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On Retirement Policy, Don't Mess with Success

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By Paul Schott Stevens

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America's fiscal challenges have led some to contemplate an alarming course reversal on the policies that help ensure retirement security for working Americans.

In the hunt for revenue, Washington could target the tax deferral on compensation Americans set aside for retirement.

A recent story in The New York Times reflected that viewpoint, musing: “The money that the government spends to encourage Americans to save for retirement is money that cannot be spent on deficit reduction, education, health care or other priorities” (since when, one might ask, has retirement provision slipped from our list of national priorities?).

And from the Jan. 1 fiscal cliff agreement, lawmakers expect to reap $12 billion in revenue, thanks to a provision that allows more 401(k) savers to convert part of their account balances to Roth 401(k)s — voluntarily paying taxes now that otherwise would be deferred until retirement. Although that change brings additional flexibility to retirement planning, it raises concerns that Congress and the White House could consider tapping retirement savings further to help meet budget targets.

As difficult as America's fiscal situation may be, backtracking on retirement policy would be a mistake.

America's retirement system has been built painstakingly over the course of decades. To start scrapping savings incentives would undermine its foundation, risking wider damage.

It also would jeopardize the unique success of America's approach to retirement provision.

Thanks to the mutually reinforcing components of Social Security, homeownership, defined-benefit plans, defined-contribution plans, individual retirement accounts and other savings, successive generations of American retirees have been better off than previous generations. Poverty among those 65 or older fell to 9% in 2011, from nearly 30% in the mid-1960s.

And future retirees will benefit from the fact that, adjusted for inflation and population growth, assets earmarked for retirement now are three times what they were in 1985.

This success reflects a history of sound policy in support of retirement security.

Through the enactment of the Employee Retirement Income Security Act of 1974, the creation of the 401(k) plan in 1981, the Economic Growth and Tax Relief Reconciliation Act of 2001, the Pension Protection Act of 2006 and other measures, the U.S. government has created the tools that facilitate saving for the long term. It has set up incentives for employers to create plans, and for tens of millions of workers to participate in them.

Overwhelmingly, Americans oppose reversing these policies.

Just over a year ago, in a survey of 3,000 U.S. households, the Investment Company Institute found that more than eight in 10 respondents agreed that tax incentives to encourage retirement saving should be preserved. That view was shared consistently, with little variation among Americans of different ages or income levels.

National Priority

Indeed, a vast majority of the respondents agreed that preserving retirement savings incentives should be a national priority. Eighty-eight percent of those owning DC accounts or IRAs said they felt that way.

What is striking, too, is the high level of support among those who weren't benefiting from these incentives. In the ICI survey, more than three-quarters of respondents without DC accounts or IRAs said they thought these incentives should be a national priority.

The strong numbers likely reflect some simple common sense. Given the fiscal pressures on governments, Americans realize they need more than ever to have the tools to help build retirement security.

Deferred tax treatment of retirement contributions also may draw its broad popularity from its value to savers across the income spectrum, not just the wealthy.

A recent ICI report found that individuals' ages typically are more important than their marginal tax rates in determining how much they benefit from a retirement plan contribution.

For example, in realistic simulations for a variety of investments, the tax benefits from a one-time $1,000 contribution to a retirement account are greater for a 45-year-old with a 15% marginal tax rate

than for a 60-year-old in the 35% tax bracket.

Long Term

There are no easy answers as our nation struggles to find a fiscally sustainable path for the years to come. Policymakers must think long-term, and that means strengthening — not weakening — America's approach to retirement provision.

Steps to take include putting Social Security on sound financial footing, improving the budget outlook and examining simple ways we can add to a retirement tool kit that has proven so valuable. The ICI and others stand ready to help with numerous ideas on realistic, attainable ways to continue to innovate and make progress on retirement preparedness.

But none of this progress will be possible if Washington starts to chip away at the foundation of our system for retirement security. Our first goal must be to preserve the tax incentives that have made our retirement system a success.

Paul Schott Stevens is president and chief executive of the Investment Company Institute, the national trade association for mutual funds.

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