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Assessing Economic Resources in Retirement: The Role of Irregular Withdrawals from Tax-Advantaged Retirement Accounts

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People save during their working lives to finance consumption in retirement. An important part of the saving is located in tax-advantaged saving accounts such as defined benefit (DB) pensions, defined contribution (DC) pension accounts, IRAs, and Keoghs. Several important policy questions are associated with such savings. First, when these plans are fully accounted for, how well are retirees economically prepared for retirement? Second, what do these plans contribute to economic preparation? This question is of considerable importance given the large tax costs of their provision. Third, who benefits from these plans? In particular, how well do they help those in the lower part of the income distribution meet the challenges of financing a comfortable retirement?

In a DB world, it is relatively easy to measure the contribution from DB plans because DB plans typically provide a regular stream of income that can be successfully queried in surveys. The Current Population Survey (CPS) has questions about DB pension income as does the Health and Retirement Study (HRS), and such income is included in total income. But the DB world, while not at an end, is shrinking. Many more workers now have DC plans than DB plans, and additional workers and nonworkers have IRAs and Keogh accounts. Because annuitization of such plans is infrequent, asking about regular income from them to assess their support for consumption in retirement will underestimate their contribution. Capturing these irregular withdrawals in a household survey is difficult, which likely has led to an underreporting of them in the CPS and, possibly, in the HRS.

This paper uses data from the 2014 wave of the HRS to assess the importance of irregular withdrawals from DC-type pensions and IRAs to complement retirement income. To this end we use data from the survey module on pensions that HRS substantially restructured for the 2012 data collection with additional restructuring for the 2014 data collection.

Prior to 2012, the HRS collected data on (regular) pension income, annuity income, and withdrawals from IRAs/KEOGHs. It also asked about the disposition of DC plans on termination of employment, to change jobs or to retire. But it did not query in a systematic way about irregular withdrawals from “dormant” DC plans, that is, from plans from prior employment that remained with the prior employer. For example, the HRS would not capture the

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irregular withdrawals by a 75-year-old from a DC plan administered by a former employer.

In 2012, the HRS revamped its pension section. It took a detailed inventory of all pensions whether current or inactive. It gave names to each pension with the objective of being able to ask about the disposition of each plan in future waves. It elicited the characteristics of each pension such as type; whether it was in pay status; and if so, amounts of any regular benefits or payments; if not, expected future benefits. In 2014, the HRS further modified the pension instrument to account for the restructuring of the 2012 pension module in the context of a longitudinal survey. Because of the complete accounting of pension holdings undertaken in 2012, the HRS was able to ask about withdrawals from each pension since the last HRS interview in 2012 on a pension-by-pension basis. In principle, this revision would permit the capturing of all extracts between the 2012 HRS interview and the 2014 interview from tax-advantaged accounts as recorded in the HRS 2012 interview. In addition, in 2014 the HRS asked respondents who were not interviewed in 2012 about their dormant plans and about irregular withdrawals since job separation. While permitting the capture of the withdrawals, the 2014 questioning sequence does not permit an accurate annualization of withdrawal flows because the time frame may span an extended time period.

We undertook two main comparisons. The first compared income measured in the CPS with income measured in HRS before and after augmentation for IRA withdrawals and irregular withdrawals from DC-type accounts. The second compared the main measure of income in the HRS (which differs somewhat from that used in the CPS comparison) with that measure after augmentation. We studied the population age 55 or older classified by marital status, household composition, and by age band. Some tables show results by wealth quartile and education level.

Among couples, HRS income is in all instances greater than CPS income. For example, among 55 to 59 year olds, CPS median income was $94,671 in 2013; HRS median income was $107,000, or 13 percent greater. The difference in mean income was greater still, about 27 percent greater. Among singles, HRS median and mean income are greater than CPS income, and sometimes by substantial amounts, except for singles in their late 0s. The differences are likely due to survey and questionnaire design.

During their late 50s, when most people are still working, the impact on income of irregular withdrawals of IRAs and DC-type pensions is minimal; but at age 65 or older when retirement assets can be expected to be used for spending, the impact is greater. Among singles age 65 or older, median income is increased by 8.1 percent and mean income by 5.7 percent . These increases refer to the incomes of the entire population of singles, whether they withdrew or not. Among couples age 65 or older, the median and mean increased by 8.8 percent and 6.8 percent respectively.

Irregular withdrawals from DC-type accounts predominate among those in their 60s, most likely because the withdrawals mainly take place at retirement; IRA withdrawals dominate among those older than 70 because of the legal mandatory distribution requirement that is active after age 70 ½.

Irregular withdrawals are highly dependent on socioeconomic status. Among couples, irregular withdrawals increased median income in the highest wealth quartile by 12.3 percent, but just by 2.8 percent in the lowest quartile. Among single persons in the lowest wealth quartile, there were hardly any irregular withdrawals, but at the highest quartile irregular withdrawals increased median income by 15.3 percent. Because of the dependence of ownership of DC accounts and IRAs on SES, irregular withdrawals have little impact on poverty rates.

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