

Business Case for Expanding Your IRA Program

November 2005

Introduction

Americans love their individual retirement accounts (IRAs). Americans hold \$3.5 trillion in IRAs, more than any other type of tax-deferred savings account, and growing.¹ To put that in perspective, that's more than double the 2004 U.S. federal tax receipts, enough to pay for the full federal budget, and would pay for just under half the federal debt.² Of course, the whole idea of IRAs is to keep the money out of the hands of Uncle Sam.

Financial organizations, however, have enjoyed more of a love-hate relationship with IRAs over the years. Financial organizations loved IRAs during the heyday years of universal deductibility from 1982 to 1986 when the market was booming and 72 percent of IRA assets were held as bank and thrift deposits.³ The luster on IRAs dimmed over the years, starting in 1987 with the loss of universal deductibility for IRAs and continuing with the steady movement of the IRA assets from depository institutions to brokerages and mutual funds.

It's time to fall in love again. The market is large; IRA owners are worth pursuing as a profitable market segment; newer IRA-type accounts expand the total opportunity; and new technology solutions—like Wolters Kluwer Financial Services | Bankers Systems' IRA Management Center[®] solution—make offering and maintaining IRAs easier than ever.

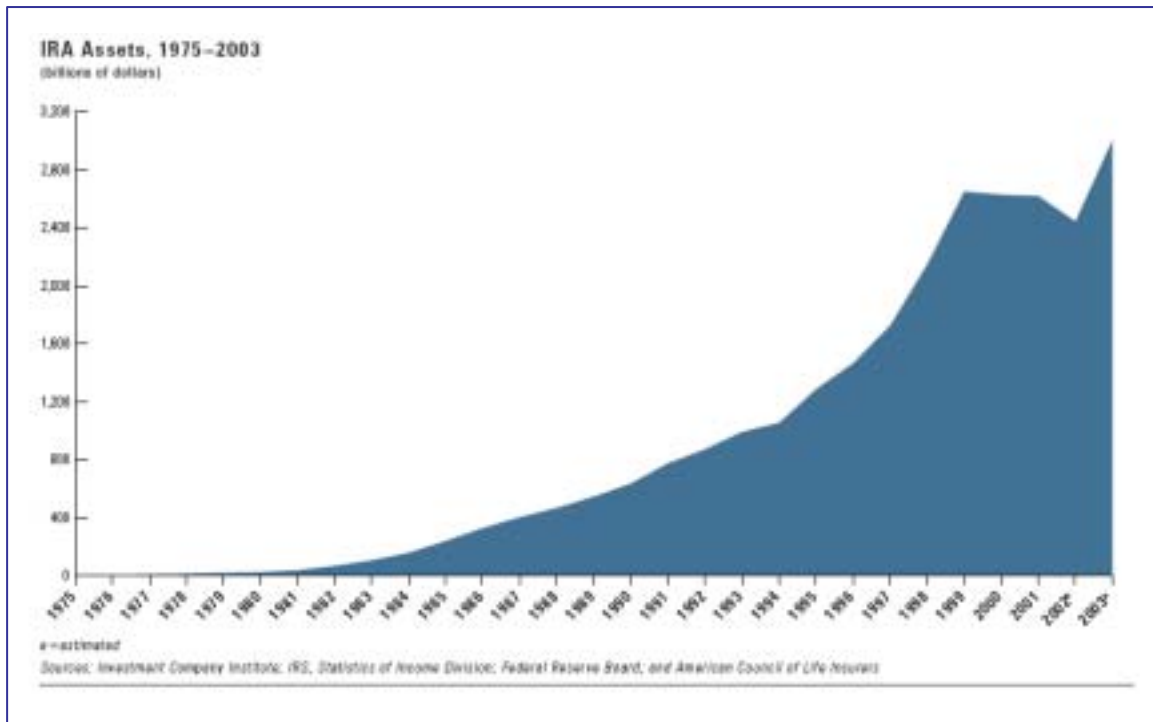
¹ Mutual Funds and the U.S. Retirement Market, Fundamentals, Investment Company Institute Research In Brief, Vol. 14, No. 4, August 2005.

² U.S. Office of Management and Budget, Historical Tables Summary of Receipts, Outlays, and Surpluses or Deficits 1789-2009. For 2004—\$1.8 trillion in receipts and \$2.3 trillion outlay. Bureau of the Public Debt, U.S. Department of the Treasury, and Federal Debt on 10/29/04 was \$7.4 trillion.

³ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute Perspective, Vol. 11, No. 1, February 2005.

Overview of IRA Market

Size. The steep upward curve on the following IRA growth chart illustrates the success of IRAs. Out of a total \$12.9 trillion in the tax-advantaged retirement plan market, IRAs' \$3.5 trillion share represents approximately 27 percent of the total market.⁴ Defined contribution plans, including 401(k) plans, by comparison held \$3.2 trillion in assets for a close second.



Penetration Into U.S. Households. IRAs are a common financial asset and reach deep into the American population. Over 40 percent of all U.S. households, 45.2 million households, maintained IRAs in 2004.⁵

Market Share of Financial Organizations. Given the long history and large market size of IRAs, it should surprise no one that this is a very competitive market with entrenched industries vying for market share. Banks, thrifts, credit unions, mutual funds, life insurance companies, and brokerages together account for virtually all IRA assets.

⁴ Mutual Funds and the U.S. Retirement Market, Fundamentals, Investment Company Institute.

⁵ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute.

It may surprise some just how much market share depository institutions have lost to brokerages and mutual funds over the years (albeit many of the mutual funds and brokerages are bank-owned or affiliated). Since 1981, banks and thrifts' share of the market dropped 63 percent: from 72 percent in 1981 to 9 percent in 2003.⁶ Mutual funds and brokerages have experienced a roughly corresponding increase with combined growth of 61 percent, from a market share of 19 percent in 1981 to 80 percent in 2003.⁷

IRA Assets and Share of Total IRA Assets by Institution, 1990–2004

	Mutual Funds		Bank and Thrift Deposits ¹		Life Insurance Companies ²		Securities Held in Brokerage Accounts ³		Total Assets (billions)
	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	
1990	\$139	22%	\$266	42%	\$40	6%	\$191	30%	\$636
1991	187	24	282	36	45	6	262	34	776
1992	235	27	275	31	50	6	313	36	873
1993	319	32	263	26	61	6	349	35	993
1994	346	33	255	24	69	7	386	37	1,056
1995	471	37	261	20	81	6	476	37	1,288
1996	598	40	258	18	92	6	526	36	1,467
1997	772	45	254	15	135	8	567	33	1,728
1998	978	45	249	12	157	7	774	36	2,158
1999	1,262	48	244	9	202	8	943	36	2,651
2000	1,232	47	252	10	202	8	944	36	2,629
2001	1,141	44	255	10	211	8	993	38	2,619
2002	1,034	41	263	10	268	11	967 ^a	38	2,533 ^a
2003	1,307	42	268	9	285	9	1,223 ^a	40	3,083 ^a
2004	1,499	43	270	8	314 ^a	9	1,402 ^a	40	3,475 ^a

e=estimated

p=preliminary

¹ Bank and thrift deposits include Keogh deposits.

² annuities held by IRAs, excluding variable annuity mutual fund IRA assets

³ Securities held in brokerage accounts exclude mutual fund assets held through brokerage accounts, which are included in mutual funds.

⁴ percent of total IRA assets

note: Components may not add to total because of rounding.

sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

⁶ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute.

⁷ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute.

IRA Demographics

IRA owners exhibit traits that financial organizations desire. The median traditional IRA owner is 52 years old, has a household income of \$62,500, maintains \$250,000 in financial assets, and holds \$30,000 in all types of IRAs.⁸ They are likely married and have two kids. Sixty-six percent of traditional IRA owners are employed full- or part-time and 54 percent have college or postgraduate degrees.⁹

The median Roth IRA owner is 47 years old, has a household income of \$70,000, maintains \$137,000 in financial assets, and holds \$21,800 in all types of IRAs.¹⁰ A bit lower than the averages for traditional IRAs; however, the lower age and higher income suggest a very valuable prospect for financial organizations.

IRA Contributions. Twenty-six percent of current traditional IRA owners made a contribution in 2003 with a median contribution amount of \$2,500.¹¹ The overall percentage of Americans making annual IRA contributions, however, is low (as low as 3 percent of all taxpayers for a recent year).¹² Forty-one percent of Roth IRA households contributed to their Roth IRA in 2003 with a median contribution amount of \$3,000.¹³ IRA owners are savers and tend to save on a regular basis.

Rollovers are a key element of IRA growth and will likely remain so in future years. Forty-six percent of IRA households have rolled assets into an IRA from another retirement plan.¹⁴ Using the most recent data, rollovers jumped from \$114 billion in 1996 to \$187 billion in 2001.¹⁵ With the coming retirement of baby boomers, rollovers from employer-defined contribution plans into IRAs are likely to increase dramatically.

IRA Demographics Attractive to Financial Organizations. The demographics of IRA owners represent a nice fit for many financial organizations. IRA owners tend to be profitable for financial organizations as they are in their financially successful years, they are stable, and they generally need multiple services from a financial organization. IRAs serve as one of the fundamental solutions for a relationship with a financial institution, with many IRA owners also having their checking accounts, other savings, and some lending solutions with an IRA provider. The nature of the IRA is a long-term savings solution. Accordingly, many IRA owners establish their IRAs, may make regular contributions, and then leave them alone. This gives financial organizations long-term core deposits and fee income from investment offerings.

Changing Demographics. As baby boomers near retirement, they are avidly contributing to retirement plans and IRAs. As they enter retirement, much of that money will likely roll into IRAs. Retired baby boomers are also expected to shift focus for their IRAs from asset investment and growth to asset protection and income. This should bode well for all financial organizations and especially well for depository institutions that offer insured investments and pay interest income.

⁸ IRA Ownership in 2004, Fundamentals, Investment Company Institute Research In Brief, Vol. 14, No. 1, February 2005.

⁹ IRA Ownership in 2004, Fundamentals, Investment Company Institute.

¹⁰ IRA Ownership in 2004, Fundamentals, Investment Company Institute.

¹¹ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute.

¹² *3 Generations of Retirement Plans*, Minneapolis Star Tribune, September 25, 2005.

¹³ IRA Ownership in 2004, Fundamentals, Investment Company Institute.

¹⁴ Mutual Funds and the U.S. Retirement Market, Fundamentals, Investment Company Institute.

¹⁵ *The Individual Retirement Account at Age 30: A Retrospective*, Investment Company Institute.

New Opportunities With HSAs, Roth IRAs, and SIMPLE IRAs

The underlying foundation of traditional IRAs has grown to include Roth IRAs, Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) IRAs, simplified employee pension (SEP) IRAs, and now Health Savings Accounts (Coverdell Education Savings Accounts also present opportunity). Although only a very small fraction of the size of traditional IRAs, these types of accounts are growing and provide new growth opportunities for financial organizations. More change is possible; President Bush and Congress have been floating a variety of new IRA-type account concepts past lawmakers over the past few years, with Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs) gaining the most attention.

IRA Assets by Type of IRA, 1997–2004
(billions of dollars)

	Traditional ¹		SEP and SAB-SEP		Roth ²		SIMPLE		Total Assets (billions)
	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	Assets (billions)	Share ⁴ (percent)	
1997	\$1,642 ^a	95%	\$85	3%	-	-	\$1	(*)	\$1,728
1998	1,974	92	115	5	\$57	3%	4	(*)	2,150
1999	2,423	91	142	5	76	3	9	(*)	2,651
2000	2,807	92	134	5	78	3	10	(*)	2,629
2001	2,295	91	121	5	79	3	14	1%	2,619
2002 ^b	2,322	92	117	5	78	3	16	1	2,533
2003 ^b	2,799	91	151	5	104	3	26	1	3,080
2004 ^b	3,150	91	172	5	120	3	33	1	3,475

^a estimated

^b preliminary

¹ includes contributory and rollover IRAs

² includes contributory and conversion Roth IRAs

³ includes Education IRAs, which were renamed Coverdell Education Savings Accounts (ESAs) in July 2001

⁴ percent of total IRA assets

(*) = Less than 1% percent.

note: Components may not add to total because of rounding.

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

New Technology Solutions Improve IRA Operations

Historically, financial organizations offering IRAs have struggled with confusing government rules, excessive technical jargon, look-alike IRA documents, and changing legislation. Add to the mix that IRAs are tax driven, with the accompanying set of tax questions, and it is understandable that some financial organizations came to the conclusion that IRAs are more effort than they are worth.

New technology solutions, however, significantly reduce the effort involved in offering IRAs. They improve operations by reducing the time commitment, the expertise required, and the errors involved in the establishment and management of IRAs. A leading example of technology applied to help in IRA establishment and management is Wolters Kluwer Financial Services | Bankers Systems' IRA Management Center® solution. The IRA Management Center solution offers the tools to help make financial organizations efficient and confident in the education, establishment, and management of IRAs.



Source: Wolters Kluwer Financial Services' Home Page for the IRA Management Center

Front-Line Fear of IRAs Reduces Efficiency. IRAs too often invoke fear and confusion in front-line personnel. These emotions are partially due to the seasonality of IRAs. With much of the IRA business completed between January and April, it's easy to forget about IRAs the rest of the year. Accordingly, many financial organizations struggle with how to effectively staff for IRAs. Some financial organizations rely on a handful of IRA specialists; or for smaller organizations, it may be a single specialist. This may be a formal policy or simply an informal understanding among employees. In either case, this policy relieves a majority of the staff from the complexity of IRAs. The downside of this approach is that it increases the expense in IRA operations as it removes the process from the lowest cost front-line personnel. Also, reliance on a few specialists can fail during the busy tax season when more assistance is required in order to manage the volume of business. A further concern is that too much institutional experience is tied to too few individuals.

Knowledge Base Increases Efficiency. The IRA Management Center solution, through the use of Internet technology, addresses the lack of knowledge and fear by front-line personnel. The IRA Management Center solution provides an IRA knowledge base on-line that even novices can quickly search to find answers to their questions. Written in plain language, the knowledge base works well for both IRA novices and veterans.

A knowledge base that is easy to access and use improves the business proposition for IRAs in a number of significant ways. It improves the ability and confidence of front-line employees. It gives them a tool to quickly and confidently answer IRA questions. This improves the financial organization's efficiency and lowers costs as newer and lower-paid employees can handle IRAs. Even more important, the knowledge base ensures accuracy and consistency in answering IRA questions. This reduces errors caused by misinformation, a historical problem for some IRA custodians/trustees.

Reduced Errors Through Technology. The risk presented by high numbers of errors in the establishment and management of IRAs can discourage financial organizations from pursuing more IRA business. Errors can occur for the reasons previously stated: misunderstanding, complexity, and lack of knowledge often due to infrequent or irregular contact with IRAs.

The IRA Management Center solution uses technology to reduce the risk of errors while at the same time increasing productivity. In addition to the benefits of the knowledge base, the IRA Management Center solution can also help reduce errors in the process of opening and managing an IRA.

Errors can occur when opening new IRAs. The errors could start with picking an outdated document. Congress frequently passes IRA legislation. Although legislation is often very good for the account owner, it also creates complexity and outdated documents. Establishing IRAs on obsolete documents is a problem that technology now helps to resolve. The IRA Management Center solution uses the Internet to automatically update forms. As soon as new documents are available, Wolters Kluwer Financial Services | Bankers Systems inserts the new document without any action required on the part of the financial organization.

A related and also common IRA error is using the wrong document altogether; for example, using an age 70½ election form for a normal distribution. The IRA Management Center solution addresses these issues by deploying automatic document selection technology that automatically selects the correct document for a particular transaction rather than allowing the customer or front-line employee to decide.

Prior to the release of newer technology, a financial organization that selected an up-to-date and correct IRA document may still have made mistakes in completing it. The IRA Management Center solution further helps to reduce errors by offering a user-friendly question and answer session rather than requiring the completion of a complex form. Historically, IRA documents have requested a lot of information in often cryptic fashion in order to keep the number of pages in the documents to a minimum. This resulted in confusion.

The benefit of using technology to solve this problem is that you can not only ask questions in a friendlier manner, but you can also reduce the total number of questions asked. Often the answer to one question drives the answer to the next or may even eliminate the need to ask a whole series of questions. For instance, you do not need to ask a rollover review question when making a regular contribution. All of this significantly reduces errors and increases satisfaction. Of course, overrides are also available for those IRA specialists who know what they need.

Permission-Based Access. Newer technology allows financial organizations to set up the IRA Management Center solution in a hierarchal fashion, allowing some users more access and permission than others. For instance, a financial organization is able to give more freedom to an IRA specialist than to a teller. You may use the permission-based tools to provide all front-line employees the ability to post IRA transactions, but also have a central IRA area review, approve, and post the transactions.

Ongoing IRA Management—Customer/Transaction Database. The IRA Management Center solution also uses technology to help manage IRAs on an ongoing basis, such as additional contributions and distributions. This is accomplished, in part, through a database that maintains customer data to avoid wasted and risky data re-entry. The system provides for interfacing with existing databases as well.

Conclusion

The business case for growing your IRA business is strong. The IRA market is large, growing, and important. The demographics are changing favorably for IRAs with the baby boomers reaching retirement age and potentially rolling money from employer retirement plans into IRAs. Congress is likely to continue to explore IRA-type legislation that should keep opening new opportunities. And, perhaps most important, new technology solutions remove many of the historical barriers to growing your IRA program. Now is a good time to direct an effort toward growing your IRA program.

