

Reimagining the Private Retirement System

2016 iOme Challenge

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EXECUTIVE SUMMARY

To assist Millennials and subsequent generations save for retirement, it is essential for the U.S. federal government to adopt several policies related to: education requirements, the myRA program, Social Security tax, and the Saver's Credit. Personal finance education is crucial for students' understanding of handling their finances; thus, it should be mandatory for all high school students to take a course related to this topic. Without this background in managing their own money, further government policies would struggle to achieve effectiveness among the Millennials.

Upon successful completion of the related financial coursework, individuals would then be further supported by government policies promoting retirement savings and making the process easier. The proposed changes in the myRA program, Social Security tax, and the Saver's Credit would accomplish just that. I outline the specific goals of each proposed policy in this paper. With coordination of new education requirements providing the framework, and policies providing the support, Millennials will have the necessary tools to successfully save for retirement.

To implement these policies, their content and specificities need to be strongly disseminated through media channels such as public service announcements (PSAs). This effort should be customized for different demographics, such as gender, in order to reach different audiences with dissimilar human capital and concerns.

Also outlined is the importance of the private sector and their role in reimagining personal retirement savings. While the government plays an important role in making retirement saving easier, it is fundamentally up to the private sector to provide innovative ideas and tools to further improve the efficiency of government policies. Something as simple as a smart phone application could be a game changer for personal retirement savings as Millennials turn away from brick and mortar banks.

Introduction

The Great Recession which lasted from December 2007 through June 2009 was the worst financial crises in the United States since the Great Depression.^{1;2} Its effects are still present nowadays. According to Katz and Krueger (2016), over the last years all of the net growth in US employment has occurred in alternative work arrangements (e.g. temporary workers and freelancers), not full time jobs.³ There is no doubt that this financial meltdown has shaped the Millennial Generation in terms of their confidence in Wall Street and their overall handling of their personal finances. Add this to the fact that young adults tend to switch from job to job directly after high school or college and that, historically, personal retirement savings has occurred through the employer, it is realized there is a potential problem. The U.S. federal government must work beside the private sector to reimagine the private retirement system and ensure adequate personal retirement savings for Millennials and subsequent generations.

Background

For several decades, employers provided their employees with retirement accounts: pensions or 401(K)s. Pensions, which are defined benefit accounts, guarantee a monthly amount to be paid to the retiree for the remainder of their life. The monthly amount is usually a calculation based on their average salary and the time spent with the employer. These plans tend to be expensive and risky for the employer and are unable to be transferred if the employee changes employers. In an attempt to solve this problem, the market turned to 401(K)s, known as defined contribution accounts, which allows the employee and employer to contribute to a retirement portfolio. Typically, employers will contribute a set percent in addition to matching up to a certain percent of what the employee contributes. While this approach allows the employee to move their 401(K) with them, they face the cyclical nature of the market. Young adults tend to have many different jobs over their early working age. A report by the Bureau of Labor Statistics (2015) which tracked multiple age groups between

1978 and 2012, found that individuals from age 18 to 48 on average held 11.7 jobs. Young adults, those between 18 to 24 years old, held an average 5.5 jobs.³ This holds true across several demographics as seen in Table 1. Additionally, it is important to note that as age increases (until age 39), the number of jobs held on average decreases. While 401(K)s can be rolled over with new employment, this process can be long and complicated, not something anyone, especially young adults, would want to deal with multiple times during their life.

Characteristic	Average number of jobs for persons ages 18 to 48 in 1978-2012					
	Total ¹	Ages 18 to 24	Ages 25 to 29	Ages 30 to 34	Ages 35 to 39	Ages 40 to 48
Total	11.7	5.5	3.0	2.4	2.1	2.4
Less than a high school diploma	11.5	5.0	2.9	2.4	2.0	2.1
High school graduates, no college ²	11.2	5.1	2.8	2.4	2.1	2.3
Some college or associate degree	12.3	5.8	3.1	2.5	2.1	2.5
Bachelor's degree and higher ³	11.8	6.1	3.0	2.4	2.1	2.3
Men	11.8	5.7	3.1	2.5	2.1	2.4
Less than a high school diploma	12.9	5.7	3.5	2.6	2.1	2.5
High school graduates, no college ²	11.7	5.5	3.1	2.6	2.1	2.3
Some college or associate degree	12.4	6.0	3.2	2.7	2.1	2.5
Bachelor's degree and higher ³	11.2	5.8	2.8	2.4	2.2	2.3
Women	11.5	5.3	2.8	2.3	2.1	2.4
Less than a high school diploma	9.6	4.0	2.2	2.1	1.9	1.7
High school graduates, no college ²	10.7	4.6	2.5	2.2	2.1	2.3
Some college or associate degree	12.3	5.6	3.0	2.4	2.2	2.6
Bachelor's degree and higher ³	12.5	6.4	3.2	2.3	2.0	2.4
White non-Hispanic.....	11.7	5.7	3.0	2.4	2.1	2.3
Less than a high school diploma	12.1	5.4	3.1	2.6	2.1	2.2
High school graduates, no college ²	11.4	5.3	2.9	2.4	2.1	2.3
Some college or associate degree	12.3	5.9	3.1	2.5	2.1	2.5
Bachelor's degree and higher ³	11.8	6.2	3.0	2.3	2.0	2.3
Black non-Hispanic	11.4	4.6	2.9	2.5	2.1	2.5
Less than a high school diploma	10.1	3.7	2.6	2.2	1.7	1.9
High school graduates, no college ²	10.9	4.4	2.8	2.5	2.2	2.4
Some college or associate degree	12.6	5.1	3.1	2.6	2.4	2.8
Bachelor's degree and higher ³	11.9	5.6	3.0	2.6	2.1	2.8
Hispanic or Latino.....	11.4	4.9	2.8	2.3	2.1	2.4
Less than a high school diploma	10.9	4.3	2.8	2.1	1.9	2.3
High school graduates, no college ²	10.9	4.9	2.7	2.3	2.1	2.4
Some college or associate degree	12.5	5.2	3.1	2.5	2.3	2.8
Bachelor's degree and higher ³	11.6	5.5	2.8	2.5	2.2	2.1

Table 1 Average Number of Jobs

Source: Bureau of Labor Statistics (2015).³

The U.S. government created the Social Security System in 1935 to provide a safety net for seniors. The system prevents close to 14.5 million seniors from living in poverty.⁴ Social Security is funded by current workers paying in, allowing for retirees to withdraw. This works fine as long as what is, on average, paid in is equivalent or more than what is being withdrawn. Recently, there is doubt the Social Security System will be in existence for generations paying in since the Baby Boomer Generation recently started collecting from Social Security. With the population size of Baby Boomers, combined with their increased lifespan, it is projected that the Social Security trust fund will become exhausted around 2037.⁵ With the first Millennials set to retire at least ten years after the exhaustion of the trust fund, it is important for this cohort to increase personal retirement savings to protect themselves in the so-called golden years.

Education

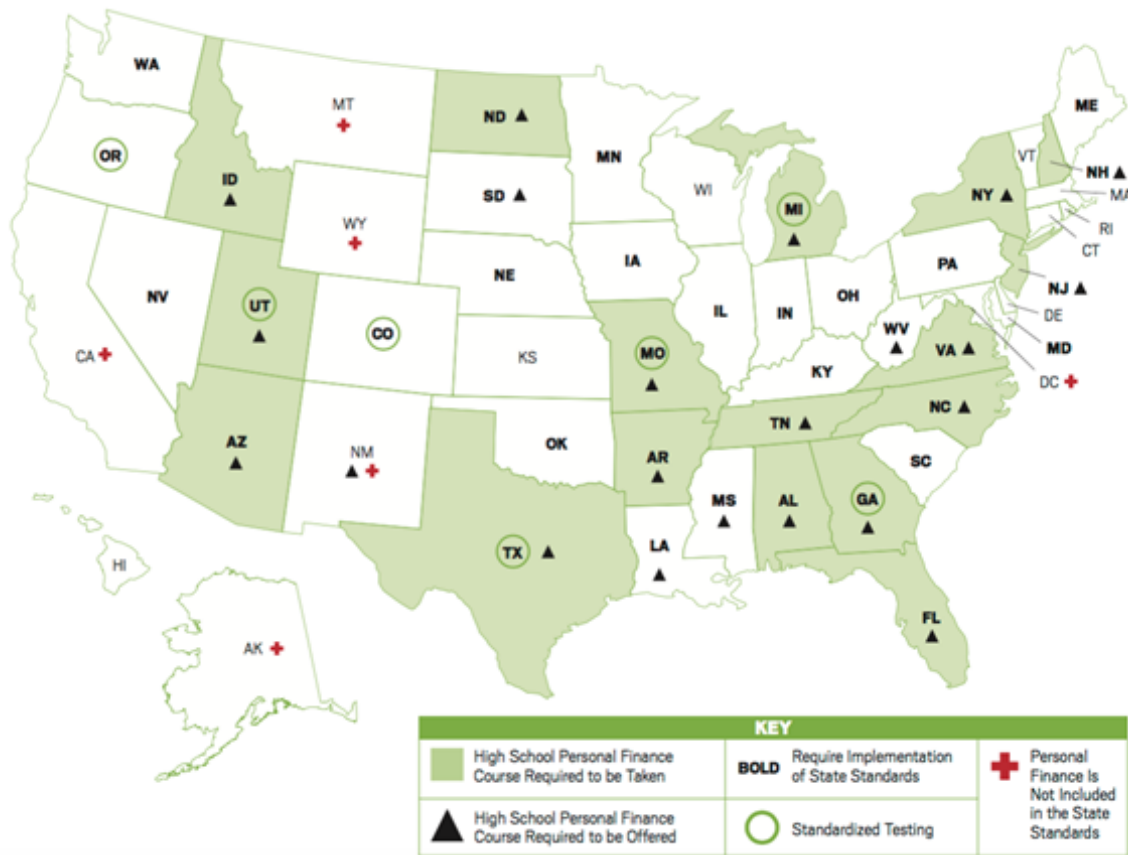


Figure 1 Personal Finance Education in the United States, 2016.

Source: Council for Economic Education (2016)⁶

Seventeen States in the U.S. currently require high school students to take a personal finance course as shown in Figure 1.⁶ Personal finance courses teach students how to write checks, make budgets, save money, pay for school, plan for retirement, and other measures to balance their finances. Students should graduate high school with a basic understanding of personal finance; therefore, the federal government should require such courses be taken.

In-school credit unions and banks would also increase financial awareness among grade-school students. These credit unions and banks set up an actual branch inside elementary through high schools to encourage financial literacy and good saving habits from a young age. Parent(s) would be listed as the custodian(s) for their student's account. To expose students to the different financial services credit unions and banks provide, a three-step exposure process could be followed:

Elementary School: Savings accounts with withdrawals available.

Middle School: Savings and withdraws with the addition to small-short term loans.
(example: up to \$100, by parent consent)

High School: Savings, withdrawals, small-short term loans (example: up to \$500, by parent consent), with the addition to CD's and basic retirement savings accounts.

These financial systems already exist in some schools today, though not providing as in depth services. While credit unions and banks would not directly profit off of these student branches, this system provides a way to grow public relations and marketing. Some of the current credit unions and banks provide a stipend and college scholarships for student employees.⁷ It would be a great opportunity for financial service providers and students alike if in-school credit unions and banks found their way into every school system nationwide.

It is key for personal finance education to take place in grade school, preparing students before they are faced with loans for college expenses and credit card offers. Mandating this education to take place before high school graduation, the government can make certain that virtually all young individuals are receiving a background in handling finances. This requirement in addition to in-school credit unions and banks will provide entire generations a framework in personal finance, including retirement planning.

Gender Differences in Retirement Planning

As previously shown in Table 1, on average there are no meaningful differences in the number of jobs held by men and women when assessing it at the aggregate level. However, Quick and Moen (1998) argued that, relatively speaking, fewer women spend a significant amount of time planning for retirement than men (53% of men vs. 37% of women).⁸ According to these authors, when compared to men, women are less likely to have a future time perspective (FTP) – the tendency to look toward the future rather than focusing on the present or the past. On the other hand, this behavior could in part be driven by the historical evidence that women tend to have lower disposable incomes, thus a lower ability to save meaningful amounts of money (US Census Bureau, 2000).⁹ It is noteworthy that this behavior in women is not only applicable to retirement but also to other types of financial planning (Glass and Kilpatrick, 1998; Simmons and Betschild, 2001).^{8; 10}

Not only do women tend to have lower disposable income when compared to men, they often times face lower pay for the same job. According to the White House, in 2014, women earned 79 cents compared to a dollar for men. This pay gap is even worse for African-American and Latina women, earning 64 percent and 56 percent of what a man makes, respectively.¹¹ This pay gap will leave women with potentially hundreds of thousands of dollars or more lost over the course of their working lives, some of which could have been contributed towards retirement.

More recently, Jacobs-Lawson et al. (2004) corroborate the findings of previous studies in gender differences within the realm of planning for retirement and recommend that educational and training policies aimed at boosting this and other types of financial decisions need to be tailored differently among genders because a one-size-fits-all approach has proven to be ineffective.¹² Besides tailoring educational and training policies, more work must be done to close the pay gap. The United States should provide its daughters the same opportunities as its sons; this starts with equal pay for equal work and skills.

Lacking Trust in Wall Street

Many Millennials lack trust in Wall Street; a survey by Goldman Sachs (2015) found that only 18 percent of Millennials found the stock market to be the best way to save for the future.¹³ The Dow Jones Industrial Average lost over half of its value due to the Great Recession caused largely by the housing bubble. On October 9, 2007, the index read 14,164.53 at close. That number had decreased by 7,361.72 to a new index of 6,547.05 on March 9, 2009.¹⁴ Historically, the stock market, the Dow Jones Industrial Average included, increases over time at a higher rate than inflation or treasury bills. Unfortunately, there are swings in the market which brings risk to those needing to withdraw during times of economic turmoil, when stock prices are low as seen in Figure 2.



Figure 2 Dow Jones Industrial Average.

Source: Dow Jones April 18, 2006 to April 19, 2016. FRED (2016)¹⁵

Individuals lacking trust in Wall Street may prefer to set up a retirement account in which their savings are exposed to less risk, regardless of the health of the economy. Such accounts already exist, including: CD's, money market accounts, savings accounts, and Treasury notes and bonds. While these accounts do not carry the same potential earnings (and losses) as those in stocks, they have lower volatility, something of value to risk-averse individuals.

Government Policy

The Federal Government should focus on three major policy changes in addition to mandatory personal finance courses taught in grade school. These policies will include: changes to the myRA retirement program, the Social Security tax, and the Savers Tax Credit.

MyRA is a U.S. Treasury backed retirement program, which eliminates the burden of a large opening deposit and fees of a normal IRA/Roth IRA. Since U.S. Treasury bonds back this program, there is virtually no risk involved. This makes it easy for an individual to start small and to see their money grow without the cyclical nature of the stock market. Another benefit is that there are no fees with myRA. In advertising for the program, myRA illustrates the guaranteed growth under the program with more volatility under a Roth IRA account. Currently, an individual can only save up to \$15,000 in their myRA before moving it to a private-sector Roth IRA.¹⁶ This cap should be removed allowing people to continue to save through myRA without the need to transfer after they reach \$15,000 in savings. Similar to 401(K)s, employers can still contribute to their employees' myRA accounts.

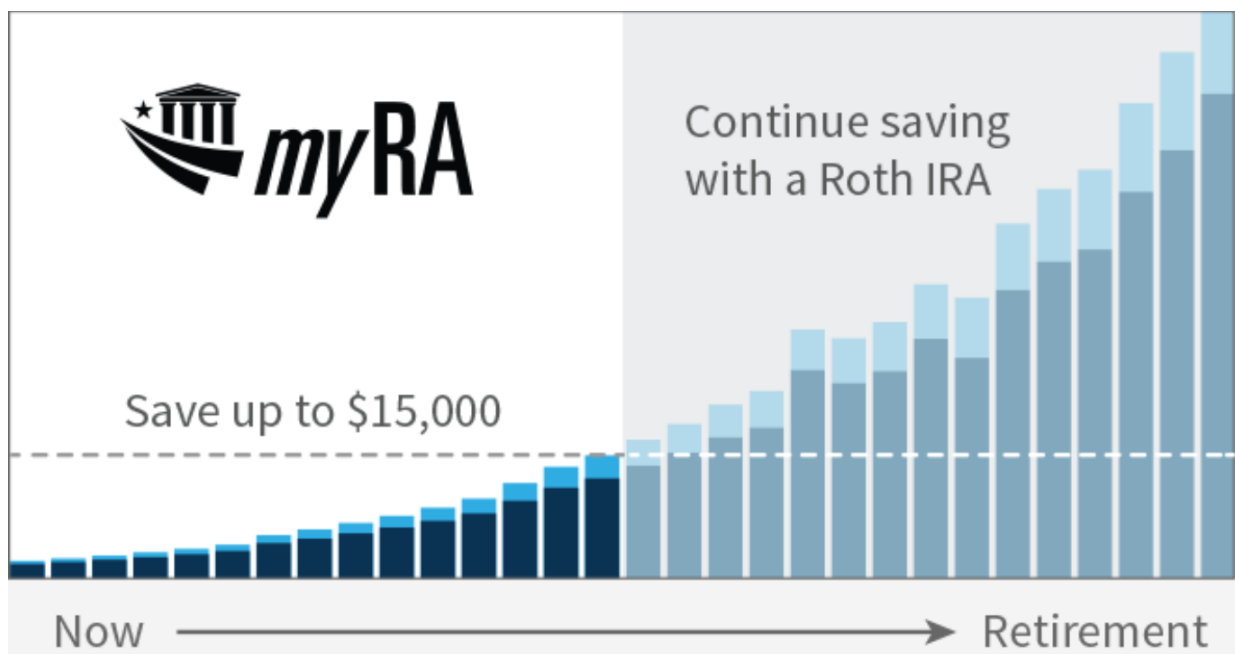


Figure 3 myRA Cap and Continued Savings with a Roth IRA

Source: myRA (2016).¹⁶

For 2016, the Social Security tax is assessed on an individual's first \$118,500 of earned income.¹⁷ An individual who makes over this threshold, pays the same amount of Social Security tax as an individual who makes exactly \$118,500. It is time to remove the tax cap, taxing all earned income at varying rates. Earnings up to and including \$250,000 would be taxed at the current rate: 12.4 percent (6.2 percent employee, 6.2 percent employer). Earnings above \$250,000 to one million dollars, the tax rate would be 4.2 percent, each. Earnings above one million dollars would be taxed at 2.2 percent, each.

Example:

Gavin has total earnings of \$12.5 million a year. \$250,000 would be taxed at 12.4 percent (6.2 percent employee, 6.2 percent employer). \$749,999 would be taxed at a total of 8.4 percent (4.2 percent employee, 4.2 percent employer). Lastly, his remaining earnings, \$11.5 million, would be taxed at a total of 4.4 percent (2.2 percent employee, 2.2 percent employer).

The additional revenue raised by this new system could help fund a myRA program for graduating high school students. Upon completion of at least one personal finance course, a myRA account would be set up and seeded for each graduating high school student.

According to the U.S. Department of Education, 3.3 million high school students are expected to graduate in the 2015-16 school year.¹⁸ If the Federal Government funds each student's myRA account \$500, the total expenditure would equate \$1.65 billion – less than 1/100th of a percent of the total 2014 GDP of the United States and less than 1/20th of a percent of the total 2015 U.S. Federal Budget.^{19; 20}

1.65 billion / 17.419 trillion ≈ 0.009 percent of total U.S. GDP

1.65 billion / 3.8 trillion ≈ 0.043 percent of total U.S. Federal Budget

Program Expenditure as Percent of Total GDP
(2014)

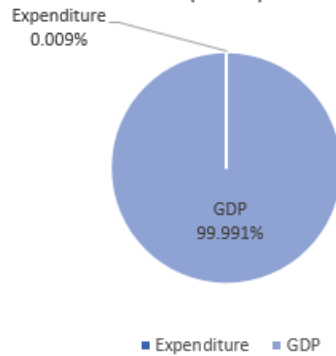


Figure 4 Program Expenditure as Percent of Total GDP

Source: The World Bank. (2016)¹⁹

Program Expenditure as Percent of Federal Budget (2015)

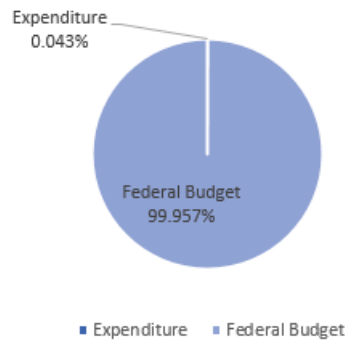


Figure 5 Program Expenditure as Percent of Federal Budget

Source: White House (2015)²⁰

By combining personal finance education with an actual seeded retirement account, the federal government would be paving the way for retirement success of young adults.

Under the tax law, individuals are able to apply \$2,000 of retirement savings towards a Retirement Savings Contributions Credit (Saver's Credit) when filing their taxes. This number should increase to \$5,500 a year, the total contribution limit for IRAs and Roth IRAs. This will increase the incentive to save more, as the claimable amount on taxes would also increase. Millennials would additionally benefit from this credit if they were eligible to claim it while still attending school full-time, something not allowed today.^{21; 22} There needs to be a careful

balance between augmenting the personal savings rate while still promoting investment and economic growth.

The above policies would provide support to the education mandate framework. By eliminating the cap on myRA and providing a seeded myRA account to graduating seniors with completed coursework, young adults will be inspired by watching their money grow. This inspiration matched with expanding the Saver's Credit will result in more individuals saving and more frequent saving towards retirement.

Implementation

To be able to implement these policies, the government should run an aggressive public service announcement (PSA) campaign to inform the masses about who will benefit from such changes. Policy makers should be prepared for backlash from Wall Street, from raising taxes, and from promoting, to an extent, saving instead of debt-driven consumption.

MyRA was selected due to the minimal risk associated with it. Backed by government treasuries, myRA accounts theoretically will be drawable as long as the United States government exists. Since the government is promoting this form of zero-risk retirement planning, Wall Street would most likely lobby against such policy. Retirement planners may also voice concern as making retirement planning easier with these policies could lower the demand for the profession along with the lowering of its earnings. Essentially, the U.S. government, by making the process to save for retirement easier, is cutting out the 'middle man' who profits from fees associated with planning and frequent reckless speculation and exploitation of people's ignorance.

Those making over \$118,500 a year (current tax cap for Social Security), may also reject policy which would increase their tax burden. Increasing taxes is usually political suicide; however, with increased public awareness, especially to those in the lower middle class, increasing taxes on wealthier American should be found justified. It is only equitable for

wealthy individuals to pay Social Security taxes on their total earnings if those making under \$118,500 a year do too.

By increasing the incentive to save with tax credit policies, the current economy may be worse off. The personal savings rate is a double-edged sword – it is good for individuals' retirement, but it also means less consumption is taking place currently. During economic downturns, such as the Great Recession, the personal savings rate increases due to market uncertainty and overall fear of current market conditions; this can be seen in Figure 4. By promoting saving with a larger Saver's Credit, the government would be promoting savings and most likely reducing the deficit in the balance of payments, as well as smoothing the national debt. It is key to remember that individuals saving for retirement will eventually spend it; therefore, consumption may decrease in the present but will be made up in the future.

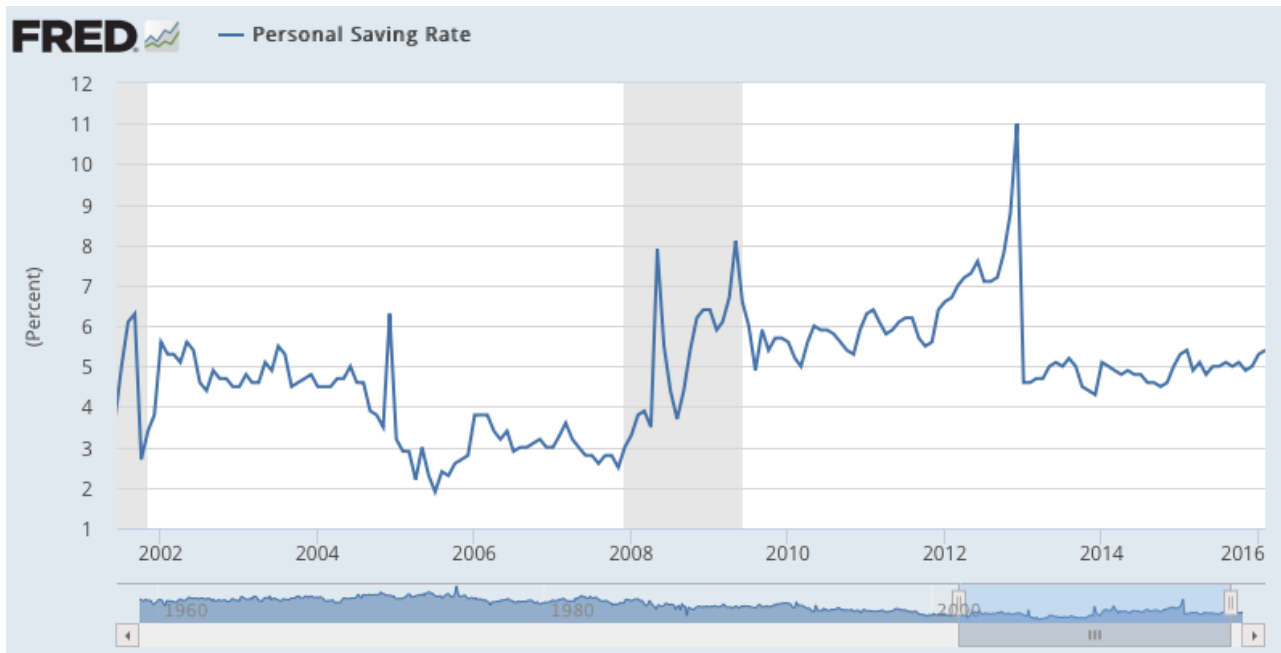


Figure 6 Personal Savings Rate

Source: FRED (2016).²³

Private Solution

The federal government cannot be expected to reimagine the private retirement system alone; the solution must come from private sector.

Millennials are connected to the world unlike any generation before them with the use of mobile technology. They are able to check the news, surf the web, pay bills, transfer money, and have much more at their figure tips through smart phones, smart watches, and tablets. Systems such as Apple Pay and Android Pay, allow users to pay in stores with their mobile devices without ever reaching into their purses or wallets.

An app, short for application, should be created for these mobile devices to help millennials visualize and to save for retirement. Users of this app would be able to link bank accounts, credit cards, and their myRA account to the app. Then, working much like Apple Pay or Android Pay, users would simply use their smart phone or smart watch to pay for transactions. When processing each transaction, users would be prompted with a screen inquiring about a percent (i.e. the desired saving rate) being added to the transaction which would be deposited into the myRA account.

Example –

Taylor buys \$23.45 worth of goods at a grocery store. She pays for the transaction using the new mobile app and selects that 5 percent be added on to her total for retirement funding. Taylor would be charged \$24.62; \$23.45 for the goods and \$1.17 to be deposited into her myRA account.

Over time these small one-time deposits in addition to routine deposits would add up to a substantial amount in retirement savings.

In addition to making contributions easier, the app could provide information on the health of an individual's retirement account based on retirement calculations. The user would be prompted to enter their retirement goals such as age of retirement, average expenditures during retirement, and life expectancy. The app would then take this data and provide users with how well they are doing to achieve their goals. It is expected that, by linking retirement

savings to spending habits rather than income, this mobile app may provide better estimates for retirement goals and improve an individual's financial discipline.

A survey by Scratch (2013) found that Millennials overwhelmingly felt negatively of banks. The results show that 72 percent of Millennials would rather go to the dentist than listen to banks, and 73 percent said they would be more open to receiving financial services from Google, Amazon, Apple, PayPal, or Square than from a nationwide bank.²⁴ Combining these results with the new app provides evidence of its potential success among Millennials.

Conclusion

The U.S. federal government should implement a series of policies to help Millennials and future generation better save for retirement. By eliminating the cap on the myRA program, individuals will be able to save, without limit, into an essentially zero risk account with no fees. Individuals should pay Social Security taxes on their full earnings with no cap in place, though based on a regressive tax rate, in order to fund a new retirement initiative for graduating high school seniors and promote the sustainability of the US retirement system. Changes to the Saver's Credit would allow working individuals to receive greater tax breaks for saving money and would allow full-time students to take advantage of it. To reinforce these three policies, the federal government should mandate that all public school students be required to take at least one personal finance course before graduation of high school. A basic understanding of personal finance will allow these students to take full advantage of the outlined policies.

The government should not be expected to reimagine the private retirement system alone. As it is a private issue, it is essential for the market to play a large role in designing new tools for younger generations. Entrepreneurs should take full advantage of mobile technology to assist young adults in saving for retirement. By linking retirement savings to spending habits, these new tools may provide a better measure of exactly how much savings will be needed in retirement years; thus, making Millennials confident of their financial security.

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