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INVESTMENT COMPANY INSTITUTE

ICI VIEWPOINTS

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Happy Birthday, IRA! Congratulations on 45 Years

Labor Day 2019 marked the 45th birthday of the individual retirement account (IRA). Signed into law on September 2, 1974, the Employee Retirement Income Security Act (ERISA) introduced bold steps to safeguard Americans' employer-sponsored pensions (both defined contribution and defined benefit plans) and created the IRA.

To give the new account flexibility in accumulating assets for retirement, Congress designed a dual role for the IRA. One was to give individuals not covered by retirement plans at work an opportunity to save for retirement in tax-deferred accounts made available through private financial institutions. The other was to give retiring workers or individuals changing jobs a means to preserve employer-sponsored retirement plan accumulations by allowing them to transfer, or roll over, plan balances into IRAs. Forty-five years later, IRAs have become a significant component of US households' retirement assets, holding $9.4 trillion in assets (Figure 1), or about one-third of the total US retirement market, at the end of March 2019.

Figure 1
IRAs Have Grown in Importance in the US Retirement System
Assets, period-end, trillions of dollars

* Data for 2019 are estimated for the end of March.

Note: Some data are estimated.

Sources: Investment Company Institute and Internal Revenue Service Statistics of Income Division

Types of IRAs Have Expanded

Since 1974, Congress has made many changes to the IRA to encourage IRA formation at small businesses. For example, Congress created the Simplified Employee Pension (SEP) IRA in the Revenue Act of 1978 because of concern that the complex regulations governing employer-sponsored retirement plans were preventing small employers from offering retirement plans to their workers (Figure 1). SEP IRAs were designed to benefit small businesses, although they may be offered by businesses of all sizes. With the Small Business Job Protection Act of 1996 (SBJPA '96), Congress created the Savings Incentive Match Plan for Employees (SIMPLE) IRA, specifically for employers with 100 or fewer employees. (It also created an IRA that only allows after-tax contributions but generally exempts investment earnings from taxation until distribution.) As of year-end 2018, SIMPLE

IRAs, with more than 635,000 plans (mainly at the smallest of employers), had nearly three million participants.

The Roth IRA, created by the Taxpayer Relief Act of 1997, provides a contributory retirement savings vehicle on an after-tax (nondeductible) basis with qualified withdrawals distributed tax-free. First available in 1998, Roth IRAs now have accumulated more than $800 billion in assets. Individuals also may invest in Roth IRAs through conversions. In a conversion, taxes are paid on any pre-tax assets in a non-Roth IRA that move into a Roth IRA. In 2010, income limits on conversion activity were lifted (with special tax treatment available for conversions made in 2010). Since 2006, direct rollovers from designated Roth accounts in employer-sponsored retirement plans to Roth IRAs have been permitted, and since 2008, rollovers from non-Roth employer-sponsored retirement plan accounts to Roth IRAs also have been allowed. While traditional IRAs are typically opened with rollovers, Roth IRAs are most commonly opened with contributions (Figure 2).

Figure 2
New Traditional IRAs Often Are Opened with Rollovers; New Roth IRAs Often Are Opened with ContributionsPercentage of new IRAs opened in 2016 by type of IRA

Note: New IRAs are accounts that did not exist in the IRA Investor Database in 2015 and were opened by one of the paths indicated in 2016. The calculation excludes IRAs that changed financial services firms. The samples are 0.4 million new Roth IRA investors aged 18 or older at year-end 2016 and 0.8 million new traditional IRA investors aged 25 to 74 at year-end 2016. Components may not add to 100 percent because of rounding.

Source: The IRA Investor Database™

Contribution Rules Have Changed

Over the years, Congress has raised limits on the amounts that individuals are allowed to contribute to their IRAs and has changed the eligibility rules for making tax-deductible IRA contributions—at one point expanding the eligibility for tax-deductible IRA contributions to all workers younger than 70½ and later returning to more limited eligibility. In 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) increased the annual IRA contribution limit and allowed additional “catch-up” contributions for individuals aged 50 or older (Figure 1). With the goal of preserving retirement accounts even when job changes occur, EGTRRA also increased opportunities for rollovers among various savings vehicles. The Pension Protection Act (PPA), passed in August 2006, made permanent EGTRRA’s higher contribution limits. Additionally, nonworking spouses’ access to IRAs has expanded.

IRAs Play a Significant Role

The past 45 years clearly show that the IRA has successfully promoted and sustained retirement saving among millions of Americans. Individuals had $9.4 trillion in IRAs at the end of March 2019. IRAs were the largest component of the $29.1 trillion US retirement market, representing about one out of every three retirement dollars. Further attesting to the importance of the IRA in the retirement saving system, 42.6 million US households—or 33.4 percent of all US households—owned IRAs in 2018. In addition, the typical IRA-owning household holds about one-third of its financial assets in IRAs.

Taking Full Advantage of IRAs

If you’re not among the 43 million US households that already own IRAs, consider opening one for yourself or your spouse. If you’re 50 or older, consider taking advantage of catch-up contributions. Saving for retirement is an important household financial goal and contributing to an IRA is a good step toward providing for those later years.