Retirement Savings among Lower-income Populations:

Challenges and Opportunities to Improve the Effectiveness of the Saver's Tax Credit

by Jade Shipman Bevans

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EARN Research Brief

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I. INTRODUCTION

The Saver's Tax Credit is a federal tax benefit created in 2001 to encourage long-term retirement savings among lower-income populations in the US. The credit has low take-up rates.[1] As a result, several US Congressional committees, including the House Ways and Means Committee, have been grappling with how to improve the design of the credit to increase its effectiveness. At the invitation of the Rockefeller Foundation, the EARN Research Institute examined retirement savings among lower-income populations, to provide guidance to help shape the evolution of the Saver's Tax Credit and to advance the field of knowledge regarding programs that help lower-income populations save effectively for retirement.

The EARN Research Institute's study offers unique insights, presented here to improve understanding about the complex economic needs of lower-income families, and to guide the creation of policies that will effectively support retirement savings among this population. The study sought to answer the following questions:

- What are lower-income adults' current opinions and behaviors regarding saving for retirement?
- Of those who do not have retirement savings, what are the key barriers that prevent saving?
- What are the central reasons why many have not taken the credit?
- What solutions do such adults in the US find appealing that would enable them to save more effectively for retirement?

[1] Among the estimated 23 million tax filers who could benefit from the Saver's Tax Credit, only 4 million claimed it in 2005, an approximate take-up rate of 17%. This number includes only those who file taxes and would see a benefit from the credit – it does not include the millions of low-income adults who do not file taxes or those who file but have no income tax liability and thus receive no benefit from the credit as it is currently structured. These groups of low-income adults are effectively left out of any potential benefit due to the structure of the incentive.

To address these questions, the EARN Research Institute conducted both primary and secondary research, including a national telephone survey of 1,004 lower-income adults in the US. All of the survey participants live in households with incomes that are below or slightly above the income cut-offs for the Saver's Tax Credit. Our results reveal that 39% of lower-income adults have savings for retirement, but less than 6% of respondents have ever claimed the Saver's Tax Credit. Based on this survey, as well as secondary studies conducted by academic and policy researchers, the EARN Research Institute has identified the following four hurdles to saving for retirement, which limit the effectiveness of the Saver's Tax Credit:

- Retirement is perceived as less important than meeting immediate financial needs and saving for emergencies.
- Many informational barriers exist, such as lack of financial knowledge, tax documents that are difficult to understand, and heavy reliance on friends and family for financial advice.
- Eligible retirement savings accounts do not meet the needs of lower-income consumers.
- The type and amount of financial incentive offered by the Saver's Tax Credit is not simple and clear enough to function as a real incentive for lower-income adults to save.

Our findings indicate that the Saver's Tax Credit, as it is currently structured, represents a missed opportunity. With approximately 77 million adults in the US reaching retirement age in the next 20 years, improvements to the structure and design of this incentive could have broad-reaching benefits for millions of families.[2] Within this paper, we present a set of concrete recommendations, as well as several innovations that are worthy of further exploration, which together address these four hurdles and suggest ways to more effectively encourage retirement savings among lower-income adults in the US.

II. METHODOLOGY

The EARN Research Institute approached this project in three phases. In the first phase, launched in 2011, we conducted a review of existing research studies, primarily focusing on findings by academic researchers. The central topics we evaluated included savings habits in the US, savings habits among low- and moderate-income populations, financial knowledge, and retirement savings. We also evaluated prior academic and applied research conducted specifically on the Saver's Tax Credit. In addition, we reached out to researchers and practitioners in the field to discuss ideas and confirm that we were aware of significant papers.

The second phase of research, which also took place in 2011, involved hosting "listening sessions" with 1,000 lower-income adults throughout the State of California. A listening session is a facilitated group discussion that gives community members an opportunity to voice their opinions, ideas, and concerns about a particular issue.

[2] Ewing, 2012

These sessions, hosted by EARN's policy team, were administered in partnership with six non-profit groups statewide. The listening sessions served a broader purpose, as our policy team wanted to understand the top economic challenges and needs of lower-income adults throughout the state. Broad questions about retirement were included in these sessions to understand its importance relative to other needs.[3]

The third phase entailed a national telephone survey of lower-income adults in the US, to build upon and answer questions not yet addressed during the first and second phases. The EARN Research Institute retained the Mellman Group, a national public opinion research firm, to provide strategic guidance, create a survey instrument, and administer the survey. The survey asked lower-income adults about their opinions, behaviors, and preferences regarding saving in general, saving for retirement, the Saver's Tax Credit, and other potential methods of saving for later in life.

The survey polled 1,004 lower-income adults throughout the US from June 14 to July 23, 2012. For the purposes of this study, lower-income adults are defined as individuals in the US who are over the age of 18 and whose household incomes are below $35,000 if single, $45,000 if a head of household, and $65,000 if married. Respondents included 504 adults whose incomes were low enough to qualify for the Saver's Tax Credit, but would not receive any benefit from the credit as it is currently structured, because it is not refundable. That is, if an individual's federal tax liability is zero, the Saver's Tax Credit does not result in a refund. Respondents also included 250 adults who qualify and would see benefit from the current Saver's Tax Credit, as well as 250 respondents whose incomes were just beyond the current income cut-offs for the credit. We intentionally over-sampled respondents who qualify for the credit and whose incomes are too high for the credit to achieve a lower margin of error for those subgroups. Due to the oversampling of those two subgroups, the overall sample size is 800, and the subgroups have been weighted appropriately. As the credit uses adjusted gross income, and we asked respondents about their "total household income for 2011," we believe that these measures are an effective proxy for qualifying households.

Survey respondents represent a broad sample of demographic characteristics. Participants' genders, racial and ethnic backgrounds, ages, and geographic locations were well-distributed, indicating that the survey is reflective of national opinions among the income categories targeted.

The margin of error associated with the full sample is +/- 3.5%. For subgroups, the margin of error will be higher, and the exact margin of error depends on the prevalence of that subgroup relative to the full sample. While we began with 800 base completes, Please note that the data points presented in this report may not add up to 100%, due to rounding or some respondents declining to answer certain questions. The exact percentages of respondents who declined to answer will be presented if noteworthy. Unless otherwise indicated, participants were allowed to select only one answer per question.

[3] A report, released in July 2012, presents the wider findings from these listening sessions. Entitled "Dreams Deferred: Opportunities, Challenges, and Solutions for California's Low-Income Families to Build Financial Security" by Sunaena K. Chhatry, Sheryl Lane, and Debby Lindsey-Taliefero, it is available online at: http://www.earn.org/static/uploads/files/EARNDreamsDeferredReport.pdf

As with any methodology, the research has limitations. It is possible that new research has been generated in the field since conducting this work. In addition, the survey relies on respondents' self-reported opinions, behaviors, and preferences, which could be different than their actual beliefs or actions.

Our research findings are presented in Section IV. These findings point to a concrete set of recommendations listed in Section V, as well as innovations that are worthy of further study in Section VI, which together can improve retirement savings in the US, especially among lower-income populations.

III. CONTEXT

Retirement Trends in the US

To understand the Saver's Tax Credit, it is first necessary to understand the major shifts that have taken place in recent decades regarding retirement savings in the US. This context is important because it sheds light on expectations about retirement and indicates how people in the US are approaching retirement savings today.

From the 1940s through the 1980s, employers primarily offered retirement benefits to their employees in the form of pensions, which were awarded after a certain number of years working for the employer. Pensions were "Defined Benefit" plans: individuals knew in advance what their annual take-home retirement pay would be, and employers managed the investments necessary to ensure their employees' retirement payouts. However, in recent decades, pensions and other Defined Benefit plans have become less common, with participation declining from 80% of workers in 1985 to 33% in 2008.[4]

Today, "Defined Contribution" plans are more common, and the most popular plans are 401(k) accounts and Individual Retirement Accounts (IRAs).[5] With Defined Contribution accounts, individuals are responsible for selecting their own contribution amounts and making investment choices to accumulate retirement savings. Defined Contribution plans allow greater worker mobility, since employees do not have to stay with one employer. However, they also impose a much greater responsibility on employees to save, invest, and manage their own retirement wealth.[6] With these plans, workers are directly exposed to investment risk and fluctuations in global financial markets.[7] In addition, the ongoing development of increasingly complex financial products makes it difficult for consumers to invest wisely. Furthermore, consumers are flooded with choices: nearly three-quarters of 401(k) plans offer six or more investment options.[8] The new investment options introduced

[4] Goda, Shoven, and Slavov, 2010.
[5] Poterba and Wise, 1996.
[6] Lusardi and Mitchell, "Financial Literacy and Retirement Planning in the United States," 2011.
[7] Lusardi and Mitchell, "Financial Literacy and Retirement Planning in the United States," 2011; Goda, Shoven, and Slavov, 2010.
[8] Hastings and Mitchell, 2011; Poterba & Wise, 1996.

today tend to have higher costs, even though higher-cost funds do not generally perform better than those with lower costs.[9] Simultaneously, many consumers are not aware of the costs of the funds into which they invest.[10]

Consequently, those saving for their retirement might contribute too little each month, or contribute the right amount but invest too conservatively or too recklessly, or unknowingly select high-cost funds that chip away at their savings over time. Due to these risks, even those who are attempting to save for their retirement may reach retirement age with low account accumulation.[11] In effect, if trends continue, many in the US will be economically unprepared for their retirement years, which has broad-reaching impacts both for those individuals and for society at large.

Taken together, these changes in the retirement savings landscape represent a dramatic shift in responsibility and risk for individuals, who must now manage their own retirement planning. It is a significant challenge, especially because these changes are not widely recognized. At EARN, we hear from our clients that they assume retirement will work out for them because they know other low-income people from prior generations who have retired successfully.[12] They have little awareness that the retirement landscape has changed.

As a result of all these factors, a substantial portion of households in the US is accumulating very little retirement wealth. Approximately one-third of adults in their 50s have not developed any kind of retirement savings plan at all.[13] In addition, nearly 45% of households have not made any contributions to a retirement savings account.[14] While 401(k) and IRA participation rates tend to increase with income, savings behaviors vary considerably, even among households with similar demographic and economic characteristics. All income categories show signs of insufficient retirement planning.[15]

Saving for retirement is incredibly important. If seniors haven't saved enough for retirement and are no longer able to work, how will they cover their basic needs? Some may rely on Social Security for income, but those benefits often are not sufficient to cover basic household necessities.[16] Already, this lack of savings has serious consequences: in the US, approximately 9% of adults over age 65 live below the poverty line, and this percentage is more than twice as high among black and Latino seniors.[17] Yet the benefits of saving are evident: those who plan for retirement accumulate three times the amount of wealth of non-planners, and studies have shown that people are more likely to achieve retirement goals when they develop concrete plans.[18]

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[9] Brown, Liang, and Weisbenner, 2007.
[10] "401(k) Participants' Awareness and Understanding of Fees," 2011.
[11] Goda, Shoven, and Slavov, 2010; Poterba and Wise, 1996.
[12] Saundra Davis, interview by author, 15 August 2011.
[13] Lusardi and Mitchell, "Financial Literacy and Planning: Implications for Retirement Wellbeing," 2011.
[14] Poterba and Wise, 1996.
[15] Poterba and Wise, 1996; Venti and Wise, 1998; Lusardi, as originally quoted in Bernheim et al., 2001.
[16] Bell, Carasso, and Seurele, 2005.
[17] Rhee, 2012.
[18] Lusardi and Mitchell, "Financial Literacy and Planning: Implications for Retirement Wellbeing," 2011; Lusardi and Mitchell, "Baby Boomer Retirement Security," 2006.

The crux of the problem is that across all income segments, planning for retirement is difficult, and as a result, many people do not save for retirement. Even among those who save for retirement, few feel confident that their efforts will leave them prepared for their retirement.[19] When looking across all income segments, academic studies have shown critical barriers to retirement planning. The most commonly cited barriers include not having enough income, lack of knowledge about finance and investing, and the self-control to delay spending now for a future that is far off and difficult to visualize.[20] For example, in 2009, one study found that 42% of adults in the US completely or mostly agreed with the statement that they "often don't have enough money to make ends meet."[21] Lower-income individuals and families face similar barriers that are presented in greater detail in the findings section.

This is the context within which the EARN Research Institute has analyzed the purpose and effectiveness of the Saver's Tax Credit. Created to encourage lower-income populations to save for their retirement, the Saver's Tax Credit operates within this broader landscape of shifting responsibility, insufficient savings, and barriers to behavioral change.

Overview of the Saver's Tax Credit

The Saver's Tax Credit, enacted by Congress in 2001 and made permanent in 2006, was created to encourage low- and moderate-income adults to save for their retirement years. For each dollar deposited in an approved retirement account (up to $2,000), tax filers receive a 50%, 20%, or 10% reduction of their tax liability. As shown in Figure 1, those in the lowest income tax brackets receive a 50% credit, and as incomes rise toward the credit's maximum allowable income, individuals and families receive smaller percentages. The maximum financial benefit is $1,000 per qualifying adult.[22]

Tax filers can claim the Saver's Tax Credit for contributions to approved retirement accounts, including the following account types: IRA, 401(k), SIMPLE IRA, SARSEP, 403(b), 501(c)(18), and governmental 457(b) plans. For 2011, the maximum adjusted gross income to receive any credit through the program is as follows: $28,250 for those who are single, married filing separately, or a qualifying widow(er); $42,375 for heads of household; and $56,500 for those who are married filing jointly. Additionally, those who claim the credit cannot be younger than the age of 18, a full-time student, or claimed as a dependent on another's tax return.

As currently structured, the credit serves a narrow set of adults in the US. Those in the lowest income tax brackets, who have no personal federal tax liability, cannot benefit from the program because the credit cannot result in a refund.[23] The income cut-offs and the graduated nature of the credit mean that a very small percentage of filers qualify to take the full credit. Based on these observations, many policy researchers

[19] Lusardi and Mitchell, "Financial Literacy and Planning: Implications for Retirement Wellbeing," 2011.
[20] Lusardi, Keller, and Keller, 2009.
[21] Pew Research, originally quoted in Lusardi et al., "Financially Fragile Households," 2011.
[22] Married couples can save $1,000 per person, for a total of $2,000.
[23] These individuals often pay other federal income taxes, often in the form of payroll taxes.

recommend that the credit should be made refundable and eligibility should expand to include more middle-income taxpayers.[24] While we agree that these changes could improve the credit's reach, our goal with this paper is broader in scope.

Figure 1. Saver's Tax Credit Benefits by Filing Status and Adjusted Gross Income in 2011

Filing Status			Saver's Tax Credit Rate	Tax Credit Given for $2,000 in Eligible Retirement Savings Contributions
Single	Head of household	Married Filing Jointly		
$0 - $17,000	0 - $25,500	0 - $34,000	50%	$1,000
$17,001 - $18,250	$25,501 - $27,375	$34,001 - $36,500	20%	$400
$18,251 - $28,250	$27,376 - $42,375	$36,501 - $56,500	10%	$200

Sources: Chart reproduced from Gale, Iwry, and Orszag, 2004, with 2011 data gathered from IRS Form 8880.

Note: The data points shown in the table do not reflect the fact that many filers have insufficient income tax liability to benefit from the nonrefundable tax credit. The data also do not take into account any tax deductions or exclusions related to retirement savings contributions, nor any employer matching contributions.

Based on our unique combination of direct experience and extensive research, we are offering guidance that focuses not just on the specific details of the Saver's Tax Credit, but also on how to better achieve the purpose for which the credit was enacted: helping lower-income families in the US prepare for retirement. For the credit to be as effective as possible, we must therefore understand, and in some cases address, the many hurdles faced by lower-income populations in the US when saving for retirement.

To set the stage for this discussion, we note one critical fact: EARN's ten years of experience with our clients suggests that lower-income populations plan for the future, are not solely focused on the present, and are able to save, even with low incomes. These ideas also are confirmed by research in the field. A broad set of research studies shows that approximately half of low-income households save for a wide variety of purposes.[25]

An incentive such as the Saver's Tax Credit can encourage individuals and families to save for retirement. A clear understanding of the opinions, desires, and challenges of lower-income adults, which are presented in this paper, can help give the credit its originally-intended impact.

[24] Gale, Iwry, and Orszag, 2005.
[25] Chan, 2011.

IV. FINDINGS

Our research identified four serious hurdles as well as promising possibilities for achieving the central goal of the Saver's Tax Credit: encouraging lower-income US individuals and families to save for retirement. In this section, we show the take-up rates of the Saver's Tax Credit, and then itemize and discuss the hurdles that lower-income populations face in establishing retirement savings.

Essentially, our study shows that the Saver's Tax Credit asks lower-income populations to invest money they believe they need for more immediate purposes, into retirement savings vehicles that many do not trust or understand and that do not meet their tolerance for risk or their needs for liquidity, in exchange for an unknown amount of tax credit they may or may not receive, depending upon their adjusted gross income at tax time. By examining these barriers in detail, we can offer appropriately crafted, innovative solutions in Sections V and VI.

Take-Up Rates of the Saver's Tax Credit

The low take-up rates of the Saver's Tax Credit in prior years spurred this research project. Our survey results indicate continued low take-up of the credit. After hearing the program's name and a brief description, just 6% of lower-income adults in our survey say they have claimed the credit, and an additional 13% are familiar with the credit but have not taken it. Approximately 81% of those surveyed do not know about or are unfamiliar with the credit. Even among those who initially respond that they have taken the Saver's Tax Credit, after hearing a more complete description, nearly one-third (31%) report that they are no longer confident that they have actually taken the credit. Thus, the actual take-up rate among those surveyed is likely to be even lower than 6%.

The six most common reasons why lower-income adults have not taken the credit are shown in Figure 2 below. Each reason has been cited by at least half of survey respondents. The most frequently cited reasons that lower-income adults have not claimed the credit are largely informational, including knowledge of the credit, eligibility, benefits, and how to claim it.[26]

[26] Survey participants were asked about each reason and the extent to which it applies to them.

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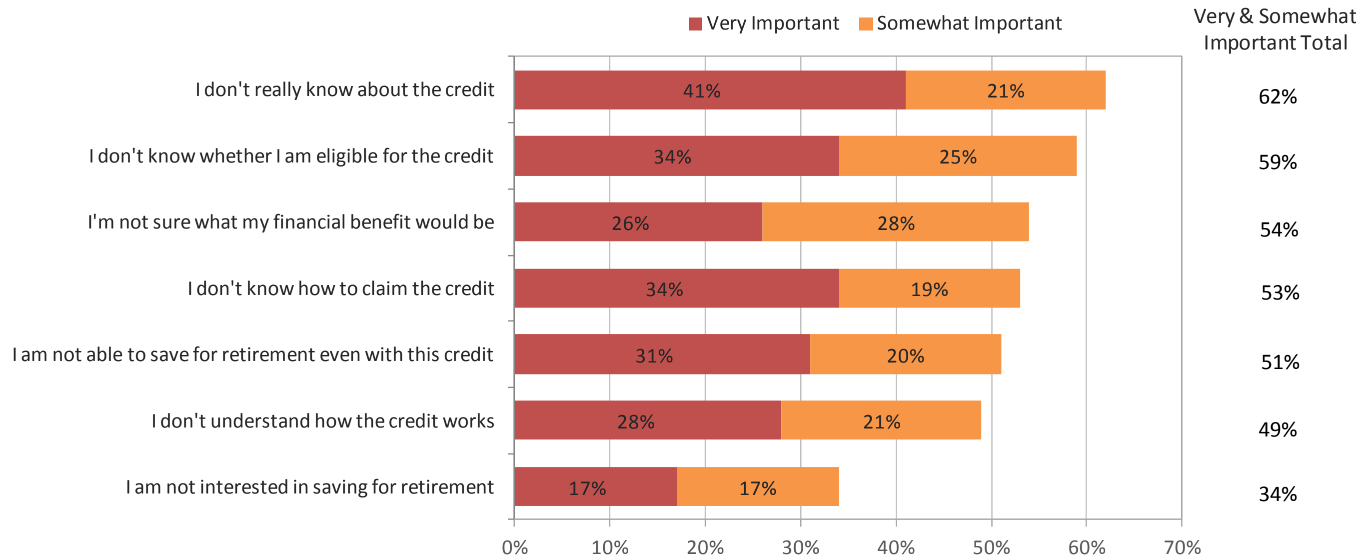
Figure 2. Commonly Cited Reasons for Not Claiming the Saver's Tax Credit



Source: EARN National Lower-income Adult Retirement Survey, N=783 (adults who have not taken the credit or are not confident that they have taken the credit)

Hurdles to Retirement Savings for Lower-income Adults in the US

Through our research, we learned that the low take-up of the Saver's Tax Credit is closely intertwined with the barriers that lower-income families face in saving for retirement in general. To be effective, the Saver's Tax Credit needs to counteract these four main hurdles.

1) Retirement is a tertiary goal, prioritized below immediate financial needs and saving for emergencies.

Studies show that lower-income adults value saving and believe it is worthwhile, and that many are able to save. However, past research also indicates that saving for retirement is not a priority for those whose incomes are lowest, due to concerns about more immediate problems and near-term goals such as saving for college.[27] This conclusion has been confirmed by EARN's on-the-ground experience with lower-income populations. In 2011, EARN held listening sessions with nearly 1,000 low-income constituents throughout the State of California. These sessions revealed that many low-income people believe they will never retire. Constituents expressed that they are struggling with insufficient financial resources to meet their present needs, let alone saving for their needs in the future.

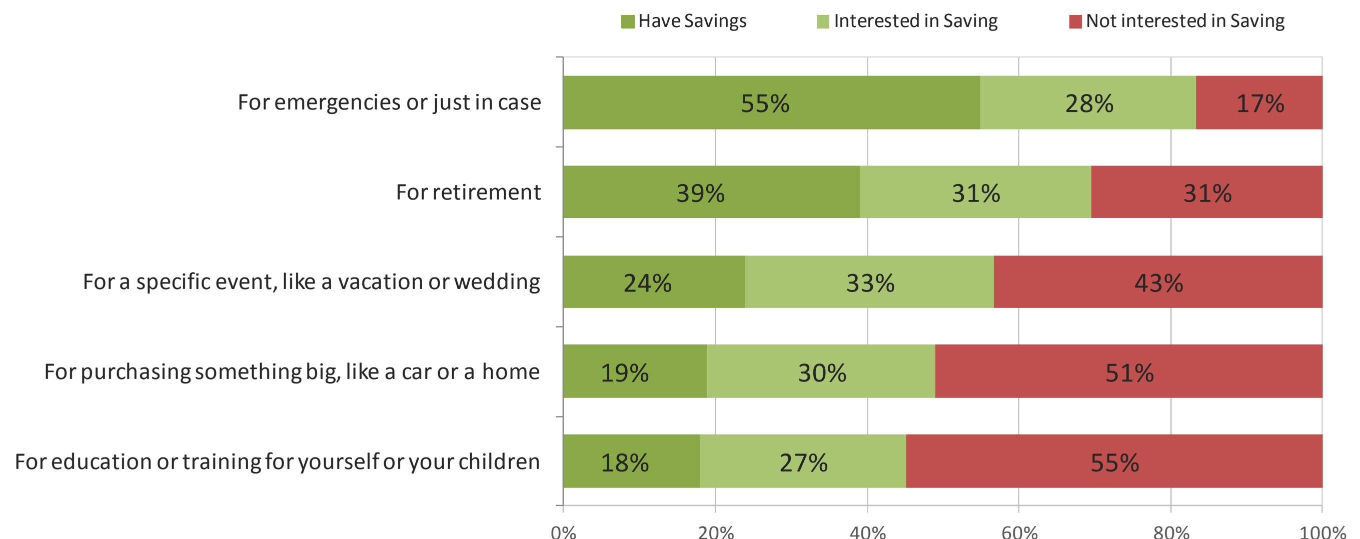
[27] Chan, 2011.

Saving for emergencies is the top savings priority

When low-income adults do save, they do so for more pressing needs, most commonly for emergencies. At EARN's listening sessions, we learned that many in this population do not have emergency savings or other support mechanisms in place to sustain themselves or their families in the event of a job loss, medical emergency, or other blows to the stability of the family. Among parents, another compelling goal is saving for their children's higher education.[28]

The EARN Research Institute tested this concept in our survey of lower-income adults in the US. Although many surveyed are saving for retirement, saving for emergencies remains a higher priority. Approximately 39% of lower-income adults have money set aside as savings for retirement, and an additional 30% do not currently have savings but are interested in saving for this goal. While these statistics indicate that retirement is important to this population, about a third (30%) of adults are simply not interested in saving for retirement. We found greater interest in saving for emergencies. More than half (55%) of lower-income adults have money set aside as savings for emergencies, and 28% do not have savings currently, but have interest in saving for this goal. About 16% of those surveyed are not interested in building emergency savings, a substantially lower percentage than those who are not interested in retirement savings.

Figure 3. Top Savings Priority is Saving for Emergencies



Source: EARN National Lower-income Adult Retirement Survey, N=800

[28] Bevans and Chiem, 2012.

The word "retirement" does not resonate for all savers

In addition, anecdotal evidence gathered at EARN's listening sessions indicate some low-income individuals do not relate to the concept of retirement. Some attendees took pride in and defined themselves as hard workers, and some made comments such as, "I will work until I die." Yet at the same sessions, attendees said they want and need to have savings for later in life, in case of illness or inability to continue working. Participants also voiced their concerns about how seniors in their communities are struggling financially.

To understand this issue more concretely, our survey tested whether the word "retirement" speaks to lower-income populations, or if other wording is more compelling. We asked survey participants about their behaviors and interest in saving for retirement, but also asked essentially the same question without using the word "retirement" and substituted descriptive phrases. We tested two distinct phrases in a split sample approach.[29] The two phrases asked about saving "in case you *decide* not to work or *want* to cut back on your work hours when you are older" or "in case you are *unable* to work or *have* to cut back on work hours when you are older. We found that 62% of lower-income adults have savings or are interested in saving if they *choose* not to work. By comparison, 72% of adults have savings or are interested in saving if they are *unable* to work. This indicates language focusing on being prepared in case one is not able to work – out of necessity, not as a choice – will have better traction among lower-income adults.

***2) Informational barriers to retirement saving include lack of financial knowledge, tax documents that are difficult to understand, and heavy reliance on friends and family for financial advice*.**

Within the US, a large majority of adults do not understand financial concepts such as compound interest, inflation, and risk diversification. This lack of financial knowledge is widespread, and is especially prevalent among the lower-paid, the less-educated, minorities, women, and individuals who are under the age of 35 or older than 65.[30] Research indicates that consumers have difficulty doing financial calculations and lack knowledge of fundamental financial concepts, which impede their ability to make good financial choices.[31]

Financial knowledge and retirement savings are related

Our nation's overall low levels of financial knowledge hinder retirement savings. The research consistently shows that retirement planning and financial knowledge are strongly positively associated.[32] Individuals with below-average financial knowledge become "overwhelmed" by making retirement investment decisions.[33] Although companies may send out brochures and booklets to help customers better understand their

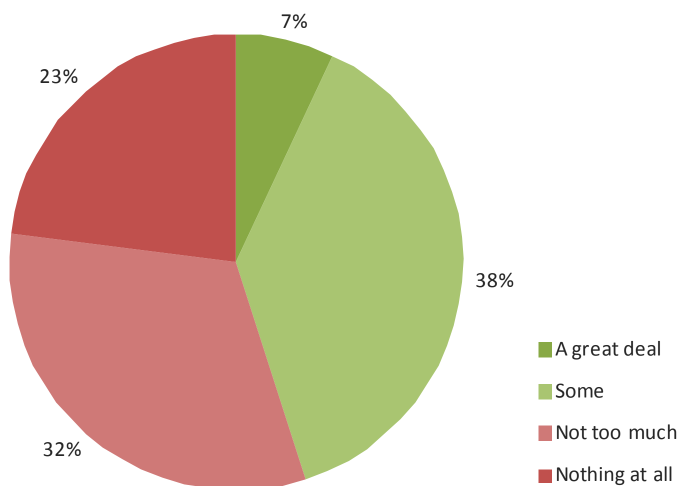
[29] A split sample methodology means that half of all participants surveyed were asked about one phrase, while the other half were asked about the other phrase.
[30] Lusardi and Mitchell, "Financial Literacy and Retirement Planning in the United States," 2011; Lusardi and Mitchell, "Financial Literacy and Planning: Implications for Retirement Wellbeing," 2011.
[31] Lusardi and Mitchell, "How Ordinary Consumers make Complex Economic Decisions," 2009.
[32] Lusardi and Mitchell, "Financial Literacy and Retirement Planning in the United States," 2011.
[33] Agnew and Szykman, as originally quoted in Brown, Liang, and Weisbenner, 2007.

retirement planning options, these materials are not always written in a simple, consumer-friendly manner.[34] Also, individuals who are less financially savvy are more sensitive to what information is being presented and how the information is framed, which leaves them vulnerable when selecting private-sector investment options for their retirement savings.[35]

Tax documents are difficult to understand

The Saver's Tax Credit poses another informational barrier: tax documents are challenging for many people to understand, and a majority of lower-income adults do not know much about tax credits and deductions. Our survey asked lower-income participants to gauge their understanding of the tax documents provided by the IRS. A majority of adults (57%) state that it is difficult to understand these documents. We also asked participants how much they know about tax credits and deductions. Only 7% say they know "a great deal," while 38% say they know "some," about a third (32%)say they know "not too much" and nearly a quarter (23%) say they know "nothing at all." These statistics show that any benefit offered through the tax code will need to be positioned and marketed wisely to ensure that lower-income adults and families know about, understand, and can take advantage of the incentive. Given the complexity of the Saver's Tax Credit, it is not surprising that our survey showed that nearly half of consumers (49%) do not understand how it works.

Figure 4. More than Half of Respondents Know Little about Tax Credits and Deductions



Source: EARN National Lower-income Adult Retirement Survey, N=800

[34] Lusardi, Keller, and Keller, "Increasing the effectiveness of Retirement Saving," 2009.
[35] Hastings and Mitchell, 2011. This idea is also confirmed by research showing that many individuals' investment choices are influenced by the design of the retirement plan, as originally discussed in Brown, Liang, and Weisbenner, 2007.

At the same time, many lower-income adults are drawing on professional assistance when completing their tax returns. This can help ensure that filers are claiming the credit if they are eligible and have saved for retirement. Our survey found that among those who filed taxes in the previous year, nearly half (49%) used a professional tax preparer or tax preparation service and more than a third (37%) used a computer program. Just 12% filled out the tax forms themselves with no guidance from a computer program or tax professional. Thus, the strong majority of those who are eligible to receive benefits from the credit are working with individuals or software that helps them to claim their benefit.

Friends and family are the primary resource for financial advice

On the other hand, when asked if they rely on eight possible sources of information for financial advice "a great deal," "some," "not much," or "not at all," survey participants most frequently rely upon friends and family, with more than half (55%) of respondents using these resources "some" or "a great deal." In comparison, less than a third (29%) of respondents turn to their tax preparers for financial advice "some" or "a great deal," while all other sources, such as the IRS, non-profit groups, financial advisors, and online resources were used "some" or "a great deal" by up to a quarter of respondents. Although a tax preparer may catch a tax filer's eligibility for the Saver's Tax Credit if they are already saving for retirement, many lower-income adults are not relying on financial professionals for broader advice, such as whether to begin saving for retirement and the benefits of creating a retirement plan.

3) Eligible retirement savings accounts have features that do not meet the needs of lower-income consumers.

Recent research indicates that utilization of the Saver's Tax Credit partially depends upon the attractiveness of eligible retirement savings products.[36] Our survey research confirms that the most prevalent retirement accounts, specifically 401(k)s and IRAs, have features that do not meet the needs of lower-income consumers, which inhibits their interest in using these accounts.

There are three central problems with mainstream retirement accounts. First, consumers' deposits can lose value depending on market performance and investment choices. Second, these accounts do not offer lower-income populations enough liquidity. Third, this population is not very comfortable or familiar with private sector investment in general.

Deposits are at risk

Lower-income adults have different attitudes toward risk than their higher-income counterparts. When studying retirement among lower-income populations, two kinds of risk are important to consider. The first is risk tolerance, which is the emotional capacity for handling risk. The second is risk capacity, which is the financial ability to absorb losses.[37] Studies indicate that lower-income groups have lower levels of both risk tolerance and

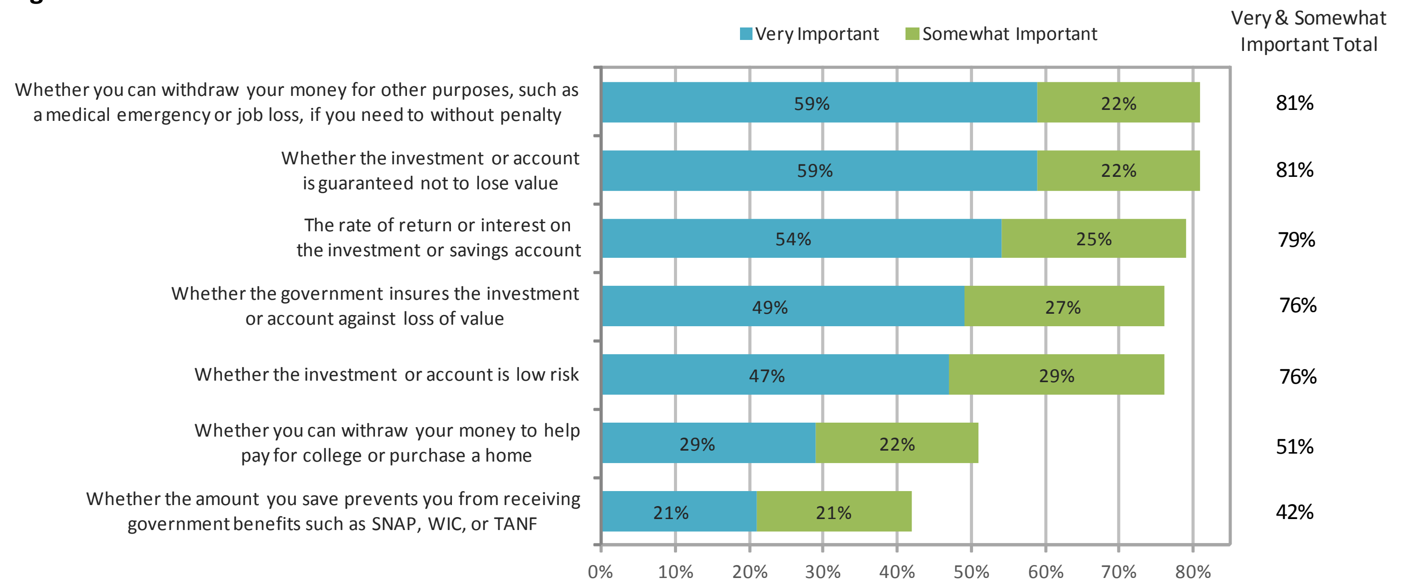
[36] Spader, 2011.
[37] Saundra Davis, interview by the author, 15 August 2011.

risk capacity. That is, they are not emotionally comfortable with risk, and they have less ability to absorb financial losses.

In one study, when low-income respondents were asked how much risk they are willing to take, more than 60% stated that they are unwilling to take *any* financial risk.[38] Given these results, it is not surprising that another study found a strong preference for low- or no-risk financial products, and yet another study determined that people make more conservative investment choices when they have lower incomes.[39]

Our survey supports these findings. We asked lower-income adults how important a series of features are when deciding to save or invest in a particular retirement program. Three key features regarding risk are very important to large numbers of lower-income adults in our survey. Approximately 59% of respondents say that it is very important to them if the investment or savings account is guaranteed not to lose value. Similarly, almost half (49%) say it is very important that the government insure the account against loss of value, and nearly half (47%) say it is very important if the account is "low risk." Thus, current private-sector investment vehicles for retirement, which do not offer these features, do not offer a level of risk that is acceptable to lower-income populations.

Figure 5. Lower-income Adults Show Clear Preferences for Account Features



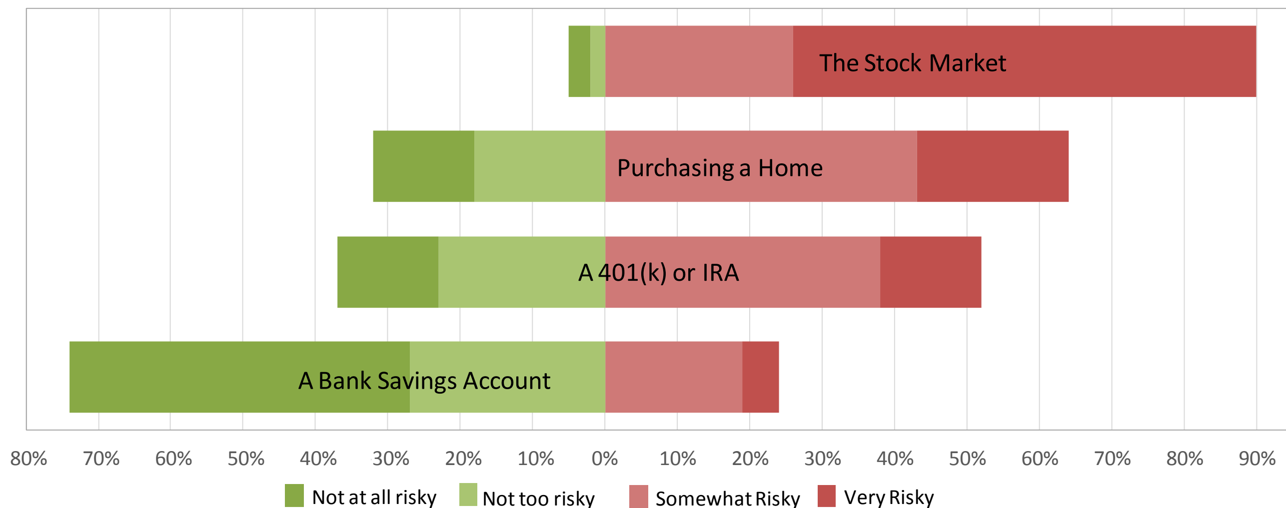
Source: EARN National Lower-income Adult Retirement Survey, N=800

Similarly, the survey asked about the perceived risk of six different types of accounts or investments. According to respondents, the most risky investment is the stock market, which 64% say is "very risky." More than half

[38] Lusardi and Mitchell, "Financial Literacy and Planning: Implications for Retirement Wellbeing," 2011.
[39] Poterba and Wise, 1996; Chan, 2011.

(52%) view 401(k) accounts or IRAs as risky, while 11% are not sure about the levels of risk with these types of accounts. Lower-income adults perceive that the least risky option is bank savings accounts, seen as "not too risky" or "not at all risky" by 74% of respondents.

Figure 6. Lower-income Adults Perceive Savings Accounts as Not Risky and the Stock Market as Very Risky



Source: EARN National Lower-income Adult Retirement Survey, N=800

Lower-income populations need appropriate liquidity

EARN's research and experience indicate that lower-income populations need the ability to access savings in case of emergencies, such as a job loss or a medical emergency. For example, in Detroit, one study released in 2009 found that 90% of low-income households had experienced at least one hardship over the course of the previous year.[40] Thus, this population may require greater liquidity than available in current retirement savings vehicles. Our survey findings confirm this conclusion. As shown in Figure 5 above, the most appealing feature to such consumers is "whether you can withdraw your money for other purposes, such as a medical emergency or job loss, if you need to, without penalty." This feature is important to 81% of respondents. Current eligible retirement savings accounts are not optimally designed to meet this need, because they typically carry substantial penalties for early withdrawal of funds.

At the same time, EARN's direct experience and our external research indicate that low-income savers prefer a relative lack of liquidity in non-emergency times, to help them stay on track with their goals.[41] This population is

[40] Barr, 2009, as originally reported in Chan, 2011.
[41] Chan, 2011; Bevans and Chiem, 2012.

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interested in commitment devices and illiquidity – that is, *not* being able to access their money until a predetermined goal or point in time – to help them stay committed to their long-term targets.[42]

Lower-income individuals are uncomfortable with private sector investment

Prior research indicates that a lack of trust, comfort, and familiarity regarding private markets are key hurdles to lower-income individuals utilizing 401(k), IRA, or other eligible retirement accounts. These groups have more trust and comfort with public sector programs than with private sector retirement accounts.[43]

This view of private sector investment is evident in their opinions about privatizing Social Security. EARN's secondary research shows that those with lower incomes would prefer to keep their money in the current Social Security system and have little desire to manage saving or invest the money on their own.[44] One study shows that individuals and families would earn *more* with a blended account that involves putting some Social Security moneys into private investment than they would with today's Social Security model.[45] However, lower-income people are less willing to take chances with money and, as a result, prefer lower risk and lower rates of return to higher-risk behaviors that might yield higher rates of return.[46]

While lower-income individuals and families have a lack of trust regarding private sector investment, it is worth noting that this attitude may stem from negative experiences that lead to the perception that private companies use predatory lending practices. In addition, highly publicized retirement savings scandals and thefts tend to further the impression that private-sector retirement vehicles are unsafe. In addition, when for-profit private banks and other financial entities seem to act in their own self-interest, consumer distrust deepens. Currently, little protects consumers from retirement account losses, as such investments are not guaranteed or insured by the federal government in the same way that savings account deposits are. Consequently, for people whose financial resources are extremely limited, the idea of giving their money to a private-sector group to manage is not very attractive because they don't trust that group and because of the lack of protections against losses.

4) The type and amount of financial incentive offered by the Saver's Tax Credit is too complex and unclear to function as a true incentive to save for lower-income adults.

Our findings indicate that the effectiveness of the Saver's Tax Credit has two central limitations inherent in its design: the type of incentive (specifically, that it is a tax credit) and the amount of the incentive, because the tax benefits are graduated depending on the tax filer's adjusted gross income during the same year in which the retirement account contributions are made.

[42] Banarjee and Mullainathan, 2010.
[43] Devroye, 2003; Saundra Davis, interview by author, 15 August 2011.
[44] Devroye, 2003.
[45] Feldstein and Liebman, 2000.
[46] Devroye, 2003.

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Type of incentive

Research indicates that while a tax credit can feasibly identify those who are lower-income and can be used by the government to pass along incentives, it is not the optimal way of motivating individuals and families to save for retirement. The US tax code is complicated, and one specific tax credit may be easily overlooked. Many tax filers are so overwhelmed by the process of doing their taxes that they simply want to get their taxes submitted. In addition, many lower-income individuals and families do not file taxes. Within our survey, 53% of lower-income adults filed taxes in the previous year, while 46% did not file. Regardless of how the credit is structured, nearly half of eligible participants are likely to not see any benefit, simply because the incentive is being administered as a tax credit.

Research throughout the field and in-house has pointed to matching incentives as a possible alternative. Savers who deposit into a qualified retirement account would see their contributions matched at a particular ratio – for example, if participants have a 25% match and deposit $1,000, they would receive an additional $250 into their retirement account, bringing their total account balance up to $1,250. In the case of an account where withdrawals are restricted, such as 401(k)s and IRAs, both the initial deposits and the match money can only be withdrawn for qualified purposes.

To test the appeal of a tax credit versus a match among lower-income adults that comprise the target market for the Saver's Tax Credit, the survey measured consumer preferences. Participants were asked in a split sample methodology how likely they would be to put savings into an account if, for every $100 they deposited, $25 was contributed either into their retirement account as a match or offered as a tax credit. For those who have tax liability, the dollar values of these benefits are identical – if anything, they might perceive the match option as less valuable because it offers a less immediate reward. For those who do not have tax liability, this match option allows them to see a tangible long-term benefit from the incentive. We learned that 58% of respondents said they would be "almost certain" or "very likely" to save in an account with the match, while just 45% of respondents were as likely to deposit into an account with a tax credit.

Secondary research shows that matching savings efforts effectively motivates low-income adults. One study showed that the availability of an employer match markedly increased employee participation in and contributions to 401(k) retirement plans, especially among low-income employees.[47] Matching also has been a successful motivator behind Individual Development Accounts (IDAs) and IRAs.[48] Although the Saver's Tax Credit is on the right track by offering an incentive to save, the type of incentive is not optimal.

Amount of financial incentive

Another central problem with the Saver's Tax Credit is that it does not provide a clear dollar amount of financial incentive. One recent study in the field indicated that the credit's complexity deters qualified taxpayers, because

[47] Huberman, Iyengar, and Jiang, as originally quoted in Brown, Liang, and Weisbenner, 2007.
[48] Engelhardt and Kumar, 2006.

of the difficulty in predicting tax benefits in advance of making retirement choices.[49] Until tax filers reach the end of the year and finish their taxes, they may find it very difficult to know if they are eligible to claim the credit and to understand what percentage of credit that they will receive (10%, 20%, or 50%). Eligibility and level of credit is determined based on adjusted gross income, which is found on line 37 of the 1040 tax form. Our survey also confirmed the importance of a simple incentive. More than half (55%) of respondents who have not taken the credit state that not knowing if they are eligible is an important reason why they have not done so. For almost as many (54%), not knowing what their financial benefit would be is another important reason they have not taken the credit. See Figure 2 on page 9 for more information.

Essentially, the credit currently serves as a reward for those who have already saved, not as an incentive to start saving. For lower-income individuals and families who wish to save, a key to success is often setting aside small dollar amounts on a regular basis, such as every month or every paycheck. If such adults save for retirement in this way, they are likely to have made the bulk of their retirement savings account deposits before they complete their taxes, all without knowing what the financial benefit of the credit will be.[50] Lower-income tax filers would be unlikely to be able to make a substantial lump-sum deposit *after* calculating their tax benefit at the end of the year. The most common source of lump-sum savings for this population comes from tax refunds, which taxpayers cannot contribute towards retirement during the same tax year in which they earned their income.[51]

Not surprisingly, our findings indicate that the greater the financial incentive, the more likely individuals are to save. Within the survey, we asked respondents how likely they would be to deposit money into a retirement account that provides different levels of matching funds. Approximately 42% say they would be "almost certain" or "very likely" to deposit into an account that matches $100 for every $1,000 of contribution, while 56% express similar likelihoods for a $250 in match for every $1,000 contribution, and 72% say the same for $500 in match with every $1,000 contribution. Yet big dollar values of incentives are not necessarily better if those incentives are hard to understand. In fact, smaller and simpler could actually be a more effective motivator. Individuals will tend to respond to *perceived* incentives, rather than *actual* incentives within retirement savings plans. It is very important that incentives are simple and clear, because of a high degree of error in perception.[52]

[49] Spader, 2011.
[50] For tax year 2011, contributions are allowed until April 2012. However, for many low-income adults, the greatest likelihood of saving comes from amassing small amounts slowly over time.
[51] Some individuals and families living on fixed incomes could potentially complete these calculations.
[52] Clark, Morrill, and Allen, 2010.

V. RECOMMENDATIONS

The Saver's Tax Credit represents a crucial opportunity, especially because its policy goals are directly in line with the long-term savings needs of lower-income populations. Our research has yielded four program design and implementation improvements that can maximize the credit's effectiveness:

- Simplify the amount of financial incentive
- Create no-risk or low-risk fund options within eligible account types
- Simplify account enrollment, including setting a no-risk or low-risk fund as the default option
- Create more effective marketing and messaging to sell the program.

Recommendation One: Simplify the amount of financial incentive.

As it stands today, the amount of financial incentive available via the Saver's Tax Credit is not clear until after the close of the calendar year, because the percentage of credit for which each saver is eligible depends upon their adjusted gross income as computed in tax returns. Currently, the amount of credit for which a saver is eligible could be 10%, 20% or 50% of the dollar amount they have deposited into a qualified retirement account – and even so, if they are income-eligible for an amount of credit that's greater than their actual tax liability, they would receive only the amount that brings their tax due down to zero, which effectively reduces the incentive.

In lieu of this complex incentive structure, we recommend the following:

- The credit should no longer be graduated, as that additional calculation adds an extra level of complexity when computing potential benefits. Instead, the amount of incentive should be a simple percentage that applies to all qualified taxpayers. If an individual's income is below the cut-off, the amount of credit would be a flat percentage of the total contribution, for example 25%.
- For ease of use, the income cut-offs should be rounded to the thousands.
- The credit should be made refundable, to ensure that the lowest-income individuals can receive the full benefit from the incentive[53]

With this series of modifications, if a potential saver is under the income maximum for their filing status, he or she is eligible for a clear dollar amount of credit. This simplicity will serve as a stronger motivator to save for retirement and claim the credit.

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[53] On the basis of income, approximately 61 million tax returns qualify for the maximum amount of tax credit, in which the filer receives 50% of eligible retirement savings contributions as a tax credit, up to the program maximum. However, because the credit is non-refundable, even if all filers made retirement savings contributions, just one-sixth of these tax filers would actually benefit from the credit *at all*. Further, just one out of every 1,000 of the returns that qualify based on income could receive the maximum possible credit of $1,000 per person if they made the maximum eligible contribution. Only these households have sufficient federal income tax liability to benefit fully from the saver's credit. For more information see Gale, Irwy, and Orszag, "The Saver's Credit: Issues and Options," 2005.

Recommendation Two: Create no-risk or very low-risk fund options within 401(k), IRA, and other eligible retirement account types.

As it stands today, most IRAs and 401(k)s primarily include funds in which consumers' deposits are exposed to some level of risk in exchange for the potential to achieve higher rates of return. Individuals' account contributions could lose value, depending upon market performance and investment choices. However, to meet the needs of the lower-income consumers that the Saver's Tax Credit is attempting to target, eligible retirement accounts should also include funds that are no-risk and/or low-risk.

Offering no-risk and/or low-risk investment options are more attractive to lower-income populations than the current range of investment products, even if the rates of return are not as high as with riskier fund choices. As described above, *it's critically important to these consumers that their deposits are protected against loss of value*. In fact, related research indicates that no-risk or low-risk options also may be appealing to middle-income and higher-income adults as well, when saving for long-term goals.[54] Ideally, these accounts would also be FDIC insured, to guarantee funds in the event of a bank failure.

These products must be marketed in a clear, honest, and concise way, and the account fees must be low relative to other offerings. One potential way of communicating effectively to potential savers that certain funds are no-risk would be to provide a governmental "stamp of approval" on a limited number of no-risk funds to give consumers more confidence. Implementing this recommendation and establishing no-risk or low-risk funds would benefit lower-income populations.

Recommendation Three: Ensure that retirement accounts offer simple, easy enrollment and that the default plan selections are no-risk or low-risk.

Currently, enrolling in most retirement plans is a complex process that involves submitting personal information, selecting beneficiaries, and making investment choices, usually from an ever-broadening menu of fund options. Secondary research indicates that consumers become overwhelmed with this process, to the point that some never enroll or save for retirement.

A simplified enrollment process would benefit consumers. Ideally, participants would not have to make investment choices in order to start saving. If they find the investment choices overwhelming, they could simply stay with the default options, which would be no-risk or low-risk funds. In addition, to maximize consumer appeal, these accounts could be made readily available both in-person at bank branches and online, as research indicates that consumers prefer this flexibility.[55]

[54] Bevans and Chiem, 2012.
[55] Bevans and Chiem, 2012.

Recommendation Four: Create more effective marketing and messaging that "sells" the incentive and retirement savings in general.

Effective marketing is a key component of leading behavioral change. Essentially, with this recommendation, we suggest using language that resonates with lower-income adults, and presenting information about the credit in a manner that is clear and persuasive.

To make the Saver's Tax Credit compelling, the language used to describe the program should make retirement savings relevant to lower-income adults. Our survey research indicates that the word "retirement" resonates with this population. However, the Saver's Tax Credit likely would have more traction if broader language is used to make retirement seem more relevant. Specifically, having savings in case you are *unable* to work when you get older is a compelling message to lower-income adults in the US, according to our survey. Others in the field can build on this idea and identify the specific phrase(s) that would motivate this population most.

In addition, marketing and messaging should be clear and exciting to motivate participation. Prior research suggests that simple educational materials can increase financial knowledge and improve adults' retirement decisions.[56] One study showed that, in a workplace, a cost-effective planning tool significantly motivated employees to save in a supplementary retirement account. The key to its success was acknowledging the barriers that stand between individuals and retirement saving, and providing motivation and guidance in order to overcome those barriers. The planning materials highlighted that small amounts are enough to open an account, and sought to provide clear information and to make each step of the process manageable and understandable.[57] To implement, one method would send potential savers a retirement guide, written in simple and colloquial language, that explains the process and time commitment needed for each step to enroll in a retirement savings plan, along with the incentive that is available with the Saver's Tax Credit. These guides could include basic information about investing, along with education regarding certain key terms and phrases. These booklets should be as succinct as possible, with a government logo, but not dry in tone like many existing tax documents. The recommendations above reinforce one another. For example, if the credit itself is structured in a simpler way, it will be easier to explain.

VI. INNOVATIONS

The recommendations discussed above would significantly improve the effectiveness of the Saver's Tax Credit. However, they do not fully address the barriers to saving for retirement that we discussed in Section IV of this report. The EARN Research Institute has identified several promising ideas that warrant further conversation

[56] Clark, Morrill, and Allen, 2010.
[57] Lusardi, Keller, and Keller, 2009.

and exploration, as our preliminary research shows they have the potential to help address these deeper issues around the attractiveness of saving for retirement among lower-income populations.

Innovation One: Allow savers to know in advance of making deposits whether they qualify for the incentive.

In Recommendation One above, we proposed simplifying the incentive structure for the Saver's Tax Credit. As the credit is currently structured, individuals must complete their taxes and determine their adjusted gross income before knowing if they will be eligible for the incentive on that past year's retirement savings deposits. Thus, the credit currently functions more like a reward for those who already save, rather than a true incentive to begin saving. To make this incentive effective as possible, we encourage additional innovation and exploration to take Recommendation One a step further and explore methods to help potential savers learn whether they will qualify for the credit prior to setting aside retirement savings. Knowing how much they would benefit, they can then decide how much to save.

Additional research and inquiry is necessary to determine the ideal way to develop this idea. One possibility is to base eligibility for the credit on the prior year's income. In another approach, savers could qualify based on their gross income before any adjustments, since more people know their wages rather than their adjusted gross income. Individuals would know, in advance of making deposits, whether they qualify for the incentive, encouraging savings. This difference could boost take-up of the Saver's Tax Credit.

Because starting to save and learning to stick with it is of critical importance, any incentive should encourage this behavior. Prior research studies indicate that once a new savings habit is established, many individuals continue to save even when the initial incentive is no longer provided. Thus, if an individual qualified for the credit and began saving for retirement, their habit of saving could remain intact even if they did not qualify for the incentive in subsequent years.

Innovation Two: Change the type of financial incentive from a tax credit to a match.

Our survey found lower-income consumers find matching funds more appealing than a tax credit as an incentive. With a match, any incentive would be deposited into a qualified retirement account, where a saver's deposits would not be accessible until retirement age. Research studies have begun to evaluate this idea as well, with favorable results.[58] This structure would help build their retirement accounts even further, and would provide a more appealing incentive for saving. In addition, the match could potentially be offered to those who are saving regardless of tax liability, without concern about potential misuse of benefit dollars, as any incentives would be deposited into a qualified retirement account.

As this innovation would represent a substantial departure from the way the credit is currently structured, it is unclear what government entities would administer such a feature. More dialogue and study will be necessary

[58] Duflo et al, 2006, Duflo et al, 2007.

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to determine the specifics. However, the idea is a compelling one, as it would offer an incentive that is more appealing to the lower-income populations that the Saver's Tax Credit seeks to target.

Innovation Three: Offer no or very low penalties in the event of an emergency drawdown to ensure liquidity.

Having access to savings in the event of an emergency is critically important to lower-income populations, as they experience financial shocks more frequently and often do not have ample emergency savings. These consumers generally prefer that accounts for long-term goals have very little liquidity outside of a handful of emergency situations. To help ensure that this population saves for retirement, accounts should offer consumers the ability to withdraw their deposits in certain emergency situations with no or very low penalty.

With the current tax credit structure, this proposal is difficult to implement, because individuals receive their incentive benefits at the conclusion of each tax year. In addition, the incentive dollars are not connected to an individual's retirement savings account. If savers need to draw down their retirement savings due to an emergency, they face early withdrawal penalties, some of which cannot be avoided in a tax credit structure because the government must recoup the incentive benefits paid out to consumers. Fear of withdrawal penalties is a psychological hurdle, impeding program participation for lower-income populations. As a logistical hurdle, savers do not really know how much money they would have available in an emergency situation, which can add stress when money is tight.

Further research is needed to explore ways of implementing this idea. If, as suggested in Innovation Two, the tax credit were changed to a match, lower-income adults could draw down their own contributions to their accounts in the event of an emergency situation, such as a job loss or medical emergency, without losing a portion of their own deposits to penalties. Of course, consumers likely would forfeit their match funds if withdrawals are made for emergency purposes to deter them from making early withdrawals. However, the actual deposits made by the consumers would be protected against penalty. Another possibility would set up a vesting schedule for the match funds.

Innovation Four: Ensure that no-risk and low-risk funds have adequate rates of return.

One view is that a central way to offer rates of return that are in line with inflation is to ask individuals to assume some risk of losses. As previously mentioned, this risk is unacceptable to the consumers that the Saver's Tax Credit targets. Yet these savers must also receive an adequate rate of return while amassing their retirement.

More inquiry is needed to understand the specifics of such funds. Early phase thinking is that the no-risk or low-risk account options discussed in our recommendations above would offer a rate of return that keeps pace with inflation.[59] To make this type of account attractive to financial institutions, the savers' deposits will be

[59] Gale, William G., J. Mark Iwry, and Peter R. Orzag. "Improving Tax Incentives for Low-Income Savers," 2005.

withdrawal restricted. As some individuals will save for 20, 30, or 40 years before they are eligible to retire, this capital is very patient, which affords greater flexibility in offering no-risk accounts with higher rates of return than are available within current savings accounts or Certificates of Deposit.

VII. CONCLUSION

Taken together, these recommendations and promising innovations represent a tremendous opportunity to improve the Saver's Tax Credit and the broader retirement landscape. We hope policymakers and program administrators will consider, explore, and implement these ideas to improve the effectiveness of retirement savings incentives, so that lower-income Americans can overcome the major hurdles that keep them from saving for retirement. The Saver's Tax Credit can be part of that solution.

While this issue is complex and challenging, our research indicates that simple steps can have a powerful impact on the appeal of retirement savings. We offer these findings in the hope that others with knowledge will join the conversation and add their own ideas to the field. The EARN Research Institute welcomes this collaboration as we seek to boost ongoing savings among lower-income families and individuals throughout the US.

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ABOUT EARN

EARN, the nation's leading provider of microsavings, is an award-winning California non-profit that gives low-income workers the power to create economic prosperity for generations to come. Since 2001, EARN has helped tens of thousands of low-wage families through innovative financial products including matched savings accounts, checking accounts for the unbanked, and financial coaching. EARN's powerful combination of lasting assets and financial know-how enables families to build wealth and achieve life-changing goals such as saving for college, purchasing first homes, or starting small businesses.

The EARN Research Institute evaluates the impact of EARN's work and publishes original data, sharing lessons learned and best practices. EARN uses this unique grounding in rigorous research and direct service experience to transform the financial services landscape and to champion effective public policies. EARN's ultimate vision is that millions of well-informed, low-income families will achieve financial success through proven strategies, fair public policy, and their own hard work.

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