

¹ Results are pooled over 2000 to 2005 survey years covering withdrawal activity in 1999 to 2004.

² Taxable IRA distributions reported on the Form 1040 include conversions to Roth IRAs.

³ The ICI and SCF data are computed among households taking traditional IRA withdrawals. The SOI data are computed among tax returns with taxable IRA distributions.

Source: Investment Company Institute, Annual Tracking Survey (2000 to 2005); Tabulation of IRS Statistics of Income Form 1040 Public-Use File Data, 2002; and Tabulation of Federal Reserve Board Survey of Consumer Finances, 2004

Model: Probability of Traditional IRA Withdrawal

- Dependent Variable
 - 0 = Household did not have a traditional IRA withdrawal
 - 1 = Household did have a traditional IRA withdrawal
- Sample drawn from SCF
 - Heads of households age 70 or younger
 - Household has traditional IRA assets in 2004
 - 6,851 observations (sample) representing 22.2 million households (weighted)
 - Observed 6.6% with withdrawals

Independent Variables in Model of Probability of IRA Withdrawal

- Independent Variables
 - Percentile of Income
 - Age of Head of Household
 - Dummy for Possible Penalty (age \leq 60 years)
 - Education of Head of Household
 - Race or Ethnicity of Respondent
 - Health Status of Head of Household
 - Work Status of Head of Household
 - Housing Status (own with/without mortgage; rent)
 - Financial Assets

Change in Predicted Probability of IRA Withdrawal*

Variable	Percentage Points
Possibility of Penalty	- 4.4
Head of Household 5 Years Older	+ 0.3
Household Has No High School Diploma (compared with household with high school diploma)	+ 8.2
Household Is Nonwhite or Hispanic	+ 2.6
Household Is Not Healthy	+ 3.8
Head of Household Is Retired (compared with working for someone else)	+ 4.4
Household Owns Home with Mortgage (compared with owns home with no mortgage)	+ 2.9

*Change in predicted probability from probit, evaluated at means of all other independent variables. Only statistically significant variables reported.

Source: Tabulation from Federal Reserve Board Survey of Consumer Finances, 2004

Change in Predicted IRA Withdrawal*

Variable	Direction of Change
IRA Assets	+
Possibility of Penalty	not statistically significant
Head of Household 5 Years Older	not statistically significant
Household Has No High School Diploma (compared with household with high school diploma)	+
Household Is Nonwhite or Hispanic	not statistically significant
Household Is Not Healthy	+
Head of Household Is Retired (compared with working for someone else)	+
Household Owns Home with Mortgage (compared with owns home with no mortgage)	+

*Change in predicted amount withdrawn; OLS with $\ln(\text{withdrawal amount})$ as dependent variable. Signs reported only for statistically significant variables.

Source: Tabulation from Federal Reserve Board Survey of Consumer Finances, 2004

Conclusions, Thus Far

- Even in the wake of several years of lessening of withdrawal restrictions, data suggest that few households/taxpayers tap their IRAs prior to retirement.
- In household surveys, RMDs are the most-often cited reason among households taking IRA distributions. Age distribution of households/taxpayers taking distributions also suggests significant influence of RMDs.
- Probit analysis finds possibility of penalty has a negative impact on the predicted probability of withdrawal. In addition, older households and retired households are more likely to take withdrawals.

Future Work

- Using the SCF data, refine the regressions for the second step of the IRA withdrawal decision: how much money to withdraw? Use Heckman selection model.
- Using IRS SOI Public-Use Form 1040 data, more rigorously examine the differences in income composition between tax returns with taxable IRA distributions and those without.
- Using cross-sectional time series data from ICI household surveys, examine the IRA withdrawal decision.

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