

[Tax Policy and Boomer Retirement Saving Behaviors]

How Changes in Tax Policy Will Impact Middle-Income Boomers

IRI

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OVERVIEW

President Barack Obama signed the American Tax Payer Relief Act on January 2, 2013. Through this law the United States averted a portion of the fiscal cliff; the expiration of the tax cuts enacted during President George W. Bush's Administration. Among other adjustments to the tax code this law made the Bush-era tax cuts permanent for individuals earning less than $400,000 ($450,000 for married filing jointly). While this comes as a relief to the majority of American tax payers, the country's long-term fiscal issues have not yet been resolved.

The Congressional Budget Office (CBO) released, on February 5, 2013, Budget and Economic Outlook: Fiscal Years 2013-2023. In its budget outlook, the CBO noted that under current law deficits will shrink, reaching a low of 2.4% of GDP by 2015. However, "deficits are projected to increase later in the coming decade because of the pressures of an aging population, rising health care costs, an expansion of federal subsidies for health insurance, and growing interest payments on federal debt. As a result, federal debt held by the public is projected to remain historically high relative to the size of the economy for the next decade. By 2023, if current laws remain in place, debt will equal 77% of GDP and be on an upward path, CBO projects."

What does this mean for retirement savers? The federal government will continue to look for ways to resolve the coming fiscal imbalances noted by the CBO potentially through increases in revenue and reductions in spending. Because of this fiscal situation, the tax deferral treatment of retirement savings vehicles, such as annuities, could be modified and the potential for tax increases in the future cannot be ruled out. In this report, new IRI research is presented on the importance Boomers, particularly middle-income Boomers, place on tax deferral, and the consequences of potential changes in taxation on middle-income Boomers' likelihood to save for retirement.

KEY FINDINGS

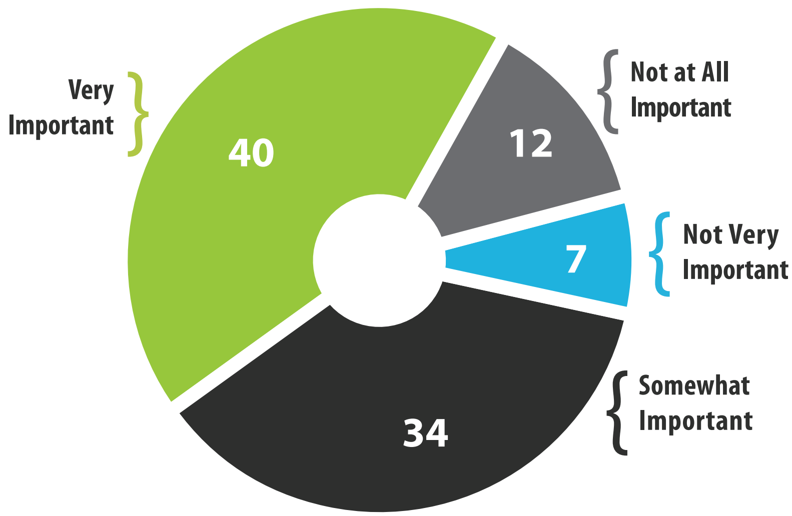
- Tax deferral remains an important consideration for investors.
    - 74% of Boomers place some level of importance on tax deferral when selecting a retirement investment; 40% consider tax deferral a very important criterion.
    - Nearly three-quarters (76%) of Boomers between ages 50-55 consider tax deferral an important feature of a retirement investment product.
    - Nearly one-fifth of investors (19%) cited tax-deferred growth as the primary reason for purchasing annuities.
- Annuity owners are overwhelmingly middle-income. Seven in 10 annuity owners had annual household incomes of less than $100,000.
- 61% of low-income Boomers consider tax deferral an important criterion when selecting a retirement income product.
- Changes in tax laws would have a negative impact on the ability of middle-income Boomers to save for retirement.
    - 77% of middle-income Boomers consider tax deferral an important criterion when selecting a retirement income product.
    - 58% of middle-income Boomers would curtail their level of retirement savings should income taxes increase, and 40% would be less likely to save should Social Security payroll taxes increase.
    - 24% of middle-income Boomers would be less likely to save for retirement if tax deferral is reduced or eliminated.
- Approximately half (56%) of advisors consider tax-deferred growth an important factor when evaluating and selecting annuities, and 28% expect tax deferral to take on greater importance in the next five years, up from 20% a year earlier.
- Taxes on retirement savings and annuities are deferred, not excluded.
    - As individuals begin to retire, distributions from annuities are taxed and revenue will flow to the U.S. Treasury.
    - Annuity distributions are taxed at the higher income rate rather than the lower capital gains rate.

THE VALUE OF TAX DEFERRAL

The deferral of taxes on the investment growth within a retirement savings product is one of the cornerstones of retirement planning. The deferral of this growth leads to a larger retirement nest egg for the investor. For example, a 45-year old investor at the 15% tax bracket contributes $1,000 one-time before taxes into a tax-deferred retirement account, earning a 6 percent interest rate. At age 60, the investor will have accumulated $2,397 but must pay a 15 percent tax—or $359—upon withdrawing the savings from the account. After taxes, there will be $2,037. If the same investor used after-tax dollars contributed to a taxable account the value of the account at age 60 would be $1,793 or $245 less than the tax deferred savings.

Boomer investors seem to understand the point. According to IRI research, three quarters of Boomers place some level of importance on tax deferral in selecting a retirement investment; 40% consider tax deferral a very important criterion.

IMPORTANCE OF TAX DEFERRAL IN SELECTING A RETIREMENT INVESTMENT PRODUCT, ALL BABY BOOMERS, 2013

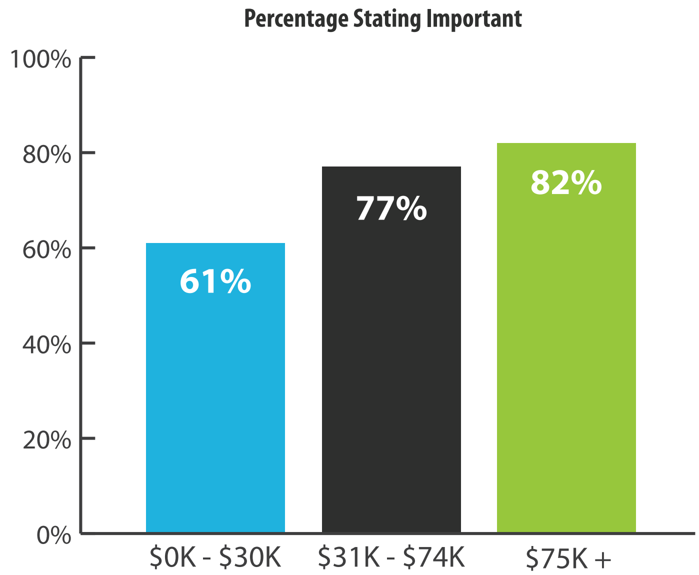


In this report, two demographics are examined in more detail, household income and age.

[HOUSEHOLD INCOME]

An examination of the data by household income reveals there is strong support for the tax deferral of investment gains within a retirement savings product across all income levels. Furthermore, the data shows there is little difference between middle-income Boomers and high-income Boomers, only five percentage points. Among low-income Boomers, two-thirds state that tax deferral is important to them when selecting a retirement product.

IMPORTANCE OF TAX DEFERRAL IN SELECTING A RETIREMENT INVESTMENT PRODUCT, ALL BABY BOOMERS BY HOUSEHOLD INCOME, 2013



The distinction of middle-income investors is an important one. According to the IRI and Cogent Research report The Evolution of the Annuity Industry: Analyzing Growth, Trends and Opportunity in the Annuity Industry, 2012 seven out of 10 annuity owners had a total annual household income of less than $100,000. This report found that tax deferral was a main reason for purchasing an annuity. Nearly one-fifth of investors (19%) cited tax-deferred growth as a primary reason for purchasing annuities, ranking behind guaranteed income in retirement (35%) and advisor recommendation (26%) yet significantly ahead of principal protection (7%) and death benefits (3%).

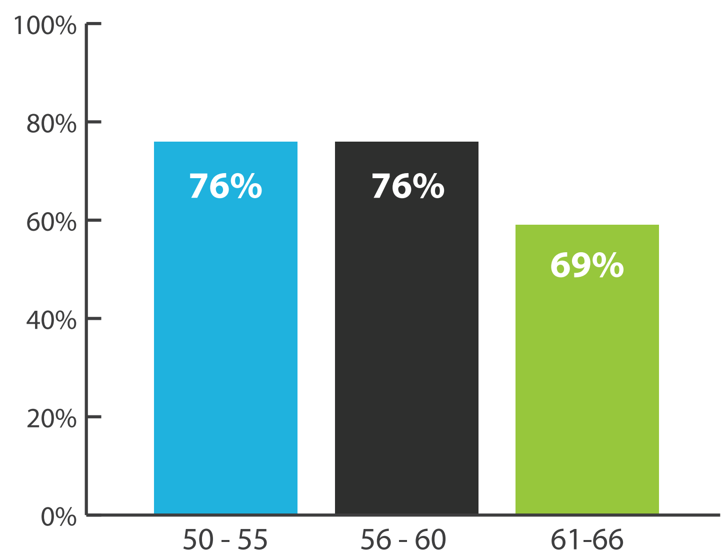
The same report also sheds light on the opinions of financial advisors. Approximately half (56%) of advisors consider tax-deferred growth an important factor when evaluating and selecting annuities. Additionally, 28% of advisors expect tax deferral to take on greater importance in the next five years, a notable increase from 20% in 2011. The value of tax deferral for investors will only take on greater significance in the coming years.

[AGE]

As with household income, there is strong support for tax deferral among all age categories. Three-quarters of Boomers in their 50s state that tax deferral is important to them. The 50s are an age when individuals tend to be most focused on saving for their retirement. This would explain the large proportion of these individuals valuing tax deferral. Among the older Boomers, those in their early to mid-60s, a larger percentage, nearly 70%, value tax deferral. The majority of these individuals are retired and in the spend-down phase of life, yet tax deferral continues to be of value because they may not be drawing down all of their savings. Individuals who are retired will still need investment growth to make their savings last throughout their retirement years which can be more than twenty years.

IMPORTANCE OF TAX DEFERRAL IN SELECTING A RETIREMENT INVESTMENT PRODUCT, BABY BOOMERS BY AGE, 2013

Percentage Stating Important



[RETIREMENT SAVINGS TAX DEFERRED NOT TAX EXEMPT]

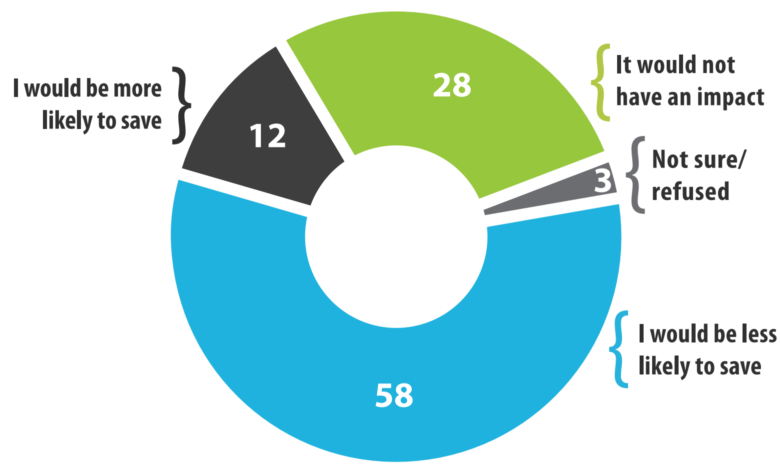
It must be reiterated that taxes on retirement savings and annuities are deferred, not exempt. Deferral treatment is not equivalent to the exemption associated with other tax expenditures. As individuals begin to retire, distributions from annuities are taxed and revenue will flow to the U.S. Treasury. In fact, deferring the taxation on retirement savings can lead to larger revenues for the federal government because distributions from retirement savings accounts are taxed as ordinary income, which is higher than investment income. Therefore, the removal of the tax-deferred status of annuities would not necessarily increase the tax revenue generated by the products. Yet, it would result in the reduced use of annuities among the populations that have come to rely on them most—middle-income investors.

INCOME TAXATION AND MIDDLE-INCOME BOOMERS

In his 2013 State of the Union address, President Obama outlined an aggressive agenda to help the middle class. Yet policymakers in Washington face many fiscal challenges with a budget deficit of over $1 trillion dollars, total outstanding debt of over $16 trillion and trillions more in unfunded liabilities primarily in Social Security, Medicare, and Medicaid. To meet these challenges, policymakers will look for new sources of revenue in addition to spending cuts.

Future increases in federal income taxes, as well as other tax increases, are a possibility. Through its research, IRI set out to quantify the impact of tax increases on middle-income Boomers' likelihood to save for retirement. Not surprisingly, higher tax rates would impede retirement saving, and the magnitude of this impact is quite high. More than half (58%) of middle-income Boomers stated that they would be less likely to save for retirement should their income taxes rise. Not only would this affect savers, but it would also affect the retirement income of middle-income Americans who rely on annuities to provide a guaranteed stream of income. This is because most annuity owners are middle income and withdrawals are taxed at ordinary income rates. If combined with a reduction or elimination of tax-deferral benefits on annuities, a rise in income taxes would be a great obstacle to middle-income Americans attaining financial security in retirement.

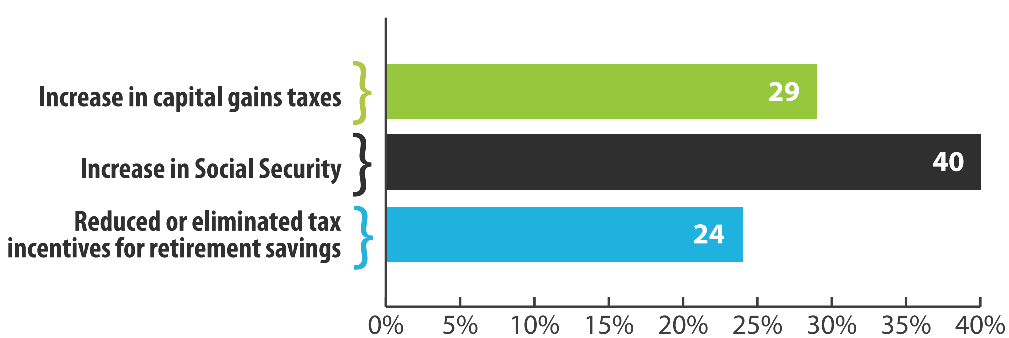
IMPACT OF INCREASED INCOME TAXES ON RETIREMENT SAVING, MIDDLE-INCOME BOOMERS, 2013



In addition to increases in federal income taxes, other forms of tax increases would lead middle-income Boomers to reduce the amount they save. Forty percent of middle-income Boomers would be less likely to save if Social Security taxes were increased and 29% if capital gains taxes were increased. Similarly the reduction or elimination of tax incentives, such as the deferral of taxation on investment gains for retirement savings, would lead 24% of middle-income Boomers to reduce their saving.

IMPACT OF INCREASED INCOME TAXES ON RETIREMENT SAVING, MIDDLE-INCOME BOOMERS, 2013

Percent Less Likely to Save for Retirement



CONCLUSION

IRI research shows that Boomer expectations for retirement are clouded by concerns about savings and income. For example, 31% of middle-income Boomers and 37% of young Boomers cite concern about having sufficient assets as a top reason why they are uncertain about when they will retire. Annuities are designed to help provide guaranteed income for all Americans who seek to ensure a stable and secure financial future, regardless of access to an employer-sponsored retirement plan. Annuities, therefore, can play an important role in helping to address the potential challenges that retirees face, such as: longevity risk, entitlement risk, inflation risk and medical expense risk that all Americans must consider as they plan for retirement.

Hundreds of thousands of Americans have come to rely on annuities for a secure retirement, and eliminating or diminishing the current tax treatment of these products will jeopardize their retirement savings at a time they can least afford it. Nearly three-quarters of Boomers consider tax deferral an important factor in selecting a retirement investment product, as do more than half of financial advisors. Additionally, more than half of Boomers anticipate having to curtail their retirement savings should their income taxes rise. Young Boomers and middle-income Boomers are the most likely to experience these negative consequences.

While IRI applauds the efforts of policymakers to address the deficit, it is imperative that we protect the tax deferral of annuity earnings and for other retirement saving products so that all Americans will continue to have access to these important savings vehicles.

METHODOLOGY

The Insured Retirement Institute (IRI) commissioned Woelfel Research, Inc. to conduct a survey of individuals approaching retirement or who have recently retired. The research was conducted by means of telephone interviews with 802 adult Americans aged 50-66. The sample was selected from a list of households in this age group, developed by Accudata, Inc. by compiling data from available sources such as motor vehicle records. Results were weighted by age and gender to the 2011 American Community Survey population from the United States Census Bureau. Data was collected from January 25 through January 31, 2013. The margin of error for the sample of 802 was ±3.5%.

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