

**THE CURRENT STATE OF RETIREMENT SECURITY
IN THE UNITED STATES**

HEARING
BEFORE THE
SUBCOMMITTEE ON
ECONOMIC POLICY
OF THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED FIFTEENTH CONGRESS
FIRST SESSION
ON
EXAMINING THE STATE OF RETIREMENT SECURITY IN THE UNITED
STATES

APRIL 5, 2017

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



Available at: <http://www.fdsys.gov/>

U.S. GOVERNMENT PUBLISHING OFFICE

25-680 PDF

WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

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C O N T E N T S

WEDNESDAY, APRIL 5, 2017

	Page
Opening statement of Chairman Cotton	1
Opening statements, comments, or prepared statements of:	
Senator Heitkamp	2

WITNESSES

Kent Conrad, former Senator from the State of North Dakota, and Co-Chair, Bipartisan Policy Center's Commission on Retirement Security and Per- sonal Savings	4
Prepared statement	24
Walter Russell Mead, Distinguished Scholar in American Strategy, Hudson Institute, and Chace Professor of Foreign Affairs, Bard College	7
Prepared statement	34

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Bipartisan Policy Center's June 2016 report, "Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings," submitted by former Senator Kent Conrad	42
Illustrations presented by Senator Heitkamp during hearing	190
Prepared statement of J. Spencer Williams, President & CEO, Retirement Clearinghouse, LLC	193
Prepared statement of the American Council of Life Insurers	223
Prepared statement of Catherine Weatherford, President & CEO, Insured Retirement Institute	228
Prepared statement of the Save Our Savings Coalition	240
Prepared statement of the Strengthen Social Security Coalition	242

THE CURRENT STATE OF RETIREMENT SECURITY IN THE UNITED STATES

WEDNESDAY, APRIL 5, 2017

U.S. SENATE, SUBCOMMITTEE ON ECONOMIC POLICY,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 3:08 p.m., in room SD-538, Dirksen Senate Office Building, Hon. Tom Cotton, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN TOM COTTON

Chairman COTTON. The hearing will come to order.

I want to welcome you all to today's hearing. As you know, this is the first hearing of the Subcommittee on Economic Policy in the 115th Congress. I look forward to working with our Ranking Member, Senator Heitkamp, and all of our Members as we use this Committee to highlight the needs of working families and what Congress can do to help them.

In my own State, more than half of Arkansans are living paycheck to paycheck. But perhaps it might be more accurate to say many are living on the edge. About one in five do not have enough savings to pay for a routine visit from an electrician, which would cost only \$100.

It is even worse for more significant expenses. The vast majority, about three in four, could not afford 6 months of unemployment. The numbers look similar in other States. In other words, most Americans are making just enough to get by and nowhere near enough to get ahead.

It is precisely because of this that a growing number of Americans are looking increasingly vulnerable as they reach their retirement years, which is the subject of our hearing today.

It is hard to overstate just how alarming the situation is. Three basic items—housing, transportation, and food—make up 63 percent of the average household budget, and these things are getting more expensive, not less. They are eating up more of the family budget, even more than they did 20 years ago. It does not take an economist to figure out that if you are spending more money just to keep the lights on, you have got less to set aside for retirement. And that is exactly what we see today.

The number that sums it all up for me is this one: The typical American aged 55 to 62 has only about \$14,500 in savings. That is it. And this is at a time when Social Security is sinking further and further into the red.

But it is even worse than that. At the very moment that people are seeing their expenses go up, they are also seeing their retirement plan options go down. In 1979, at least a third of our workers had defined benefit plans. Today it is only 14 percent.

You might say to move from defined benefit to defined contribution plans was inevitable. Overseas competition has increased, and companies were feeling the pressure to become more efficient. And that is fair.

But today fewer workers have access to any retirement plans at all, defined benefit or 401(k). And then, even if you do have a 401(k), you still may not be saving enough to retire in comfort and security.

These are the facts. They call out for a rethinking of how to achieve retirement security in America. We have to rethink how Americans can save and plan for retirement if we hope to maintain the kind of lifestyle to which so many Americans have grown accustomed over the years.

Luckily, we have two distinguished witnesses to help us think through how to tackle this problem. Our goal today is not to solve the problem, but to answer a few basic questions. How many Americans are prepared for retirement? What is holding them back? And what can Congress do to make it easier for working families to save?

First, we will hear from former Senator Kent Conrad, of North Dakota, now a Senior Fellow at the Bipartisan Policy Center, where he co-chaired a Commission on Retirement Security and Personal savings. Senator Conrad has done excellent data-driven work on the state of retirement security in the United States, and we are fortunate to have him here.

Next we will hear from my good friend, Walter Russell Mead, Distinguished Scholar in American Strategy, the Hudson Institute, Chace Professor of Foreign Affairs and Humanities at Bard College, and Editor-at-Large of the American Interest. Professor Mead has been studying the change in the American workforce over time and its ramifications for many years. Professor Mead has testified many times about foreign policy before Congress, and we are happy to welcome him to the Banking Committee now to discuss economic policy.

I want to thank you both for taking the time to join us today. I look forward to hearing your testimony, but first, Senator Heitkamp.

STATEMENT OF SENATOR HEIDI HEITKAMP

Senator HEITKAMP. Thank you, Chairman Cotton, and thank you for being such a great partner in putting together this hearing on such a critical and important topic. Our hearing today is our first Banking Subcommittee hearing this Congress, and I am very pleased that we are starting off exploring the issue of retirement security.

You know, I wake up every morning thinking about the men and women in rural America, especially in North Dakota, who play hard, play by the rules, and try to earn an honest living and save for retirement—in fact, their golden years. The working class is the

backbone of our country, and they should not have to fear about their retirement future.

Unfortunately, the trends we are seeing suggest that retirement security is far more uncertain today than it was even 20 years ago. Only 22 percent of workers are very confident that they will have enough money in retirement, according to the Employee Benefit Research Institute, and 64 percent say they know they are behind in where they should be in their savings.

In fact, somewhere between 60 and 70 percent of all working Americans have access to a workplace retirement account or a 401(k). That leaves about 30 million full-time workers without access to a workplace-sponsored plan. And among those who do have access to a 401(k), a recent Census Bureau study determined that up to two-thirds—let us repeat that again: Of those that do have access, up to two-thirds do not put away nearly enough to cover the cost of retirement. This should not come as a surprise given the fact that about half of all adults in our country would be unable to come up with \$400 to pay for an emergency expense. They would have to borrow that money or sell a possession.

In my home State of North Dakota, about 41 percent of all private sector employees—that is roughly 112,000 workers—work for an employer who does not offer a retirement plan. These are the truck drivers, the sales clerks, and the farm workers that are working very hard to make ends meet, put their kids through college, cover healthcare costs, and provide a better life for their children, thinking they will just put off that decision of their retirement security until tomorrow.

We owe it to these men and women to strengthen our retirement system. There is certainly no silver bullet, but we need to think creatively to educate workers and expand access to retirement vehicles so more workers can afford to save and take advantage of the substantial benefits a sponsored retirement plan can offer.

We also need to protect the men and women who still have access to a defined benefit plan or a pension as we transition to this new model. This means standing up against cuts to private pension plans, like Central States Pension Fund, whose members would economically be devastated if they lose access to the pension benefits that they bargained for and that they earned.

As we dive into these issues, I look forward to hearing the testimony of today's brilliant witnesses—I said that just as a moment of suck-up, "brilliant witnesses"—Senator Kent Conrad, my mentor and great friend, who has spent a lifetime working to help the men and women of this country, and particularly the men and women of North Dakota, achieve economic success. And I am interested to explore some of the proposals he has put together as part of his work as co-chair of the Commission on Retirement Security and Personal Savings.

I am also very eager and grateful for Mr. Mead's testimony and Mr. Mead's appearance. He has me doing some rethinking of fundamental ideas that I have had about what we need to do with pensions. There is no doubt that the new economy where work is taking place in a series of one-off gigs presents challenges in the retirement space. And we have to develop a model that is realistic

for today's economic model, especially at a time when we are really uncertain about what the future of work will look like.

So I want to thank both of you for, number one, your enormous work that you have done in the past for our country, in the case of both of you, and the thinking that you have done about the future of the people of the United States of America and how we can improve the economic outlook for them.

And so, Mr. Chairman, with that, I look forward to the testimony.

Chairman COTTON. Thank you, Senator Heitkamp.

Both of our witnesses' written statements will be entered into the record, as will a written statement from the American Council on Life Insurers.

We will start with Senator Conrad. Senator Conrad, welcome back. I am sure you are thrilled to be back.

[Laughter.]

Senator HEITKAMP. I keep trying to get him to trade places with me. He is not buying it.

STATEMENT OF KENT CONRAD, FORMER SENATOR FROM THE STATE OF NORTH DAKOTA, AND CO-CHAIR, BIPARTISAN POLICY CENTER'S COMMISSION ON RETIREMENT SECURITY AND PERSONAL SAVINGS

Mr. CONRAD. Well, thank you, Chairman Cotton, Ranking Member Heitkamp, Senator Kennedy. Good to see you as well, sir.

Senator KENNEDY. Good to see you, too.

Mr. CONRAD. Chairman Cotton, if you will permit me just a moment of personal reflection, Senator Heitkamp succeeded me as tax commissioner when I came to the United States Senate. She succeeded me in the U.S. Senate when I went into retirement. And I am so delighted to see her on that side of the dais.

And, Senator Cotton, my daughter I think went to college with you and tells me that you are very smart. And I have a very smart daughter, so when she says that, I listen.

So thank you very much for this opportunity to talk about retirement security. For the last 2 years, as the Chairman mentioned, I have been running a commission, along with Jim Lockhart, now the co-chair of Wilbur Ross, who helped run Social Security during the Bush administration. We were the co-chairs of this Commission on Retirement Security. And the numbers that both of you used are exactly what we found. I brought this slide. This is from a Gallup poll of last year, and they asked the American people what were their biggest financial worries. And number one, was not having enough money for retirement. Fully 64 percent of the American people said they were worried about not having enough money for retirement. The Urban Institute reported to our commission that the median retirement assets of the age group 62 to 69 is \$30,000. We have got a problem.

Senator Heitkamp, you talked about the Federal Reserve study that showed 46 percent of the American people would have a hard time coming up with \$400 for an emergency car repair. So we have got issues, and one of the biggest is access to retirement plans at work. Both of you mentioned this in your opening statements, and this slide shows the gap between access and participation. Access

and participation. As you can see, about half the country is participating in a retirement plan at work, but fully half the country is not. Thirty-four percent do not have access, 17 percent have access but do not contribute. So to me there is a big opportunity here, and our commission really fastened on this opportunity.

Just a word about the commission. Nineteen members, as I indicated, co-chaired by Jim Lockhart, diverse backgrounds, former Governors, Senators, Congressmen, Republicans, and Democrats. We had thought leaders, business leaders. We had both public trustees of Social Security, both the Republican and the Democrat. So this was a very diverse commission.

At the end we had 18 of the 19 agree to the recommendations of the commission, so after 2 years of discussion and study, we were able to achieve agreement.

And we had the Chief Actuary of Social Security say if our recommendations were adopted, Social Security would be solvent for 75 years and beyond.

The top-line results of our work were this: that if our commission recommendations were adopted, we would improve retirement savings by 50 percent for middle-class Americans once all policies are phased in; and that implementing those recommendations would also reduce old-age poverty by one-third from today's levels by 2035. I think those are significant accomplishments.

We started with this whole question of retirement plans at work, and we advocated creating a new vehicle, something we called "Retirement Security Plans." When we talked to small business, they told us, "Look, we would like to offer plans, but it is too expensive. There is too much administrative burden." I come from a small-business family, as Senator Heitkamp knows well, and I found that to be absolutely true. The administrative burden for small businesses, the cost, the liability, just prevents them from doing something many of them would like to do.

So we said let us cut away all the chaff. Let us make it easy for companies with up to 500 employees to offer Retirement Security Plans by having third parties administer them and take on the financial responsibility. The only thing the employer is asked to do is make payroll deductions and transfers. That is the only thing they have to do.

We suggest, after that has been in place for several years, that then we would recommend establishing a national minimum coverage standard for all businesses with 50 or more workers.

Now, this is controversial, and we understood it is controversial, asking businesses to take this on. But the finding of the commission—and, again, this is on a totally bipartisan basis—was if we are going to simplify it to the point all they have got to do, all the employer has to do is make a payroll deduction and transfer, it is not unreasonable then to ask businesses with 50 or more employees to offer some kind of plan. They can choose which kind of plan. They can choose these retirement plans that we have constructed, or they can offer something else.

We also allowed employers to automatically enroll employees into multiple savings accounts so they could save for retirement and also have a rainy-day fund, because one of the things we found is—kind of surprising to me, frankly, but we found that people are

saying to us, “Look, yeah, I have got a retirement fund, but I have got to go to that because I do not have any other savings account because it is not offered.” And you go to the employer and ask why it is not offered, and there are all kinds of legal problems constructing multiple accounts. We take away the legal chaff that prevents employers from offering multiple accounts.

We also incentivized retirement savings for young workers. I will just touch on the Saver’s Match, a refundable credit of up to \$500 per individual or \$1,000 for a couple, to encourage younger workers, those 18 to 35, with lower wages to start savings. The income limit for an individual is \$30,000, for a couple it is \$60,000. But if they put away \$1, it is matched up to \$500, age 18 to 35, with up to \$30,000 of income for an individual, \$60,000 for a couple.

We also facilitated the establishment of a Retirement Security Clearinghouse to improve portability. Many individuals, when they go from job to job—and we are in an economy where people go from job to job—they leave accounts behind. In fact, the Government Accountability Office reported that over the course of a decade, 25 million Americans changed jobs and left at least one account behind.

Now, for those of you who serve in this body, I can attest to the fact that when I left here, I had multiple accounts, and, you know, it is hard to put them together. And managing dribs and drabs here and there is a challenge. So it makes a lot of sense to create these clearinghouse functions to allow people to unite their accounts.

We also encourage plan sponsors in general to integrate easy-to-use, sophisticated, lifetime income features. One of the things, if you talk to financial advisers, they will tell you is a lot of people do a pretty good job in the accumulation phase, but they are really flummoxed when it comes to converting those financial assets into income. In fact, I was just with a financial adviser in Florida who told me he just had a multi-millionaire come to him and say, “You know, I was great at accumulating money. I have no idea how to turn it into lifetime income.” And this is somebody from one of the most prestigious financial firms in America. If anybody does not think this is a problem for people, the testimony before our commission indicated it really does create an issue for people.

We also encouraged plan sponsors to do this through automatic purchases of annuities over time, so-called laddering, because as you know, the value of annuities is so dependent on interest rates, and you do not want to get locked in when interest rates are low. So we think to provide an ability to ladder these investments to make them over time so you are not taking on too much interest risk at any one time makes a great deal of sense.

Finally, we think it would be wise to accurately reflect retirement tax policy changes in the budget process. As a former Budget Committee Chairman, I know how these things look from a scoring perspective. Most of the costs of tax-deferred accounts occur within the 10-year budget window. The costs of Roth accounts occur outside the 10-year window. So there is a tremendous incentive for policymakers to take advantage of that budget window in terms of their tax policy. I would just alert colleagues that could lead us

down a road that we already have serious problems with, and that is the budget outlook for the United States.

Let me just close there and say it is an honor to be joined by a professor and a scholar and an author of the repute of Mr. Mead. Thank you.

Chairman COTTON. Thank you.

Professor Mead.

STATEMENT OF WALTER RUSSELL MEAD, DISTINGUISHED SCHOLAR IN AMERICAN STRATEGY, HUDSON INSTITUTE, AND CHACE PROFESSOR OF FOREIGN AFFAIRS, BARD COLLEGE

Mr. MEAD. Well, Chairman Cotton and Ranking Member Heitkamp, thank you so much for inviting me here today. It really is an honor to be asked to appear at this Subcommittee and a privilege to sit next to Senator Conrad, who is one of the leading lights in this whole field in the country and whose commission I think has done ground-breaking work that we can all learn from. So thank you.

I would also just like to commend the Members of the Subcommittee for setting an example. This is the kind of issue the American people need for their Congress to be working on, and this spirit of bipartisan amity and pragmatism that you are bringing to this process is an example of the way America can solve its problems. Both of you are people who have roots, deep roots in the lives of ordinary America. You do not come from fancy backgrounds. And unlike some people who come from Middle America and then go on to the fancy lifestyles, you have maintained your commitment to the issues that matter to ordinary people. So this is a good place, and you are doing good work, and I just want to thank you both for that.

When I look at retirement and the real crisis that we are in, I inevitably see this—maybe it is because I am a historian and try to think in these terms—in the context of sweeping changes that are not just affecting retirement but are affecting every other part of our society. And we are now in the middle of, perhaps in the early stages of a transformation of human life that is as profound and as far-reaching as the Industrial Revolution was. And if you think about how the Industrial Revolution in 100 years changed the nature of the family, of the state, of religion, of the economy, of the way people earned a living, of the ideas that people used to understand the world, it really was a revolution.

We are in the middle of one now, and more to the point, we are in the most difficult part of that transition where the old system no longer works as well as it used to, but we have not quite figured out where the new system is going or how it will work. And many of the Americans, I think, today who are coming up to retirement without a clear path forward are people who have been caught in this transformation. That is, if you went back to the 1950s and 1960s, most people then thought that defined benefit pensions were going to become a universal feature in the workforce. And, in fact, starting in the 1970s, for a whole variety of reasons, the change went the other direction, and defined benefit pensions began to disappear. And many of the companies that had made these

commitments went out of business, which created another set of problems.

We then tried to improvise to some degree with programs like the 401(k), IRAs, ways of trying to substitute for this system. But, clearly, as we look at some of the statistics on lack of availability and lack of participation that Senator Conrad has drawn our attention to, the new improvised system was not adequate. And we now have a couple of generations of people who have been going through life without the kind of solid pension and retirement set of policies and institutions that people really need in a society as complicated as ours. So I think we have the challenge of helping these bridge generations manage the reality that they are approaching retirement with very, very small retirement savings.

And at the same time, if we talk to Millennials and younger people, there is a sense that the institutions we do have do not work very well for them. If you have a part-time job and you work for Uber some of the time and you rent out an extra room in your apartment on Airbnb, you sort of do all of these things, none of that is really connected to a retirement or savings program.

Our system is focused on the employer as the nexus, because in former times these large, stable corporate employers were the places where Government could intervene. They in a sense collected taxes for the sake of the Government, and they administered benefits and other programs on behalf of the Government.

Some companies are still able to do that, and still do it very well, but in more and more cases, particularly younger workers simply do not fall under the umbrella of this kind of system.

So, without wanting to take more of the Committee's time, I would just like to underline the reality that our retirement system, like our entire society, is in a time of upheaval and unpredictable change. Yet retirement of all the aspects of a person's lifecycle is the one that is most affected when we are not able to plan long term or think long term. So this Committee's decision to make retirement a focus of its work in this year I think, again, is commendable and vital, and I wish you every possible success in what you do.

Thank you.

Chairman COTTON. Thank you, Professor Mead.

In your opening statement as well as your written testimony, Professor Mead, you described the shift from the agricultural economic model of the 18th and 19th century, what you call "the green model," into the industrial model, especially the post-war model, what you call "the blue model," and the stresses that model is beginning to see. What happened to stress the blue model, a model that seemed to work so well in the immediate post-war period?

Mr. MEAD. That is a very good question, Senator.

Chairman COTTON. Would you press your microphone, please?

Mr. MEAD. That is a good question, Senator. And I think what happened was that the nature of the world economy and technology began to change so that, you know, before World War II, for many years, as the Industrial Revolution was taking place, we did not understand, our ancestors did not understand that industrial economy very well. We would have financial panics and crashes, depressions, and people did not feel they had a reading on what caused

these or how to prevent them. The industrialization created huge new problems. In an agrarian society, if there is a banking depression, people simply eat what they grow on the farm. But if you are in an industrialized city and there is some kind of banking depression and work ends, you have millions of people with nothing to eat, no work to do, no ability to heat their houses.

By the end, I think, of World War II, at least in this country, we had a pretty good sense of how to use the wealth that the industrial economy creates in order to address the problems that it causes. We had a system of large national champion firms. We had, you know, the three car companies, the big seven oil companies, the one phone company. And these pretty heavily regulated monopolies and oligopolies could give—you know, when you had one phone company in the United States, they could give somebody a job for life. Or when you had only the Big Three auto companies making cars for the American market without a lot of competition, again, GM, Ford, Chrysler could offer stable opportunity, could work with unions.

So after the 1960s, as Germany and Japan and other countries began to recover from the devastation of World War II, you had a more competitive economic environment. As the financial system escaped the very, very tight, rather unrealistic post-war constraints, and you began to get international banking and offshore banking, interest rates became more volatile. In the 1970s, we had the oil price shocks; inflation rates went up. A massive inflation rate is devastating to a company that is trying to operate a large guaranteed benefit pension program.

So you had all kinds of new stress coming onto the system. In order to respond, companies had to become much more nimble, much more competitive. They could not say, "Well, we are not making much off of that factory, but it has really been a part of our company for many years, and that city is an important part of who we are." They were under much tighter pressure.

And at the same time, particularly as countries like China and Japan came back into the market, you had a competition from low-wage labor. You had automation. You had the development of these global assembly chains. And so there was increasing pressure on wages and salaries in the United States. The pace of technological change increased, so we see today a company like—oh, now I am trying to think of them, the video—Blockbuster Video that you used to rent the tapes from. It rose and fell in a very short period of time. Companies were no longer able to provide lifetime employment. All of this means defined benefit pension plans do not work as well and are not offered as widely.

So the system has come under stress. Wages have come under stress. And I suppose we should add that costs in certain areas—health care and education—however, continued to go up. So the basic needs of a middle-class family are getting more expensive, but their ability to buy these goods is not increasing over time. All of this stresses the retirement system in many, many ways.

Chairman COTTON. Can the blue model be resurrected or preserved? Or should we focus on transitioning to what the next model will be?

Mr. MEAD. My own sense is that you could not stop the Industrial Revolution in its tracks, and you cannot stop this transformation in its tracks either.

I would also say that for all the disruption and pain that the transition causes, the Information Revolution, like the Industrial Revolution, is going to enrich us. Since we are in the presence of a flood, not the presence of a drought, you know, we cannot manage the immense new capabilities. We like to romanticize factory jobs today, and I certainly do not want to take anyone's job away or do anything but honor people who work hard. But do we really think that in an economy where 38 percent of the population is doing repetitive labor on an assembly line 8 hours a day for 40 years of their life, is that the highest possible use of human creativity?

So I actually think this transition, which is a difficult transition, is one that opens the door to a much better life for people, just as in the end the Industrial Revolution, despite all of the commotion and upheaval that it caused, brought people to a much higher level of living.

Chairman COTTON. Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

I want to follow-up on all of that. You know, there has been a series of reports about automation and about the future of work. What does the future of labor look like? One report is saying we are going to lose 47 percent of all of our jobs in the next 20 years. I do not know if that is an exaggeration. I think sometimes people write these reports so you can get a big headline and get more attention to the report. But I will tell you I think things are changing dramatically, as the professor has outlined.

The question is: Without knowing the future of work and the future of labor—and this is for both of you—can we really design a retirement plan today that will address these concerns? And how nimble do we have to be as we are going through this transition? Let us start with you, Senator Conrad.

Mr. CONRAD. You know, I listened with great interest to Professor Mead's description of what has happened, and I thought he was spot on. If you had to reduce it to a word, I would reduce it to "globalization." But it is really more than that because it is this remarkable technological revolution that we are going through. You and I have talked about these long-term challenges. What is going to happen to all the truck drivers of America when we have self-driving vehicles? And this is not so far away. What are we going to do to a whole series of other jobs that Professor Mead describes, repetitive, in some cases back-breaking, difficult jobs that people have that are being replaced by technology?

I do not know if you have seen the video of a new Tesla plant. Five minutes, watch what happens there, how few people are involved in the process of building a Tesla automobile.

So things are changing very rapidly, and it presents us with a requirement to change how we envision retirement as well. That is one reason we came to this idea of having Retirement Security Plans to make it much, much easier for those employers who want to offer them, who are small business, because small business is

going to continue to be one of the chief job creators in our economy, make it infinitely easier for them to offer plans.

I know from a business family, I remember these discussions in our own family about offering retirement plans. And people wanted to do it, but the administrative hassle and the financial burden were just too great. I mean, it was not so much the money that was involved. It was the liability that was involved.

So, look, I think we are going to have to be much fleetier in terms of our ability to react to these fundamental changes in the economy, both here and across the globe.

Senator HEITKAMP. Professor Mead?

Mr. MEAD. Well, your concerns are spot on, Senator. When I think about the jobs of the future, I do say sometimes, you know, in the 1850s, when well over 50 percent of the workforce earned its living farming, and you had said, well, now, suppose in 100 years only 2 percent of the workforce will be in farming, the question would be: What on Earth are all those people going to do? And no one would have guessed, for example, that there would have been a factory that made fuzzy dice that hung down from car windows and that people would be making a living in such a factory.

So there are ways in which we cannot imagine the future, but I can think of things today—we are rich in goods as a society. Any ancient king or emperor could only dream of the stuff that even the average American family has today; but in services not so much.

For example, my father lives in a retirement center not far from here. Suppose there was somebody there who said to me, “If you will pay me X amount a month, I will make sure your father’s computer is always working, he is always able to use his email. And if there is some kind of issue with the printer or something, we will be there to help him.” There are lots of services. We are seeing some of these proliferate. Certainly, when I was a kid, only the Rockefellers had wedding planners. You know, now that is a real profession, and it enhances the quality of life, and people make a pretty good living helping others celebrate these high moments in their lives.

Senator HEITKAMP. If we look at kind of the need to have a much more nimble retirement system—I am going to have Craig just put up a chart because I love—I do this with high school kids and college kids that I visit with. I say, “What did Albert Einstein say was the greatest invention of the 20th century? Compound interest.”

And so we put together a chart that shows what happens if people invest early and then stop investing compared to people who delay that decision to later in life, and what does that result in? And you can see that early investment makes all the difference in the world if we could just get people to do it, if we could just get people to make those investments.

But as they are struggling in this transition period of time—you know, am I going to start my own small business? Am I going to augment my salary or the work that I do with Airbnb or with Uber? And what does that mean in terms of my retirement and what are the economic challenges I have today? And this is the challenge that we have as a country because one thing that we have not talked about, which is this lack of savings, this lack of retirement security, is not going to go without a cost on the public

fisc. You know, whether it is earlier involvement of Medicaid dollars for assistance and whether it is food assistance, whether it is Section 8 housing, whatever that is, we are going to pay the price for the lack of retirement security in this country.

And so I think what I am grasping with is I do not know what the future, 20 years from now, the work world looks like, so it is hard to design a retirement system around the workplace. And I think, Professor, that is exactly what you are telling us in your testimony, I think.

Mr. MEAD. That is right. And this is why I was trying to imagine this kind of one-stop account where you would set up a specially designated account, and if you are working for Uber and you are working for Airbnb and so on, this money goes into that account, the financial institution does whatever withholding and so on, but also it is at that point of that account where the retirement programs can set in, where there can be the point of—you move it away from the employer, which is no longer the center of that person's economic life, and you move it to the person in a sense.

Senator HEITKAMP. But that person has to be literate.

Mr. MEAD. Again, when we went from an agrarian society to an industrial society, people had to get smarter. It is actually harder to live in a city full of immigrants who are different from you than to live in the country where everyone is related to you and you know all the customs. And our school system actually changed dramatically as a part of this shift. So, yes, as individuals, as a society, we have to raise our game so that we are producing young people who have the financial literacy, entrepreneurial spirit, all of these elements that can help them to flourish in this new kind of complex environment that is coming into existence around us.

Chairman COTTON. For the record, I think the Ranking Member and I would agree that it is not only easier to live in the country but more enjoyable as well.

[Laughter.]

Chairman COTTON. Senator Tillis.

Senator TILLIS. Thank you, Mr. Chair. Thank you both for being here.

First, I want to underscore what has been talked about. I come from the technology sector and spent a lot of time, most of my time in the private sector, and these discussions about how do we stem the tide of technological innovation and make sure that the current job base exists really ignores the fact that we work in a globally competitive economy, and that is the surefire way to have us go to second or third or fourth in terms of economic performance and prosperity if we do not recognize that near-peer economies understand it, embrace it, and have to deal with it. And there are unknowns, but every time we have had these unknowns, we have found a way to move from the agrarian to the industrial, and we will move through the Information Age. The real question with respect to the topic before us today is how do we also help better ensure that people are creating some amount of wealth that help them as they get further into their lives.

I actually made my first contribution into Social Security in 1972 at the age of 12, \$33 that year. One thing for everybody who has not done it, you really need to go on the Social Security

Administration website and see where you are today. And I have not missed a year of contribution since then.

I think a part of what we have to do when we talk about Social Security is be realistic about the reality, the lack of indexing and the lack of foresight. I am not faulting anybody. It is just the reality of the system today. We do not have a sustainable system. And not unlike the defined benefit plans that are out there with certain States, our State has a relatively solid—I am from North Carolina—a relatively solid plan. But as Speaker of the House, I was really urging consideration of transition to a defined contribution plan so that we could make sure that the variables that we do not know about would not put those savings plans at risk, and I think other States would be well advised to do that.

And, Senator Heitkamp, I could not agree more in terms of financial literacy. A part of what we have to do is see this multifaceted challenge. And one of the things that the States need to do is make sure that they have curriculums that are educating people at a very early age. We now have financial literacy, something I did when I was back in the legislature, in school at the appropriate time, and I think the workplace needs financial literacy. I do it in my office. We have an annual meeting where I tell these people what boneheads they are if they are not maxing out the Thrift Savings Plan that they have. I apologize to all of you who may not have maxed out, but it is because of that miracle of compounding.

My daughter just went into nursing, and I told her, “You are about to get a major increase in compensation from school. Set a different baseline for how much disposable income you have, and you will see exactly what Senator Heitkamp has said happens over a brief period of time.” So financial literacy is also important.

Now I want to get down to some of the policies that could affect—that are right before us. The fiduciary rule probably will get delayed, but we need to determine whether or not it is going to be implemented. In your opinion, does that help or hurt the people who have limited capacity to put into plans and also limited capacity to pay for advice for those plans? Professor Mead, we will start with you.

Mr. MEAD. Well, Senator, thank you, and as someone who spent many happy years as a kid in North Carolina, I am glad to see the State is so well represented, and it is a time when all true North Carolinians are very excited about the recent NCAA championship.

Senator TILLIS. Really, did we win a championship this week?

[Laughter.]

Senator TILLIS. It happens so frequently, it is hard to keep up.

Mr. MEAD. But, you know, when I think about this, I actually think that one of the problems we have in a way is that the current system, people have scattered plans, small balances. There the costs sometimes of the fiduciary rule would make it very difficult for them to operate, the cost structure would be so high.

Senator TILLIS. They would have an “eeny, meeny, miny, moe” strategy for portfolio allocation.

Mr. MEAD. You know, the thing to think about is, again, the lifetime accounts that build significant balances where also both for the financial institution that is issuing the account and maintaining it, it is a more profitable approach.

Senator TILLIS. I do believe that going to a worker-centric versus workplace-centric model where things can move around makes a lot of sense. It has a lot more prospects for longevity.

As a matter of fact, I chair the Personnel Committee in Senate Armed Services, and that is why we are moving toward different pension options within Armed Services, allowing those who want the pension plan as it currently stands to move in that direction, but allowing others to be able to opt in to a 401(k) type of a model that I think makes sense.

My time has gone over, but, Senator Conrad, do you have anything to add on the fiduciary rule or what has been discussed?

Mr. CONRAD. Well, let me just say our Commission did not deal with the fiduciary rule. I would say personally I would not go to a company advising me on wealth management that did not have it because I think whoever is advising me ought to have as their highest responsibility to be giving me advice that is in my interest. And I am very concerned about people giving advice that is in their interest and it is not revealed to the person they are giving advice to.

Now, with that said, Professor Mead makes a very important distinction here. You have got lots of people, as I indicated in my opening remarks, who have very little money. In fact, you know, when I talk about people with \$30,000, 62 to 69, as being the median retirement savings, one-quarter of those people have nothing. Have nothing. So we may need a system that takes account of people's different circumstances in terms of what rules apply.

Senator TILLIS. Thank you.

Thank you, Mr. Chair.

Chairman COTTON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. Thank you for holding this hearing today, and Ranking Member Heitkamp.

As we have all been discussing, we know there is a retirement crisis in this country, that across the board wages are flat, fixed costs are going up, people cannot save for retirement, pensions are disappearing, and that means more reliance than ever on Social Security. For almost two-thirds of seniors, Social Security makes up the majority of their income in retirement, and for 22 million Americans, Social Security is literally the only thing standing between them and poverty.

When a parent dies or is incapacitated, grandparents often step up, and this can create a huge additional burden on the family for people who are already struggling because of the financial crisis. In these cases, Social Security is a double lifeline for both the grandparents and for the kids. Today about 98 percent of children in America are eligible for survivors' benefits when a working parent dies.

So I want to ask you about this, Senator Conrad. You are the principal author of the Bipartisan Policy Center's report on retirement security, and in the report, you propose several expansions of Social Security for low-income seniors. But you also propose expanding Social Security survivors' benefits, something not many people have talked about from this report. Can you tell us a little bit about the survivors' program—how it currently works and what your proposed expansion would entail?

Mr. CONRAD. Well, if we remember our history, until 1981 we had a survivors' benefit in Social Security for kids who stayed in college until they were 22. If they were in an approved college, they would continue to get benefits. This also applied to those who qualified for disability. And this made a major difference to thousands, tens of thousands of kids who were survivors, tens of thousands of people who had a disability, that they were able, if they stayed in school, to get an additional Social Security income. However modest it was, it made a big difference.

In the work of this commission, we agreed on a bipartisan basis—and, again, 18 of the 19 commissioners agreed with the recommendations—that we ought to reestablish this benefit for survivors and those affected by disability.

You know, if we think about the transition Professor Mead has been talking about, quite rightly, others from the dais, we are going through this dramatic economic change. We have got to be sensitive to that. And, you know, I think about when we were growing up, high school was a minimum requirement. Right? If you did not graduate from high school, your prospects probably were not very good. I have to say now we look at society, if you do not have a college education, your prospects are not very good. In fact, I have just been talking to some young people who did not finish college. They cannot get a job interview, even for things they are actually qualified for, because they do not have that certificate. So I think this is something we have got to adjust to.

Senator WARREN. I very much appreciate that, and I want to be mindful of the time, but I understand, Senator Conrad, you were actually a beneficiary of this program?

Mr. CONRAD. Well, I was. And, you know, when I was going to school, I remember getting that check, and I tell you, it made a world of difference. I was going to school out in California, and I remember very distinctly that green check that would arrive once a month and really made it possible for me to be in college and complete school.

Senator WARREN. And you think about overcoming the loss of a parent is devastating for any child, but loss of the income and savings should not also destroy a family's financial security and a child's chance to go to college.

This is a problem that is going to get worse in the years to come. Last year, for the first time since 1993, life expectancy in America decreased. And there are a number of reasons for that, but one is that tens of thousands of Americans are dying of opioid overdoses every year. And many of the victims of these overdoses leave children behind, and often grandparents are the ones who step in to help.

So let me just ask one more question here. Senator Conrad, it seems to me that given this decline in life expectancy and the increase in deaths from opioid overdoses, shoring up the survivors' program may be more important than ever. Do you agree?

Mr. CONRAD. Well, I do, and I made that argument to the commission, and others on the commission made some of the points that you are making now. It was very interesting. And, again, one of the things that was most interesting was how bipartisan this particular discussion was in the commission. Some of the most

prominent Republicans on the commission felt strongly we ought to restore this benefit. And I was very pleased that we agreed to do so.

Senator WARREN. I am pleased that you did as well and glad to try to highlight your good work on this. My view is we should be talking about expanding Social Security across the board. But we also ought to be able to agree that it is long past time to expand survivors' benefits to age 22. Children who have lost their parents need to have a chance to be able to build a future for themselves without destroying the finances of their surviving parent or of their grandparents and others who step in to take care of them.

So thank you very much for your work. Thank you for the report on this, and thank you, Mr. Chairman.

Chairman COTTON. Thank you, Senator Warren.

Senator Conrad, how many workers today participate in a defined benefit plan? Do you have that handy?

Mr. CONRAD. I do not. We all know what is happening to defined benefit plans. I mean, in large measure, what we see is a decline in defined benefit, a dramatic rise in defined contribution. I have actually got that chart—did not bring it with me—but would be happy to provide it to the Committee. But these trends are very, very clear.

Chairman COTTON. So do you think there is anything that we can do as a matter of policy to reverse that trend, or is it a function of changes in the economy like we have been discussing with you and Professor Mead and we simply need to make defined contribution plans work better for all Americans?

Mr. CONRAD. I wish I could look you in the eye and say, you know, if we just had the will, we could reverse this, and we could go back to a time when defined benefit plans were on the increase. I do not think that is in the cards. I think because of the things we have previously discussed, these fundamental changes in the economy here and globally, that it is just not a realistic prospect.

What is realistic is to deal with these changes in a way that does expand access, that does expand the opportunity for people to participate in a retirement plan at work. What is a possibility, as we were talking about Social Security, is to make Social Security solvent for the long term. And, yes, we can have some expansions while we do that, but it will require hard choices.

Chairman COTTON. Professor Mead, do you agree with that, that defined benefit plans are going to continue to decline in their usage in America?

Mr. MEAD. I think they will, and this is in part because of the choices that workers are making. That is, one of the disadvantages of a defined benefit plan is often it is stacked in such a way that it strongly rewards seniority and longevity of service. So, you know, one of the tragic things for someone who has been working for 18 years and is 2 years short of a pension, if that factory closes, they suffer an immense loss.

But, also, let us look at the part of the economy where defined contribution plans are still common, which would be Government work, and especially in the State and local sectors. We see, first of all, in many States and cities these plans are in a state of real financial disrepair and are causing serious risks to the well-being of

communities. I think the city of Chicago is trying to keep its schools open while it pays what it needs to pay on its pension plan.

And at the same time, if you are a public employee and you want after 10 years—you do not want to teach middle school anymore after 10 years, and you want to move on, you take a hit in the pension with a defined benefit program. So it locks people into life choices.

Now, the good thing about defined benefit programs is they did provide a certain kind of security and stability to income. And as I say, we have failed as a society to replace the defined benefit program with defined contribution programs that accomplish the same objectives as well. And so our focus has to be, I think, on making defined contribution plans work better, make it easier for employers to offer them, find ways even perhaps for the case, say, of low-income workers, a Government match of some kind of contribution can also be possible. Again, thanks the miracle of compound interest, if the Government is going to have to support a low-income person in old age, it is actually better to do that on the basis of long-term contributions to retirement plans. It is cheaper to the taxpayer that way.

Mr. CONRAD. Can I just make a quick point—

Chairman COTTON. Senator Conrad.

Mr. CONRAD.—on the point that Mr. Mead made? Because I think it is so important. On defined benefit plans, if you look at the chart that I discussed looking at defined benefit in terms of firms offering, that is in decline. You know, at one point it was growing rapidly back in the 1950s. Defined contributions now are rising dramatically. But if you look at defined benefit plans in terms of individuals covered, you see a very different pattern between firms offering and individuals covered, because what Professor Mead just talked about was a very real thing that we have not sort of talked enough about; that is, yes, companies offered them, but all too often, when somebody got to the point of being qualified, they lost their job.

And so there is a gap between firms offering and individuals covered with respect to defined benefit plans, and that was true long before these recent trends.

Chairman COTTON. You both, as you talk about what future retirement models would look like, have proposals in your written statements, but also you have said it today, Senator Conrad, you have talked about Retirement Security Plans which would have two elements: one, retirement savings, and, two, short-term savings, especially for smaller businesses. And, Professor Mead, you have spoken about American Mobility Accounts, which would also include what you call Supplemental Retirement Accounts and Human Capital Accounts. As you have listened to each other here today, do those two concepts strike you as similar or close to identical?

Mr. MEAD. I think we are both looking at the same sets of problems, and there is a lot of parallels in the way we are thinking. I think both sets of proposals are identifying the need to move toward a more worker-centered approach. I would guess we have not discussed it, but I think we are both concerned that there is kind of a multiplicity of 401(k), four-oh this, five-oh that. After a while,

the average not only, you know, person but the average supervisor, the average business just looks at this and says, "I cannot do this. This is too complicated."

So the issues that we are looking at are universality, flexibility, and individual-centric. Then I think, again, given, as we have all been saying in this hearing, that we cannot really predict what the economy of 20 years will look like, what jobs will look like in 20 years, we need an architecture that is open to change because we do not want to put the next generation in a straitjacket that does not fit. And I think when you put all those things together, you end up with—there is actually not that wide of a range of approaches that would cover these bases.

Chairman COTTON. Go ahead, Senator.

Mr. CONRAD. I would just say our Retirement Security Plans and our Retirement Security Clearinghouses are responding to the underlying dynamic that Professor Mead has done such a good job in describing. You know, we got a circumstance in which people just do not go to the same job for most of their careers and have a pension. Those days are changing, and we need to respond to this new dynamic, this new reality.

Chairman COTTON. And you both have spoken about the administrative challenges that multiple accounts can cause, especially small accounts of different types, and you are speaking there not only of the individual who is trying to save but also of the business that is trying to sell cars or sell farm equipment or sell clothing, and it is not in its core competency, and your concept in these accounts would be to get that out of the hands of those businesses and into some kind of third-party organization, whether it is a financial institution or an administrator, somewhere where it is in their core competency to manage those accounts.

Mr. CONRAD. I think you have described it very well. You know, here we have a circumstance where we have got 25 million orphaned accounts. You know, what sense does this make? It does not make any sense for the business who has got the orphaned accounts. It does not make any sense for the employee who has got maybe a string of orphaned accounts, which makes it very hard to manage, very hard to keep track of. In some cases, they completely forget that they have got them. I mean, we found that in the work of the commission.

Chairman COTTON. Senator Heitkamp?

Senator HEITKAMP. I think the component of all this—and it is like you can lead a horse to water, but can you get it to drink? And there are a couple complexities that we have not talked about, one of which is choice. There has been a number of sociological studies that say if you give people too many choices, they will make no choice because it is overwhelming.

The other problem that I think is that we keep saying, well, if this account or this, you know, opportunity performs the way it has in the past, this is where you will end up, and there is no certainty to that. So there is not this idea that if I do this, then I am guaranteed that that is what it is going to look like when I am age 65 or age 70, right?

So people have this insecurity, and they say, “Live today. I probably will not live long enough,” or, you know, “I am not going to ever retire,” which really is very problematic.

And so I want to talk about another vehicle that we have not spent a lot of time talking about and get your reaction to it, and that is low-cost guaranteed annuities. When we look at the defined benefit plans, it is that you knew that at the end of your work life there would be a guaranteed set sum that would come every month, that you could count on, that was predictable, that was taken care of. And my question to both of you is: Do you believe that annuities—not annuities with big front-end loads—you know, a product that reflects Senator Conrad’s statement that it should be fiduciary to them, it should be for me, do you believe that annuities can fill the gap for retirees looking to access some kind of guaranteed minimum income in the years going forward.

Mr. CONRAD. I would just say in this whole area of lifetime income options, there is a tremendous opportunity here, and there are lots of models. If you look around the world at what other places are doing, lots of interesting ideas about how you can give people lifetime income options and give them a choice to make. You know, we talk about just-in-time choices. When people are about to make those decisions, to get advice to them at the critical moment that they have a decision to make. We talk about capability. We talk about people having the basic information. Well, hard to get them taught in high school to prepare for what is to come 30 years from now. But when they are at the moment of choice, getting them help in making those decisions makes a lot of sense and is affordable.

Senator HEITKAMP. But, Senator Conrad, if we look at—if your choice is, you know, here is this high-yield fund, it has got more risk, or this or that, you know, all of a sudden people go, “I do not know enough to make that choice. I am not going to decide that. I would rather have that money today to pay off the bills that I have rather than risking that that will not ever come in the future.”

Professor Mead, what do you think about some kind of product that would guarantee monthly income at a low cost?

Mr. MEAD. Well, I think that it has a place in retirement planning, and I think you are right that simplifying options is important.

I think there are other elements of this sort of, you know, hesitation about saving and investing, and I agree with you that this is an important barrier, because we see that there are these products that people are not—you know, there are plans that they are not participating in, even though they have the option.

One thing that I think is worth looking at is the Singapore approach to this where there is an account which you can use—you know, it is sort of you have to have an account, but you can use it for different things, including some are really annuity-type products. But you can also use it toward a downpayment or even part of the principal payment of housing.

Senator HEITKAMP. So, Professor Mead, is this structured as a mandate or is this structured as an option in Singapore?

Mr. MEAD. In Singapore, it is a mandate that you must have this—

Senator HEITKAMP. Like everything else in Singapore.

Mr. MEAD. Exactly. And you must smile, yes.

[Laughter.]

Senator HEITKAMP. And not spit on the sidewalk.

Mr. MEAD. Please do not. Do not scratch cars with keys either, I am told.

But, you know, they have a homeownership rate now of about 90 percent in Singapore because if you can—you have to put this money away, but you can put it in different purposes. People do have some freedom. So this is—

Senator HEITKAMP. So it would include things that build wealth for the family.

Mr. MEAD. Exactly, and so the system is you have to maintain a certain balance in your account before you can do certain discretionary things, but you can count property value against that core amount.

So I think we can actually be—we can think much more flexibly about what we do. We are fortunate now. When the United States started Social Security, there were some similar examples, but it was a pretty simple menu of choices that existed. Today a number of countries around the world have tried very different approaches. So I think we might as well benefit from the experience.

Senator HEITKAMP. I just want to say I think this is something that everybody needs—to check ideology at the door, you know, all of this stuff, and look with very clear vision at what is going to happen in the next 20 years as we transition away from defined benefit plans to a society that is not saving for retirement, and we need to look at what works, not what fits within an ideology. And that is a critical component. But we need to understand the human dynamic of choice and why it is difficult for people to see value in making a choice of saving for retirement.

But I look forward to learning more about the Singapore plan and more about your reaction to Senator Conrad's report. I think it sounds like there is some merging of ideas here, and then how can we effectuate that either working with the private sector to develop products or looking at—we do it typically through tax incentives, but also taking a look at how we can make this a social norm that we are saving for retirement and not necessarily an anomaly, which we are beginning to see that it is.

Chairman COTTON. Senator Toomey.

Senator TOOMEY. Mr. Chairman, Senator Heitkamp, thank you very much for doing this hearing. I appreciate it.

Senator Conrad, it is good to see you again, and, Professor Mead, thank you for joining us.

I apologize I was late. I was the presiding officer. I am not going to ask any questions at this time, but I do look forward to reading the testimony of the witnesses and looking at the discussion that you had.

Chairman COTTON. Thank you, Senator Toomey.

And he replaced me, which is why I was late initially to the Committee. I was the presiding officer. As Senator Conrad remembers

from his days as a junior Senator, it is very much a duty and not an honor.

[Laughter.]

Chairman COTTON. Professor Mead, we talked a lot about a lifetime of savings and how Americans save because it is so important, as Senator Heitkamp pointed out, that you save from the beginning of your life, even small amounts, to take advantage of the miracles of compound interest.

But then there is how you live at or near retirement. One point you have written about is the payroll tax on elderly Americans who are still working. Could you elaborate on your thinking there?

Mr. MEAD. Well, I think, again, work is becoming, you know—more and more of our workforce have jobs now that you do not really need to leave at 65, and many people do not want to. The work I do teaching is work I enjoy. And while I am able to, I hope I can continue. But if I were a bricklayer or, you know, doing hard physical labor, I would need to be able to retire at a certain point.

So as we think about how our system works and how we can make the system work for everyone, it does seem that, first of all, it is in our interest that people defer taking out of the system. Those who enjoy working and want to work continue to work and are able to do so, we should say, yes, go ahead. We do not need a one-size-fits-all approach to this. So if you have someone who has paid up to Social Security and they want to continue working, maybe you take the payroll tax off their shoulders at the end. In the same way, I have suggested we now require mandatory withdrawals from IRAs and other tax-deferred investments to start, I believe, at 70½ years, why not, if someone is still working, let them postpone that, let their assets grow a bit?

So I think there are very much—we penalize people who are continuing to work while drawing Social Security benefits by withholding some of their benefit. Again, we should be looking at a system that allows Americans in very different circumstances with very different sort of needs to be able to design their own lives without penalty, and where their choices actually help strengthen the system, we should be blessing and encouraging and incentivizing those choices.

Chairman COTTON. Senator Conrad?

Mr. CONRAD. Could I just say, I am very happy to hear Professor Mead talk about these ideas. We tried to include some of these ideas in our Social Security reform package, to actually provide incentives in the system for people to continue to work. You know, the way the Social Security system works now, once you get your PIA, the primary insurance amount, established, it is done by looking at 40 years or 37 years of work—35 years of work, what we say is do it year by year, so those additional years add to somebody's Social Security payment.

We did a whole series of things in our Social Security reform not to discourage people from working, but to encourage them to continue working if they are able to do so. That makes great economic sense for the system. It makes great economic sense for the individual.

Chairman COTTON. Professor Mead, one final question about living in retirement. You wrote in your statement and you have

written elsewhere about the possibility of retirement overseas and the lower-cost options that some Americans who are looking for warmer climes might have. Could you elaborate on those ideas?

Mr. MEAD. I am happy to do that, Senator. We should remember that no matter what we do, there are Americans who are approaching retirement with inadequate savings, and we cannot change that, much as we would like to.

What I think we can do is think about ways where even—we could help them stretch their dollars a bit, and it is certainly true that in many countries living costs are lower than in the United States. Originally, one of the reasons that many people retired to States like Florida and Arizona was that costs were lower there than they were in the States where they were. So today someone could just stay on the plane a couple of hours south of Miami and retire there.

One of the obstacles to this—and, by the way, many Americans are already doing this in countries like Costa Rica. Also, many immigrants who come here, work hard, retire basically with Social Security, can go back to the country where they came from where that retirement income stretches farther. But one of the problems is that you cannot use your Medicare insurance for most things outside the United States.

Now, since healthcare costs are often much lower outside the United States than in it, some kind of system that allows American citizens to access their Medicare benefits for treatment in approved hospitals and facilities overseas would simply give a lot more Americans more choice in retirement and might provide some options that would help these bridge generations who have grown up after the old system began to fail but before we as a society have gotten a new system that works for them, they still have choices. No one has to do it. I suppose it is the opposite of what people used to say happened in the far North, that you would put the old folks out on the ice floes. Maybe we can send the old folks to tropical beaches. That seems a bit more humane.

But, in any case, I think this is about—we need to think creatively about giving people choices as they try to have a good retirement when not all the circumstances are favorable.

Mr. CONRAD. Mr. Chairman, could I just say that we would welcome people from higher-cost jurisdictions to retire in North Dakota?

[Laughter.]

Mr. CONRAD. Perhaps you would welcome them in Arkansas as well. You know, it is amazing, the difference in cost between these more urban areas and the more rural areas that we have grown up in, and, really, a Social Security dollar goes a lot farther in North Dakota than in the more urban places on the east and west coasts. I am sure that is true of your home State as well.

Chairman COTTON. Given the realities of the brutal winters in North Dakota, we would be happy to welcome North Dakotans who do not want to go all the way to Costa Rica to the Ozark or Ouachita Mountains. It is very affordable.

Senator HEITKAMP. And then when the mosquitoes get you in Arkansas, we will welcome you back to North Dakota.

[Laughter.]

Chairman COTTON. Senator Heitkamp.

Senator HEITKAMP. I want to just ask a question. You guys have just been—you know, just thought-provoking testimony and really quite an enjoyable hour and a half. I think both Senator Cotton and I are deadly serious about this topic.

I want just a couple of pieces of advice from both of you on if you were sitting not where you are sitting but sitting back on this side of the dais. What would be your next steps? And we will start with you, Senator Conrad.

Mr. CONRAD. Well, organize and educate are always my two notions of how you get something done around here. I think there is just a tremendous opportunity here, and I really applaud the two of you for doing this in a bipartisan way, because as I learned, very little happens around here unless it is done in a bipartisan way. Even less is sustainable unless it is done in a bipartisan way. And these are issues that really should not be partisan. There is no reason that it should be partisan to expand opportunities for people to participate in retirement plans at work. There is no reason that it should be partisan to change the incentive systems that we have in Social Security to encourage people to work longer. You know, there is nothing partisan about it.

So I would say those would be my observations.

Senator HEITKAMP. Professor Mead?

Mr. MEAD. Well, I would second that, and I would add to it. I would try to remind my colleagues, if I were in your situation, that we see a lot of lack of trust today between so-called elites and the folks in the grass roots. One of the reasons that that is the case is because of the failures of national systems like the retirement system. People do not expect the Government to guarantee them affluence, but they do expect to have a system that, if they play by the rules and do their part, it brings them to a decent result. And the sense that somehow something as fundamentally important to the lives of the American people as our retirement system, we have not yet put the kind of effort and diligence into constructing and repairing that system, is a message from Washington to the folks out there that we do not care.

So I would urge you to impress the importance of this issue on your colleagues as a concrete kind of governance issue that can help rebuild the faith of the American people in our democratic system, and that is really something that we need to do.

Senator HEITKAMP. OK.

Chairman COTTON. Gentlemen, thank you both for your appearance here today and your work on this important issue. Thank you both to your organizations and your teams. We appreciate the hard work they do. We know that those statements do not write themselves, and the spread sheet models are not created by themselves. So we appreciate very much also the Bipartisan Policy Center, the Hudson Institute, and the American Interest. We thank you again for your testimony.

This hearing is adjourned.

[Whereupon, at 4:31 p.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for the record follow:]

PREPARED STATEMENT OF KENT CONRAD

FORMER SENATOR FROM THE STATE OF NORTH DAKOTA, AND CO-CHAIR, BIPARTISAN
POLICY CENTER'S COMMISSION ON RETIREMENT SECURITY AND PERSONAL SAVINGS

APRIL 5, 2017

Good afternoon, Chairman Cotton, Ranking Member Heitkamp, and Members of the Subcommittee. Thank you for inviting me here to discuss the state of retirement security in America.

Millions of Americans are financially unprepared for their retirement. Too many lack adequate savings, having set aside money at insufficient levels. Even those who do accumulate sufficient savings for retirement run the risk of outliving those funds, and others are forced to raid their retirement accounts early due to a shortage of short-term, emergency savings. Compounding these challenges is the fact that Americans often lack the financial capability to take actions that are in their own best interests. Meanwhile, the Social Security system—the bedrock of retirement security in America—is facing a serious shortfall, with its trust funds set to be exhausted by 2035.

The lack of retirement savings is eye-opening. According to research from the Urban Institute's DYNASIM model, the median amount of retirement assets held by Americans aged 62–69 stood at just \$32,000 in 2015. More than one-quarter of households in this group had zero in retirement savings.¹ But this problem is not limited to older Americans. Research from the Employee Benefits Research Institute (EBRI) has found that more than four in 10 Gen-Xers are projected to run short of money in retirement.²

Part of this problem can be attributed to a lack of access and contributions to employer-sponsored retirement plans. Modeling from EBRI has found that 31 percent of civilian workers lack access to an employer-sponsored retirement plan. Among those with access, many choose not to contribute. In total, just over half of civilian workers contribute to an employer sponsored-plan.³

Given these disturbing statistics, it is little wonder that Americans are concerned about their retirement. A 2016 Gallup poll found that 64 percent of Americans are either very worried or moderately worried about not having enough money for retirement, making it their top financial concern in the survey.⁴ A recent study by the Federal Reserve found that around half of adults say they would be unable to come up with even \$400 in an emergency without borrowing or selling possessions.⁵

The Bipartisan Policy Center's Commission on Retirement Security and Personal Savings, which I had the privilege of co-chairing with the Honorable James B. Lockhart III, former Principal Deputy Commissioner of the Social Security Administration, identified six key challenges associated with retirement security in America today:

- 1) **Too few workers participate in a workplace retirement savings plan.** As described previously, just around half of private-sector workers contribute to an employer-sponsored retirement plan. One primary cause of this lack of access is that some businesses find it too expensive and complex to sponsor either a traditional “defined benefit” pension or a 401(k)-style “defined contribution” plan. Small businesses, in particular, are often unprepared to take on what can be large administrative, financial, and fiduciary burdens. In a recent survey by the Pew Charitable Trusts, 59 percent of small- to medium-sized businesses not offering a plan attributed that decision to either the associated expense or the firm's resource constraints.⁶ As a consequence, 53 percent of workers at businesses with fewer than 50 employees do not have access to a plan, compared to only 10 percent among companies with more than 500 employees. Simply put, workers without these plans are less likely to enjoy

¹The Urban Institute. 2016. DYNASIM3.

²VanDerhei, Jack. 2014. “What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model.” Employee Benefit Research Institute Issue Brief, no. 396. Pp. 6–19. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.

³EBRI, Policy Forum #79. Basic Facts: Retirement, December 15, 2016.

⁴McCarthy, Justin. 2016. “Americans' Financial Worries Edge Up in 2016.” Gallup. <http://www.gallup.com/poll/191174/americans-financial-worriesedge-2016.aspx>.

⁵Federal Reserve. “Report on the Economic Well-Being of U.S. Households in 2015.” May 2016. P. 1. <http://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf>.

⁶The Pew Charitable Trusts. “Small Business Views on retirement Savings Plans.” January 2017. <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/01/small-business-views-on-retirement-savings-plans>.

retirement security. According to projections from EBRI, 56 percent of those without ongoing access to a DC retirement plan will run short of money in retirement.⁷

- 2) **Many Americans lack the income or resources to save for short-term needs, forcing them to raid their retirement accounts for unexpected expenses.** Usually called “leakage,” preretirement withdrawals occur when savers withdraw their DC plan or IRA assets before retirement. Research suggests that between 1 and 1.5 percent of 401(k)-plan and IRA assets are lost to leakage each year.^{8,9} Individuals who pull savings out early tend to withdraw a high percentage of their retirement assets, averaging around 20 percent.^{10,11} Leakage can not only lead to high fees and penalties, but it also directly translates to a reduction in retirement assets.
- 3) **Americans are living longer and are increasingly at risk of outliving their savings,** but despite rising life expectancy, the average retirement age has stagnated. Between 1962 and 1996, the average retirement age among men actually declined from 65 to 63. Though the average retirement age increased for women—along with workforce participation—it remains relatively low, at 62 in 2013.¹² To make matters worse, most Social Security beneficiaries claim their benefits well before the full retirement age (FRA). In 2014, roughly three-fourths of individuals claiming Old-Age and Survivors Insurance (OASI) benefits did so at an age below the FRA.¹³ Early claimers in 2016 saw their monthly payment reduced by up to 25 percent from what it would have been if they claimed at the current FRA of 66. A diminished stream of income from Social Security compounds the problem of having fewer years in the workforce to save for retirement. This is especially concerning for the large number of older Americans who depend on Social Security for the overwhelming majority of their income.
- 4) **Home equity is an under-utilized source of retirement savings.** For many retirees, home equity represents a significant portion of their assets. Americans own more than \$13.3 trillion in home equity—a sum that rivals the \$14.9 trillion that Americans hold in retirement savings.^{14,15} Just like retirement savings, housing assets are built slowly over most people’s working life, making home equity a crucial stock of wealth for many older Americans. Unfortunately, the past several decades have seen increasing indebtedness among older Americans—driven by increases in mortgage debt—which poses a unique threat to retirement security. The share of older households holding any form of housing-related debt has more than doubled since 1989, from 15 to 32

⁷This result is for Gen-Xers (born between 1965 and 1974) who are in the second income quartile (*i.e.*, between the 25th percentile and the median of the income distribution). For more information, please refer to: VanDerhei, Jack. “What Causes EBRI Retirement Readiness Ratings to Vary.” Employee Benefits Research Institute. Issue Brief #396. February 2014. P. 7. https://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.

⁸Munnell, Alicia and Anthony Webb. 2015. “The Impact of Leakages From 401(k)s and IRAs.” The Center for Retirement Research at Boston College. P. 1. http://crr.bc.edu/wp-content/uploads/2015/02/wp_2015-2.pdf.

⁹Butrica, Barbara A., Sheila R. Zedlewski, and Philip Issa. 2010. “Understanding Early Withdrawals from Retirement Accounts.” The Urban Institute. P. 23. <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412107-Understanding-Early-Withdrawals-from-Retirement-Accounts.pdf>.

¹⁰*Ibid.*

¹¹Argento, Robert, Victoria Bryant, and John Sabelhaus. 2015. “Early Withdrawals from Retirement Accounts During the Great Recession.” *Contemporary Economic Policy*. Vol. 33. No. 1. (January). P. 14. <http://onlinelibrary.wiley.com/doi/10.1111/coep.12064/epdf>.

¹²Munnell, Alicia H. 2015. “The Average Retirement Age—An Update.” Center for Retirement Research at Boston College. Pp. 3–4. <http://crr.bc.edu/briefs/the-average-retirement-age-an-update/>.

¹³Social Security Administration. 2015. Annual Statistical Supplement, 2015. Table 6. B5.1. <https://www.ssa.gov/policy/docs/statcomps/supplement/2015/6b.html>.

¹⁴See, Board of Governors of the Federal Reserve System. Financial Accounts of the United States: Fourth Quarter 2016. P. 138. March 9, 2017. <http://www.federalreserve.gov/releases/z1/Current/z1.pdf>. Home equity is equal to total household real estate less total home mortgages, as calculated by the Board of Governors of the Federal Reserve System.

¹⁵See, Investment Company Institute. 2016. Report: The U.S. Retirement Market, Fourth Quarter 2016 (xls). Table 1. March 22, 2017. <https://www.ici.org/research/stats/retirement>. Retirement savings include assets in DC plans and IRAs.

percent.¹⁶ Federal tax policy worsens this problem by promoting mortgage debt. Mortgage interest payments are usually deductible for taxpayers who itemize. Ultimately, holding mortgage debt in retirement limits retirees' ability to tap home equity and is among the many considerations that Americans need to understand as they make decisions about their own savings and retirement.

- 5) **Many Americans lack financial capability.** Financial capability is defined as the knowledge, ability, and opportunity of all individuals to manage their personal finances. It is more important now than ever, as workers are increasingly responsible for their own retirement security. Unfortunately, too many Americans struggle in this area. A 2014 study found that 23 percent of Millennials and 19 percent of Gen-Xers spend more than they earn, and only about one-third of each group has set up a rainy-day fund.¹⁷ In addition, Americans fare poorly on assessments of financial literacy.
- 6) **Social Security is facing a significant financial shortfall and needs modernization.** Social Security is the foundation upon which Americans across the economic spectrum build their retirement. While the program continues to serve as an essential safety net for nearly all American workers, its financial troubles put that position at risk. Under current projections by the program's trustees, the OASI Trust Fund—which pays benefits to older Americans, their dependents, and their survivors—is projected to be exhausted by 2035.¹⁸ At that point, beneficiaries would face an across-the-board benefit cut of 23 percent.¹⁹ While that may seem far off, Social Security is already paying out more in annual benefits than it collects in taxes. Waiting to address this shortfall increases uncertainty for beneficiaries and makes the policy fixes more difficult.

Though these challenges are indeed daunting, our commission put forth a comprehensive package of recommendations to improve retirement security for all Americans, focusing on the six broad challenges described above.

To expand access and make it easier for individuals to save for retirement, we propose several solutions. Generally, our strategy is to reduce the burden on small businesses and simplify the process of providing retirement benefits to employees, incentivize enrollment in workplace retirement savings plans, and create a national minimum-coverage standard that would require all businesses with at least 50 employees to offer their workers some form of workplace retirement savings option. Our modeling shows that such changes would increase savings among middle class Americans by 50 percent once fully phased in.

Enhancing retirement saving opportunities is critical, but planning for retirement should never be considered in a vacuum. Retirement security is inextricably linked to everyday financial security decisions during one's working years. Americans need to increase their personal savings so that they are better positioned to handle emergencies and major expenses, and when appropriate, purchase insurance against the vicissitudes of life. Insufficient short-term savings can lead workers to draw down their retirement accounts, incurring taxes and (often) penalties. This "leakage" of retirement savings—while it might address an immediate financial squeeze—jeopardizes many Americans' long-term retirement security. To address this issue, we recommend allowing employees to be automatically enrolled in multiple savings accounts—a standard checking account for short-term savings and a tax-preferred retirement account. We would also reform the regulations surrounding retirement accounts to further deter preretirement withdrawals.

Once workers reach retirement, they face the daunting prospect of making their savings last for the rest of their lives. With Americans increasingly living into their 80s and 90s, this challenge has only become more difficult. By clearing regulatory barriers to lifetime-income options for retirees and encouraging Americans to claim

¹⁶ Board of Governors of the Federal Reserve System. 2014. 2013 Survey of Consumer Finances. <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>. Housing-related debt is defined as debt secured by one's primary residence.

¹⁷ Mottola, Gary R. 2014. "The Financial Capability of Young Adults—A Generational View." FINRA Investor Education Foundation. <http://www.usfinancialcapability.org/downloads/FinancialCapabilityofYoungAdults.pdf>.

¹⁸ The Congressional Budget Office expects the OASI Trust Fund to be exhausted in 2029—six years sooner than the projection of the trustees.

¹⁹ Committee on Ways and Means. 2016. "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." U.S. House of Representatives. 114th Congress. H. Rep. 114–145, P. 6. <https://www.ssa.gov/OACT/TR/2016/tr2016.pdf>.

Social Security benefits later to maximize their incomes, our recommendations would ensure that fewer retirees outlive their savings.

To diversify Americans' options for retirement income, our proposals would make home equity more readily available for retirement needs. We discourage the use of home equity for preretirement consumption by removing the deduction for interest on second mortgages and other lines of credit that reduce home equity before retirement. We also recommend expanding awareness of Federal Housing Administration (FHA)-insured reverse mortgages and establishing a low-dollar reverse-mortgage pool, allowing retirees to tap into a smaller portion of their home equity without incurring the large fees that accompany larger loans.²⁰

Increased use of IRAs, 401(k)s, and other defined-contribution accounts means that today's workers have more responsibility for managing their personal finances than previous generations. To improve Americans' financial knowledge and better equip them to manage their own finances, we recommend expanding personal financial education at all ages and stress the importance of "just-in-time" interventions, in which individuals are provided with important information at the moment that they are making major financial decisions.

Finally, no discussion of retirement policy would be complete without addressing the significant challenges that face Social Security. Our package would avoid the 23 percent cut that is set to take effect and give Americans certainty about what to expect in benefits from the program as they prepare for retirement. The Chief Actuary of Social Security found that our plan would achieve "sustainable solvency," meaning that the program's reserves would be increasing even after 75 years. We achieved this outcome through a balanced package of revenue increases and benefit savings. Our policies include gradually increasing the payroll-tax rate, raising the amount of income subject to Social Security taxes, very gradually raising the full retirement age, and using a more-accurate measure of inflation for Social Security's annual cost-of-living adjustments. But what I am most proud of is the enhancements that we were also able to make for the most vulnerable beneficiaries, including surviving spouses and low-income workers. These groups would see dramatic increases in benefits, which is why the Urban Institute found that our package would reduce elderly poverty by 30 percent in just 20 years.²¹

To achieve agreement, the commission voted on these recommendations as a package, not as individual policies. My fellow commissioners and I continue to believe that, taken as a whole, these policies represent the most comprehensive, bipartisan proposal to reform U.S. retirement policy for the benefit of all Americans.

Based on the interests of this Committee, there are a few policies I would like to highlight that might be particularly ripe for near-term action:

Establish simplified Retirement Security Plans for small businesses. To expand access and make it easier for individuals to save for retirement, the commission recommends creating new Retirement Security Plans that would dramatically simplify the process of offering automatic enrollment plans for small businesses.²² These plans would allow employers with fewer than 500 workers to band together and form well-run, low-cost retirement plans that defuse administrative expenses. Responsibility for operating and overseeing these plans would fall to a third-party administrator that would be certified by a new oversight board designed to protect consumers from bad actors. A similar proposal (entitled "pooled plans"²³) was included in the Retirement Enhancement and Savings Act of 2016, which was unanimously reported out of the Senate Finance Committee on a bipartisan basis.

Allow employers to enroll employees in multiple savings accounts. To help ensure that retirement savings last until retirement, we believe that employers should be able to automatically enroll their employees into two accounts—one meant for retirement savings, another for short-term savings. By building up these rainy-day savings, individuals might be less likely to raid their retirement savings in the event of an unexpected emergency.

Incentivize retirement savings for young workers. To help build a culture of savings and improve the financial resilience of American families, we propose a new Starter Saver's Match, which would replace the existing Saver's Credit for individuals under the age of 35. The current Saver's Credit reduces the income-tax burden for lower-income individuals who contribute to retirement accounts, but the credit is not refundable, meaning that individuals with no income tax liability cannot benefit from it. The Starter Saver's Match would instead be a refundable credit

²⁰Please see page 69 of our report for our full recommendations on facilitating the use of home equity for retirement consumption.

²¹Please see page 78 of our report for our full recommendations on strengthening Social Security's finances and modernizing the program.

²²Please see page 39 of our report for more information about Retirement Security Plans.

of up to \$500 deposited directly into the claimant's retirement account. This change would better encourage younger workers with lower wages (those who are least likely to save on their own) to start saving for retirement. It would also maximize the Government's "bang-for-the-buck" by allowing the invested match more years to grow.²³

Facilitate the establishment of a Retirement Security Clearinghouse to improve portability. Many savers face the problem of having several retirement accounts scattered among their previous employers. For this reason, we recommend the creation of a Retirement Security Clearinghouse to ease the process of consolidating accounts.

Encourage plan sponsors to integrate easy-to-use, sophisticated lifetime-income features. Including lifetime-income options can be a complex endeavor that entails concerns about fiduciary liability; in addition, businesses often have to invest significant time and resources to develop lifetime-income features. We recommend providing limited protection for fiduciary liability, modifying regulations, and giving additional guidance to plan sponsors that wish to incorporate lifetime-income options within a DC plan.²⁴ These developments could have a similar effect for lifetime-income solutions as the Pension Protection Act of 2006 had for retirement plan auto-features. Removing barriers to auto-enrollment and auto-escalation, as well as providing limited protection from fiduciary liability for the use of qualified default investment alternatives, increased substantially the number of plan sponsors that implemented auto-features. The lifetime-income field is ripe for comparable changes.

Accurately reflect retirement tax policy changes in the budget process. Last but certainly not least is an issue that I know well from my years chairing the Senate Budget Committee. As tax reform discussions progress, the tax treatment of retirement savings accounts appears to be on the table. In particular, some have proposed moving all traditional tax-deferred retirement plans (such as 401(k)s and IRAs) to an after-tax Roth system in order to create "budget savings" in the 10-year window. However, the current scoring system significantly overstates the costs of tax-deferred accounts and understates the cost of Roth accounts. We recommend changing the scoring of these tax provisions to a system that would score both types of accounts on an equal basis.²⁵ I would encourage caution among policy-makers when considering dramatic changes to retirement policy for tax policy purposes. Hundreds of billions of dollars are saved in these retirement accounts every year and the tax incentives play a significant role in this system. While debating the merits and structure of retirement tax preferences is certainly appropriate, hastily overhauling them without due consideration for the impact on American savers could serve to worsen the retirement security predicament about which we are all concerned.

Conclusion

I am encouraged that the issues of savings and retirement security have attracted bipartisan interest among not only members of Congress, but also business leaders, the media, the Administration, and the States, as well as from candidates seeking public office. I hope that the work of our commission can inform these efforts and can contribute to meaningful action by individuals, businesses, and governments to improve the economic well-being of all Americans.

Thank you for inviting me to be here today, and I look forward to answering your questions.

²³ Please see page 53 of our report for more information about our Starter Saver's Match.

²⁴ Please see page 61 of our report for our full recommendations on Lifetime-Income Options.

²⁵ Please see page 51 of our report for more information about our recommendation on changing congressional budget-estimation rules for retirement tax expenditures.

NOT HAVING ENOUGH MONEY IN RETIREMENT IS ONE OF AMERICANS' BIGGEST FINANCIAL WORRIES



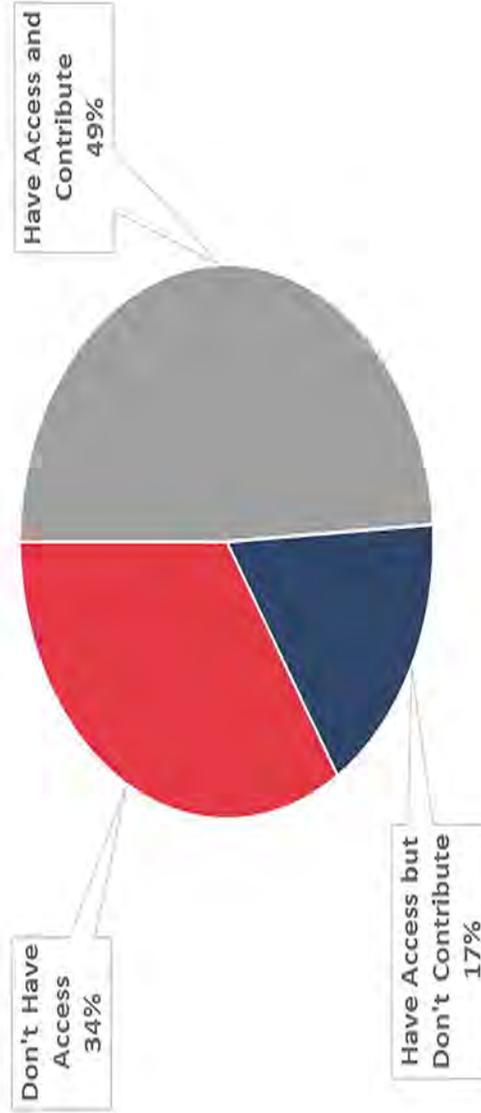
Americans' Specific Financial Worries, 2016	"Moderately" or "Very" Worried
Not having enough money for retirement	64%
Not being able to pay medical costs of a serious illness/accident	60%
Not being able to maintain the standard of living you enjoy	51%
Not being able to pay medical costs for normal healthcare	45%
Not having enough to pay your normal monthly bills	41%

Source: McCarthy, Justin. 2016. "Americans' Financial Worries Edge Up In 2016." Gallup.

THERE IS A GAP IN BOTH ACCESS AND PARTICIPATION



Today: Less than half of private-sector workers participate in a workplace retirement savings plan; those with access are more likely to participate if automatically enrolled (even though they can choose to opt out).

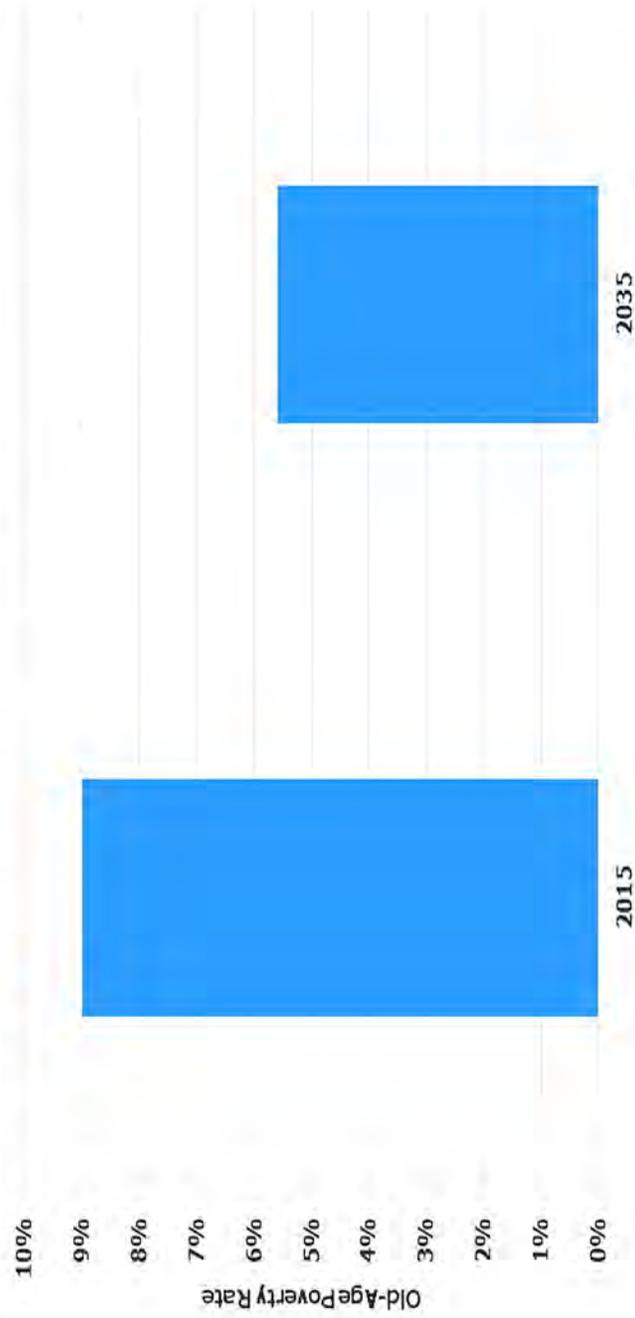


**SIX MAJOR RECOMMENDATIONS FOR RETIREMENT
SECURITY AND PERSONAL SAVINGS**



- Improve Access to Workplace Retirement Savings Plans
- Promote Personal Savings for Short-Term Needs and Preserve Retirement Savings for Older Age
- Facilitate Lifetime-Income Options to Make Savings Last in Retirement
- Facilitate the Use of Home Equity for Retirement Consumption
- Improve Financial Capability Among All Americans
- Strengthen Social Security's Finances and Modernize the Program

SOCIAL SECURITY PACKAGE REDUCES OLD-AGE POVERTY RATE BY ONE-THIRD OVER 20 YEARS

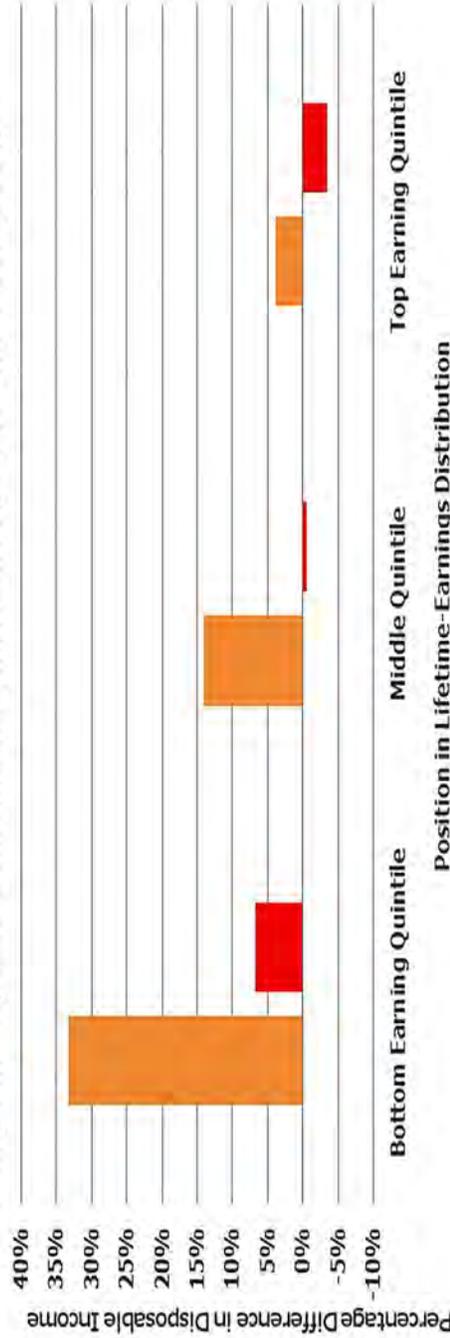


Source: The Urban Institute -- DYNASIM3

COMMISSION PACKAGE RAISES RETIREMENT INCOMES ABOVE PAYABLE BENEFITS FOR ALL QUINTILES



Change in Disposable Income for Americans Aged 62 and Older (2065)



Commission Package Compared to:
 Payable (Fully Financed) Benefits Scenario
 Scheduled (Underfinanced) Benefits Scenario

Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. Population is segmented based on lifetime earnings. Figure is presented on a per-capita basis.

Source: The Urban Institute — DYNASIM3

PREPARED STATEMENT OF WALTER RUSSELL MEAD

DISTINGUISHED SCHOLAR IN AMERICAN STRATEGY, THE HUDSON INSTITUTE AND
 CHACE PROFESSOR OF FOREIGN AFFAIRS, BARD COLLEGE

APRIL 5, 2017

Good afternoon, Mr. Chairman, Ranking Member Heitkamp, and Members of the Subcommittee:

It is an honor to be invited to testify before this Subcommittee and its distinguished Members. Moreover, it is a privilege to testify alongside former-Senator Kent Conrad. I congratulate the Subcommittee on its interest in creating a sustainable and viable retirement system for the 21st century.

My testimony today is divided into three parts. In the first, I look at the history of Federal policy with respect to the economic security of the American people, how that policy changed in response to changing economic conditions, and how our current set of retirement programs and policies emerged from these changes. In the second section, I draw the Subcommittee's attention to the ways in which the economic changes our country is currently undergoing are deep enough and pervasive enough to require fresh thinking about economic and retirement policy. Finally, I offer some suggestions that I hope will assist the Subcommittee's distinguished Members as they work to craft novel retirement security policies for an approaching economic order while preserving programs like Social Security that remain essential to the economic security of older Americans.

The American Dream & Government

Many believe that the Federal Government's promotion of the economic security of the American middle class is a relatively recent development, dating back to Franklin Roosevelt and the New Deal. This is far from the truth. From the revolutionary period to the present day, American presidents and congresses have worked to develop policies and laws that promote the American Dream—to help the American people build dignified and secure lives through hard work. Our understanding of the American Dream has changed over the centuries, and successive generations have changed the methods by which they seek to promote the common welfare, but the prosperity and the security of the American people has remained at the center of national policy from the time of George Washington into the 21st century.

For much of our history, the majority of the American people earned their living in agriculture. In the 18th century, farmers comprised approximately 90 percent of the American labor force. Only in the 20th century did the percentage of agricultural workers fall significantly below 50 percent of the labor force. For both American citizens and the immigrants drawn to our shores, the American Dream at this time meant a freehold family farm; elected officials understood that the opportunity to own a farm was what constituents most wanted, and they made it their business to ensure that Federal policies supported that goal.

Politicians also understood that the independence and security of family farming was the foundation of the American political system. Political theorists like Thomas Jefferson believed that independent free farmers made the American democratic system possible. Freed from the servile dependency that characterized so much of peasant agriculture in Europe, and trained in the habits of responsibility and hard work by the requirements of property owning, American farmers could be safely entrusted with the choice of elected officials. Federal support for the independence and prosperity of farmers was not just in the country's economic interest; such support strengthened the foundations of American society in line with Jefferson's belief that "Agriculture . . . is our wisest pursuit, because it will in the end contribute most to real wealth, good morals, and happiness."

Indeed, the Land Ordinance of 1785 and the Northwest Ordinance of 1787, both of which were adopted by Congress before the Constitution was signed, already envisioned a future of independent, yeoman farmers in early America. These ordinances helped create a system that organized the sale of Federal land west of the Appalachians to private citizens, and remain a basis of the Public Land Survey System and the Bureau of Land Management that we know today.

The Federal Government continued to promote the establishment of the family farm throughout the 19th century with a full range of economic, diplomatic, and even military policies. President Jefferson's Louisiana Purchase opened up over 800,000 square miles of land for Americans to settle. The 1862 Homestead Act gave away millions of acres of land to settlers who were willing to brave the treacherous

westward journey and settle in the interior.¹ The early diplomatic emphasis on gaining free access to the Port of New Orleans for western farmers, like the later promotion of railroads to open up the vast western territories, was designed to ensure that farmers in the remote American interior were able to sell their goods on world markets. The establishment of land grant colleges at the end of the 19th century sought to both train young farmers and to conduct important research into new farming methods. Taken together, these policies, among others, formed what might be called the “Green Model”—a coordinated Government effort to provide Americans, who lacked opportunities to own large tracks of farmland on the coast, with the ability to seize the 19th century American Dream if they moved to the interior.

By promoting land ownership at low cost and encouraging agricultural education, the Green Model sought to deliver for Americans the unique financial and societal security that a family farm could provide. Besides the revenue and sustenance from working the land, family farming helped Americans accumulate wealth. Additionally, family farms provided for retirement. Grown children could continue tending the land while taking care of their elderly parents, or the family farm could be rented or sold, providing an income for farmers who could no longer work the land for themselves.

The security provided by the family farm began to erode in the late 19th century. As more settlers took advantage of Green Model land policies, the remaining unsettled land became ever more marginal. At the same time, a more competitive, large-scale, and capital-intensive farming model emerged, which gradually made family farming riskier and less rewarding. The share of farmers in the labor force declined from approximately 64 percent in 1850 to 27 percent in 1920.

As the American economy shifted away from American agriculture and toward factories and mines, Americans experienced growing inequality and uncertainty between 1865 and 1900. Following the Civil War, portions of American society clung to the Green Model way of life even as the rural economy fell behind the manufacturing economy of the great cities.

Farmers lobbied for Federal assistance to achieve ‘parity’ with urban workers, but the relative decline of the agricultural economy continued. While pro-farm policies aimed to preserve Jefferson’s idyllic vision of a Nation of yeoman farmers, these policies were no match for larger economic trends that were recasting American society as well as the economy.² It became increasingly clear that the Green Model could no longer serve as the ordering principle for Federal policy, but the dynamics of the new economy were not well understood and its full wealth creating potential had not yet been realized.

As the twentieth century witnessed a clear transition from an agricultural to an industrial era, a new version of the American Dream appeared and a corresponding Federal policy model began to take shape. Teddy Roosevelt capitalized on widespread calls for reform and ushered in a new kind of politics. Past presidents made history by opening new land for settlement; Theodore Roosevelt made history by protecting Federal lands from settlement and establishing our system of national parks. Franklin Roosevelt’s New Deal policies further advanced the evolution of a new system tailored to an urban society with a manufacturing economy.

The process of transition was a slow one, with many setbacks and upheavals, but by the 1950s, a new and stable social system had emerged. Americans had learned to manage the forces of industrialism, to regulate the power of finance, and to use the vast resources which an industrial society creates to address the unprecedented social problems that the rise of the modern city and the modern factory system brought into being. In post-World War Two America, both blue-collar and white-collar workers increasingly had stable, lifetime jobs in a growing economy. Within this new economy, high school graduates were essentially guaranteed lifetime employment in a job that, at a minimum, provided a comfortable, lower middle-class lifestyle. Likewise, college graduates could expect an equally secure future with an even greater standard of living.

The new economy led to a new American Dream. Americans no longer dreamed of owning a family farm, rather they dreamed of owning a suburban home accompanied by a consumer lifestyle. To ensure that Americans willing to work for it could have that dream come true, the United States Government created a novel

¹It is important to note that, although the Homestead Act essentially provided free land to settlers, the westward journey inflicted heavy physical, emotional, and fiscal costs on settlers. It would be incorrect to view the Homestead Act as a handout.

²It is worth noting that a disproportionate number of policies seek to aid American farmers today despite the fact that less than 2 percent of the American labor force works in agriculture. One can argue that these policies harken back to Jefferson’s vision of America and the Green Model.

policy system during the 1950s and 1960s—a set of policies and practices sometimes called the “Blue Model.” New transportation measures, like the Federal Aid Highway Act of 1956, aimed to link cities and employment centers with cheap, suburban housing, so that geography would not prevent Americans from achieving the new American Dream. Likewise, 30-year mortgages with low interest rates allowed lower- and middle-class Americans to own suburban homes and accumulate wealth. Tax advantages for the municipal bond market allowed American cities and towns to build the infrastructure the new suburbanites wanted at an affordable cost.

The United States Government demonstrated its commitment to promoting opportunities for working Americans. While Blue Model policies differed significantly from those of the Green Model, both models aimed at the same goal—to provide as many Americans as possible with the opportunity to realize the American Dream in accordance with the economic and societal conditions of the time. Neither model sought to accomplish this goal through ‘handouts’ or guaranteed outcomes. Rather, they provided Americans with the ability to accumulate wealth through hard work.

Sadly, both the Green Model and the Blue Model developed policies to the exclusion or even the detriment of American minorities and particularly African Americans. American slavery and the share-cropping era under Jim Crow meant that free black farmers were virtually absent from the independent yeoman-farmer vision of Jefferson and his 19th century successors. In the 20th century, red lining prevented many African Americans from attaining the financial security and independence of home ownership, while New Deal programs often excluded domestic workers, wait-staff and farm-hands—occupations that were disproportionately held by minorities or women. Nonetheless, for a large majority of Americans, these policies contributed to the enormous growth of economic prosperity of 19th and 20th century America.

Retirement policy was one of the areas in which policy had to change in response to new conditions. Factory jobs did not provide the same kind of economic security that farm ownership did. Especially in the early years of the factory system, and again during the Depression, many ordinary working people lacked the ability to save for retirement, but the factory system was unforgiving.

Like the Green Model, the Blue Model began to fail over time. As foreign manufacturers recovered from the devastation of World War II, German and Japanese companies challenged complacent American firms.

In this new and often more challenging environment, companies had to become more flexible. Industry became more competitive, private-sector managers shed bureaucratic habits of thought, and defining characteristics of the economy, like lifetime employment and defined benefit pensions, began to disappear. Additionally, the combination of low-wage competition from the developing world and automation in advanced country manufacturing began to cut into manufacturing employment in the United States. The process of change started in the 1970s; in subsequent decades it became clear that the global economy, and the American economy with it, were caught up in a process of transformation as dramatic and far reaching as the industrial revolution itself.

A New Economic Revolution

Americans today are caught up in a whirlwind of change, and most basic assumptions on which our social policy are based are coming under challenge. Old jobs and old industries are disappearing, and new ones are sometimes frustratingly slow to emerge. Wages for many workers have stagnated as well paid jobs, especially in manufacturing, become scarcer. The percentage of nonfarm workers in manufacturing has declined from a World War II-high of approximately 38 percent to approximately 8.6 percent in 2016, and many clerical jobs have also disappeared.

New technology and competition also have pushed out, and will continue to push out, many legacy 20th century employers and the jobs and job security they provide. For example, nearly 88 percent of the employers featured on the 1955 Fortune 500 list did not make the 2014 Fortune 500 list. The rise and fall of companies like Blockbuster highlight the pace and intensity of change in the 21st century economy.

In addition to the decline of stable companies and the lifetime assurance of stable employment that they brought, the traits that define jobs today vary significantly from the traits that defined mid-20th century jobs. Workers today are no longer guaranteed long careers with a single employer or within a single industry, nor do many of them want to be confined by a lifetime job, and the percentage of the labor force employed by the same company for 20 years or more continues to decline.

Workers today, especially millennial workers, are more likely to “job hop” than past generations. According to the employment-based, social networking website LinkedIn, “the number of companies people worked for in the 5 years after they graduated [from college] nearly doubled” from 1.6 jobs in 1986 to 2.85 jobs in 2010. Polling data has also shown that millennials view job hopping more favorably than

other generations. Gallup found that 60 percent of millennials are open to a new job opportunity (as compared to 45 percent of nonmillennials) and that millennials are the “least engaged generation in the workplace.”

The advent of the technologically facilitated gig economy also has added to the high level of “churn” in the workplace today. The McKinsey Global Institute estimates that between 20 and 30 percent of working-age Americans currently participate in the gig economy. As apps and websites like Uber, Lyft, Airbnb, TaskRabbit, Ebay, and Etsy have become commonplace in our society, there has been a growing acceptance of gig jobs. Indeed, out of the 68 million independent workers in the United States, McKinsey estimates that 72 percent of them chose to be independent workers. As technology continues to engrain gig work into the ethos of American workers—especially younger workers—I believe that gig work will contribute to an increased restlessness in the future workplace and could well become a defining characteristic of the information era.

The structural employment changes that have taken place in the information era have coincided with important societal changes. Americans have a dramatically different concept of retirement than previous generations. American living standards and life expectancy have increased. (In 1935, American average life expectancy was 61 years; by 2016 it had risen to 78.) Now, Americans need enough retirement income to facilitate an active lifestyle defined by travel and leisure. Historically, many people saved to avoid poverty in old age; Americans want more out of their later years—but neither as individuals nor as a society are we making the choices that can sustain these expectations.

At the same time that Americans expect to spend more years, and more active years, in retirement, they are increasingly delaying their entry into the world of work. In 1900, many Americans went to work after eight or even fewer years of formal schooling; more and more young Americans today spend 16 or more years in education before they begin their life’s work. In 1935, many Americans entered the workforce at 15, stopped working at 60, and died soon thereafter. Today, many don’t enter the workforce until they are almost 30, retire between 65 and 70, and live for 15 to 25 years longer. In 1935, Americans spent almost 75 percent of their lives in the workforce; today, we are only in the labor force for about 50 percent of our lifespan, but the income from those years must support the costs of child-raising and the costs of a long retirement. As a people, our savings patterns do not reflect these realities.

In the long run, this pattern cannot be sustained. We must either save more, work longer, or consume less in retirement. Yet even as we contemplate this uncomfortable reality, many Americans feel their choices are constrained. Stagnant or falling wages make it harder for many families to save. The costs of college continue to rise, and ‘degree inflation’ means that more students must spend more years in school—during which time their parents, instead of saving to fund their own retirement, must struggle to support their children in school. Rising healthcare costs continue to press on family budgets. As employers shift insurance costs onto the workforce, and as more gig workers and self-employed people buy insurance in the individual markets, Americans often have a harder time setting money aside for old age.

Two-hundred-fifty years of American history tells us that the Federal Government cannot and will not remain indifferent to the difficulties of the American middle class. But in both agrarian and industrial America, the Government found ways to give an assist to hardworking Americans seeking to build stable and prosperous lives, rather than providing handouts and creating dependencies. Providing a policy framework so that young people could clear the land and start a farm is very different from creating a lifetime income entitlement; supporting the development of a financial system and transportation network so that young families could buy their own homes is very different from offering each citizen a housing voucher.

The question for retirement policymakers in this time of transition isn’t, or shouldn’t be, how to give Americans a retirement that they can’t afford. It is how to set up a system that makes it possible for hardworking Americans to build the kind of future they want through their own efforts.

A New Vision for Retirement

Today, we are caught between an old system that is getting less effective and a new one that is still developing. This is not, of course, just true for the retirement system; it is true of the economy and society at large. But the retirement crisis is rapidly becoming one of the most serious and damaging consequences of the decay of American social order, and the outdated assumptions on which the retirement system relies make matters worse. To put it simply: Our three-legged retirement

system—public savings (*i.e.*, Social Security), employer-provided retirement plans (*e.g.*, pensions)—and private savings and investments—are failing Americans.

It is important to remember that Social Security was never intended to serve as the only source of retirement income for older Americans. Social Security payments were to be supplemented by employer pensions and from individual savings and investments. While Social Security faces some financial challenges, the real problem we see today is that the other two legs of the system are in much worse shape. Increasing numbers of American workers face a future in which Social Security is their only significant source of income in retirement; this places a burden on Social Security, and on the Federal treasury, that will be difficult to bear.

In the Blue Model era, the idea was that for more and more workers, employer-provided pensions would supplement Social Security. From the 1930s to the 1960s, the percentage of workers covered by employer-provided pensions tied to length of service tended to rise. This system fit the needs of a workforce that looked to stable, long-term employment from big business and stable nonprofit employers like hospitals and State and local governments. But as the economy began to change, the private pension system came under increased stress. The percentage of workers covered by employer plans began to decline, and the plans themselves tended to become less generous and less secure.

At the same time, the third leg of the stool, personal savings and investments, is also under stress. Stagnating wages and the rising costs of raising children make it hard for families to save. As Americans delay starting families and raising children until later in life, parents are older when their children start college, and there are fewer ‘empty-nest’ years in which parents, free at last from the financial responsibility of raising their children, are able to focus on funding their own retirements.

Policymakers have, of course, been aware of these problems, and the last few decades have seen a number of initiatives, like the rise of 401(k) programs and the IRA system, to strengthen private pensions and personal savings. Thanks to these programs, a significant number of Americans have more assets for retirement than would otherwise be the case. But those programs have not lived up to the hopes that were placed in them. Only 58 percent of workers today, for example, have access to employer-based retirement plans. Of that 58 percent, fewer than half participate in these plans. At the same time, only 10 percent of workers contribute to private savings plans like IRAs, which were meant to help augment employer-provided retirement plans and Social Security.

As a result, we now face a retirement problem that is both serious and complex. More and more Americans are approaching retirement age without having the savings needed for the kind of retirement they want. Moreover, the millennial generation is currently set on a dangerous course that would make this generation even less well prepared for retirement than their parents and grandparents.

Clearly, our programs for employer-based retirement systems and for encouraging private savings have not accomplished what we hoped they would do. We must think more deeply and act more decisively to create a system that will work in the new economy taking shape around us. The paradigm is shifting and we must shift with it. Just as policy made at the end of the 19th century could not fully account for the needs of the 20th century economy, our new policy model will have to adapt to the profound changes we now face.

While these failures owe something to larger social challenges (hard pressed families are less likely to set money aside for future needs even if such savings are tax-advantaged), there are some ways in which our retirement programs don’t align well with the emerging new economy. In particular, the link between the employer and the individual was at the center of Blue Model era social policy. Firms were expected to provide defined benefit pension plans and promote personal savings, even as firms were expected to handle health care, tax collection, and a variety of other social missions.

With the end of lifetime employment and the shift to a job hopping and gig economy—to say nothing of the decreased stability of many larger firms in an era of global competition and rapid technological change—the employer is losing the capacity to act as the intermediary between the individual worker and Government, while simultaneously being the locus for Government mandates, tax collection, and social policy. For retirement policy especially, the focus needs to be on the individual rather than the employer. Employees will have many employers over the course of a career and, often, many income streams at the same time. The same person may simultaneously be a full-time employee in one job, a part-timer in another, while moonlighting as an Uber driver, renting out a spare bedroom to travelers, or selling goods on eBay. Such a worker still needs to think about retirement, and still has taxes to pay, but there is no single employer who plays a role in this person’s life

comparable to that of, say, General Motors in the heyday of the old industrial system.

Small businesses and the self-employed are particularly poorly served by the current system. These businesses and workers often do not have the time or resources needed to scour the marketplace to find the savings plans best suited to their needs. Nor do employers have the capacity or resources for the complex and often expensive work needed to comply with various Government mandates about how retirement plans work. This has created a perverse economic reality, in which saving for retirement has become a perceived benefit of working for a large corporation that is less attainable for small businesses and the independently employed.

At the same time, we need to understand that the retirement crisis is part of a larger problem of savings. Young workers may not be focused on retirement savings because more urgent needs preoccupy them: student loan repayment, savings for a down payment, healthcare costs, and so forth. We cannot look at retirement savings in isolation from the other economic challenges facing Americans today.

What I propose below is intended to stimulate new thought on the Committee and elsewhere as a new generation of Americans rethinks the foundations of our social contract and economic system. After looking at what a new approach to retirement and related issues might look like, I also offer some suggestions about how we can help members of the 'bridge generations,' people caught up in the transition from the old system to a new one, cope with the challenge of retirement given the financial issues they face.

There are, I believe, two basic things we need to do: first, to begin shifting the tax collection onus and the retirement savings apparatus from employers to private-sector financial institutions. At the same time, we need to blend retirement savings with other forms of savings, so that Americans have multiple, clear-cut avenues toward wealth accumulation in the information era. The creation of a flexible and multifaceted retirement savings system that better aligns with our current and near-term economic conditions and can adapt to the unknown economic conditions of the future will be critical to the 21st century success of the United States.

One way to move toward this goal would be to offer every American citizen and Green Card holder the ability to open an account known as an "American Mobility Account" (AMA).³ These 'one-stop-shop' accounts would be managed and administered with a financial institution, in which employers or independent workers would deposit gross, pre-tax income. Financial institutions would collect and withhold the variety of different taxes that businesses and contractors are currently required to withhold, thereby shifting the tax collection onus from employers and the self-employed to third-party financial institutions. In addition to managing tax collection and withholding, financial institutions would be able to provide a variety of Government-regulated and tax-advantaged financial options within AMAs that promote retirement savings and human capital formation.

With the introduction of AMAs, our tax regime would be better able to accommodate the increasing amount of gig work and job-hopping that I believe will take place in the future. Since all earned income would be deposited into one AMA, an individual could earn income from a variety of different employers, and have a streamlined accounting process. For example, instead of multiple employers filing a collection of W-2 and 1099 forms on behalf of an employee working several gigs, the financial institution would be responsible for compiling all streams of earned income and filing a single reporting form on behalf of the worker.

This system would benefit employers, workers, and Government. On the employer end, AMAs would largely shift the accounting and compliance burdens from employers to financial institutions: an important change that would be particularly beneficial for small businesses, the self-employed, and startups. Additionally, AMAs would help workers comply with tax laws and simplify the task of tax preparation while ensuring that they receive all benefits and credits to which they are entitled. Finally, Federal, State, and local governments would benefit from the increased transparency and accountability that AMAs would provide them. As part-time work and multiple sources of income proliferate (*e.g.*, combined income from Uber driving, eBay sales, Airbnb rentals, *etc.*), tax collection will become more difficult and less fair without reforms along these lines.

The ability to better accommodate self-employed workers who may play a defining role in the 21st century innovation economy is another benefit of an AMA-centered system. In many ways, our current retirement system hinders self-employment since

³"American Mobility Account" and the other, subsequent account names are merely descriptive placeholders. Ideally, these programs would be swept into a simpler package, as the proliferation of programs with complicated names, rules, and eligibility requirements itself becomes a disincentive for individuals to participate.

self-employed workers have to pay the regressive Self-Employment Tax of 15.3 percent, which covers both the employee- and employer-end of the payroll taxes levied against traditional businesses and their employees. While this high tax rate discourages many individuals from pursuing self-employment opportunities, it incentivizes others to avoid taxes altogether. Making AMAs cheap and easy to understand for the self-employed population, enabling the holders of these accounts to benefit from various tax savings and other programs, and increasing penalties for those who pay self-employed individuals outside of the financial system will improve tax collection and reduce monitoring and enforcement costs for the Government. (Such accounts will also make it easier for the self-employed and gig workers to demonstrate their creditworthiness by documenting their income, an important consideration for promoting home ownership).

Additionally, to promote retirement savings, a Supplemental Retirement Account (SRA) would be embedded within an AMA. A certain percentage of an AMA-holder's monthly income would be deposited automatically into the SRA. The deposited income could only go toward saving for retirement, with all SRA holdings initially defaulted into a Roth IRA savings plan. AMA-holders would be able to opt out of their monthly SRA deposits, change to a different retirement savings plan with different tax preferences (*e.g.*, a traditional IRA), or further diversify their SRA holdings into several different savings plans.

An SRA would solve the issue of workers lacking access to employer-supported retirement plans. Moreover, employers could be given tax incentives to encourage contributing toward employee SRAs, thereby addressing some of the major issues with current individual retirement savings accounts. Further, SRAs would reduce costs for employers since they will no longer need to maintain retirement plans of their own, thereby leveling the competitive playing field for small businesses and startups. Means-tested Government programs to promote retirement savings for low-income workers could also be more effectively and transparently administered through the use of these accounts.

Finally, AMAs would promote human capital formation to augment the financial security provided by retirement savings. For example, much like an SRA, a worker could choose to deposit a certain percentage of his or her paycheck into an embedded Human Capital Account (HCA). In turn, individuals could spend HCA monies on certain items deemed important to enhancing individual financial security (*e.g.*, job training, professional licensing, college education, *etc.*) in a tax-free or tax-preferred fashion up to a lifetime maximum limit.

The formation of human capital will be vital to growing wealth in the future. Giving Americans the opportunity to use savings to take the future version of today's coding class, for example, will be imperative to both their success and to the success of the Nation, and is in line with past social policies like the creation of land grant colleges during the Green Model years. Following the example of the very successful Singaporean Central Provident Fund, the accounts can also contribute to wealth creation. Through its public social security scheme, which allows Singaporeans to finance the purchase of homes with retirement savings, the Singaporean government has increased home ownership to 90 percent. A simple homeownership savings account option would encourage financially sustainable homeownership and wealth accumulation in the United States. During the housing bubble, well-intentioned lawmakers and officials tried to promote better access to home ownership by relaxing the criteria needed to qualify for a mortgage. It would be much better policy to encourage home ownership by helping more people to qualify legitimately under existing, prudential rules.

In sum, the introduction of AMAs would better fit the current and future direction of our 21st century economy. The transition would not happen overnight, and a variety of regulatory mechanisms and changes would need to be put into place to make sure that this plan would benefit all Americans in a fair and transparent way. Finally, there would need to be incentives to encourage the adoption of AMAs among employers, workers, and financial institutions, as an outright mandate would be too disruptive in the near-term.

Reducing the Costs of Retirement

While the introduction of AMAs would help transition the United States from an outdated, employer-based system and increase saving for retirement, the reform is primarily geared toward younger and future generations of workers. In order to enhance retirement security for Americans, policymakers must enact reforms that help older generations of workers successfully retire during the transition.

On the front end, we should allow workers later in their careers to accelerate their savings. It is human nature to postpone thinking about retirement, and, in any case, younger people often have more immediate needs, whether this involves

paying off student loans, buying a home, or caring for their children. Older workers often have more discretionary income, fewer calls on their resources, and a greater focus on the need to save for retirement. Government policy should aim at creating more tax deferred savings opportunities for these people. It is good social policy to encourage savings, and greater savings equate to retirees being better prepared to handle retirement costs. Current policy allows older workers to accelerate their contributions to retirement plans; those allowances should increase.

Many seniors today are not only physically capable of working longer, but they also want to work longer as they find work fulfilling and intellectually stimulating. Advances in medicine and in technology, such as driverless cars and enhanced telework capabilities, will make it easier for older generations of Americans to continue to work well into old age. To encourage more capable seniors to work longer, the Government should eliminate the Social Security Payroll Tax for seniors and delay the age requirement (generally 70 ½-years old) that triggers mandatory withdrawals from retirement savings plans. To increase the attractiveness of tax deferred savings plans to lower income Americans—those who have the hardest time saving for retirement and most need the financial security that those savings provide—income from tax-deferred investments below a certain (low) threshold should also be tax free.

Government could also enhance the menu of retirement options available to seniors who cannot or do not want to work longer. Promoting retirement abroad, where income that can barely cover a trailer home in Florida can equate to a luxury condominium in Costa Rica or Mexico, is an easy way to give seniors comfortable retirements. Today, Medicare does not cover health care received abroad, except for in an extraordinarily limited set of circumstances. This lack of healthcare coverage is a major barrier to retiring abroad. Though health care and prescription drugs can be far cheaper in Latin America and the Caribbean (LAC), serious illness is a financial issue anywhere, and, as younger and active retirees become older and more frail, they often have to return to the United States to obtain better services, which hinders permanent and/or semipermanent retirement abroad.

Helping seniors move to countries where costs are low could reduce Medicare costs and give seniors more choices during the transition from the Blue Model retirement system to a new retirement system. To that end, the Federal Government should smooth the path for seniors looking to retire abroad. Congress should pass legislation to allow Medicare to cover eligible seniors using certified, inspected, and qualified providers. Medicare payments should be lower to these providers, reflecting different cost levels.

Conclusion

Much as they did during the transition from the Green era to the Blue era, Americans find themselves at an important, historical inflection point. Like the Industrial Revolution, the Information Revolution has disrupted the economy in unpredictable, complex, and far-reaching ways. Not all of the changes to come can be predicted or understood today, but there is an immediate need to craft policies to account for those changes we can discern before the consequences of the failures of the current system become unbearable. Adopting a system of retirement policies that shifts the burden of taxation and collection from employers to financial institutions while protecting the retirement security of those caught in the gap would do much to promote the emergence of a dynamic new form of the classic American Dream in the 21st century.



Securing Our Financial Future:

Report of the Commission on Retirement Security and Personal Savings

June 2016

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ACKNOWLEDGMENTS

The commissioners and BPC staff are grateful to the many individuals who assisted our work. Stephen C. Goss, Chief Actuary of the Social Security Administration, and his team at the Office of the Chief Actuary provided estimates of the impact of the commission's Social Security proposals on program finances. Karen Smith, Senior Fellow at the Urban Institute, analyzed the distributional impacts of proposals to reform Social Security and expand access to workplace retirement savings plans using the DYNASIM3 microsimulation model. Lisa Mensah served on the commission in 2014 prior to her confirmation as Under Secretary for Rural Development at the U.S. Department of Agriculture. Jack VanDerhei, Research Director of the Employee Benefit Research Institute, provided technical assistance to the commission. Joshua Gotbaum, Guest Scholar at the Brookings Institution, supplied many useful insights. Numerous other experts offered valuable feedback throughout the process. BPC's Emma Weil provided administrative support during the final stages of completing this report. Former BPC staff members Alex Gold, Kelly Isom, and Zuzana Jerabek made substantial contributions to the commission's work. Jordan Berne, Jack Ramatta, Kelly Turner, and Jillian Zook contributed to this project during their internships at BPC. Marika Tatsutani assisted with editing this report.

DISCLAIMER

This report is a product of BPC's Commission on Retirement Security and Personal Savings. The findings expressed herein are those solely of the commission, though no member may be satisfied with every formulation in the report. The findings and recommendations expressed herein do not necessarily represent the views or opinions of the Bipartisan Policy Center's founders or its board of directors.

Table of Contents

5	Letter from the Co-Chairmen
6	Executive Summary
14	Mission Statement
15	Introduction
17	Six Challenges for Retirement Security and Personal Savings
38	Recommendations:
38	I. Improve Access to Workplace Retirement Savings Plans
58	II. Promote Personal Savings for Short-Term Needs and Preserve Retirement Savings for Older Age
61	III. Facilitate Lifetime-Income Options to Reduce the Risk of Outliving Savings
69	IV. Facilitate the Use of Home Equity for Retirement Consumption
74	V. Improve Financial Capability Among All Americans
78	VI. Strengthen Social Security's Finances and Modernize the Program
101	Conclusion: A Comprehensive Package of Proposals to Improve Retirement Security
104	Appendix:
104	A. Detailed Policy Specifications
114	B. Detailed Specifications for Modeling Commission's Social Security Proposals
117	C. Measuring and Projecting Retirement Outcomes

Letter from the Co-Chairmen

A large segment of Americans struggle to save for any purpose. Millions are anxious about their preparation for retirement as well as their difficulty accumulating a savings cushion for short-term unexpected needs. Policymakers are concerned about the consequences of insufficient retirement savings for individuals, families, and the nation. Recent economic headwinds — stagnating wages and weak economic growth — have heightened these anxieties.

The nation's retirement system has many strengths, but it is also experiencing challenges. Retirement and savings policies have evolved over the decades into a true public-private partnership. Assets in workplace retirement savings plans and Individual Retirement Accounts (IRAs) have grown dramatically over the last four decades, but too many Americans are still not preparing adequately. Social Security remains the base of financial support in old age for most Americans, yet the program faces substantial financing problems. A long history of bipartisanship built these systems to promote savings and improve retirement security, but much work lies ahead.

To address these challenges, the Bipartisan Policy Center launched the Commission on Retirement Security and Personal Savings in 2014. Over the last two years, our 19-member commission has carefully reviewed the issues and explored many potential approaches to boost savings and strengthen retirement security.

Members of the commission possess considerable expertise about the U.S. retirement system — including Social Security, employer-sponsored retirement plans, and personal savings. They have a variety of backgrounds and relevant experiences, including operating businesses and sponsoring employee-benefit plans, administering state and federal government agencies, serving as elected officials, advocating for workers, advising large companies on their retirement plans, and conducting research on savings and retirement policy. We thank them for their commitment and willingness to find common ground.

No relevant policy idea was off limits. Commissioners considered many ways to build on strengths and address weaknesses in savings and retirement security. Our deliberations benefited from extensive modeling simulations, conducted for us by the Urban Institute. They showed the impact of various policies on savings and income for older Americans. Results of these simulations are included throughout the report.

All commissioners came to the Social Security discussions with strongly held views. Therefore, not surprisingly, our Social Security negotiations were particularly challenging. In the interest of encouraging compromise and informing the public debate, the commissioners operated under the restriction of a roughly 50-50 balance between increased revenues and changes to benefits in future years. Not all commissioners agree with this constraint. Some want proposals with more revenues, while others prefer greater changes to benefits compared to current policy. Nevertheless, all signatories to the recommendations agree that if the constraint of a 50-50 balance between increased revenues and changes to benefits in future years is adhered to, then the Social Security package put forward by the commission is a balanced, effective and good set of proposals.

We are encouraged that the issues of savings and retirement security have attracted bipartisan interest among business leaders, the media, elected officials in Congress, the administration, and the states, as well as from candidates seeking public office. We hope that the commission's recommendations will contribute to meaningful action by individuals, businesses and government to achieve a secure retirement future for all Americans.

Sincerely,



JAMES B. LOCKHART III



KENT CONRAD

Executive Summary



Retirement challenges dominate media headlines and present policymakers with a tremendous opportunity for action. Tectonic shifts in demographics, policy, and the marketplace have transformed the U.S. retirement landscape. The most profound change has been an ongoing shift by many employers from defined benefit pensions to defined contribution plans. As a result, 401(k) — previously an obscure section of the tax code — has become a household name.

Workers have found themselves part of a great experiment — one that has given individuals and families far more control and responsibility for financing their own retirement, and simultaneously exposed them to greater risk. Some families are preparing appropriately, but others struggle to save for retirement while meeting competing, and often more-immediate, personal needs related to emergencies, homeownership, and education.

As average longevity increases, Americans need to save more or work longer if they hope to maintain their standard of living during retirement. While Social Security, the foundation of the U.S. retirement income system, is paying benefits over more retirement years, the current benefit schedule is underfunded.

Given all of these changes and risks, it is no surprise that Americans are anxious about retirement. Many are uncertain about what they should do to prepare. As the retirement system evolves, Americans need up-to-date guidance and better information to navigate a path to long-term financial security.

Today, more than in the past, personal responsibility is of central importance in retirement preparedness — individuals and families can't afford to take a passive approach to retirement savings — but that doesn't mean everyone should be or can be on their own. People

need the assistance of a well-designed system as they accumulate, invest, and spend down their retirement savings. Public policy has a critical role to play in facilitating savings and a secure retirement.

This report presents a comprehensive package of bipartisan proposals to address six key challenges:

- Many Americans' inability to access workplace retirement savings plans;
- Insufficient personal savings for short-term needs, which too often leads individuals to raid their retirement savings;
- Risk of outliving retirement savings;
- Failure to build and use home equity to support retirement security;
- Lack of basic knowledge about personal finance; and
- Problems with Social Security, including unsustainable finances, an outdated program structure and failure to provide adequate benefits for some retirees.

Taken together, the recommendations contained in this report aim to establish a better savings culture and renew the promise of an adequate retirement — across the income spectrum — for current and future generations of Americans.

Improve Access to Workplace Retirement Savings Plans

Too many Americans, especially those who work for small businesses, lack access to a payroll-deduction workplace retirement savings plan. This is partly because offering such plans entails burdens and costs that employers may be unwilling or unable to bear.

We recommend the creation of a new, streamlined option called *Retirement Security Plans* that would allow small employers to transfer most responsibilities for operating a retirement savings

plan to a third-party expert, while still maintaining strong employee protections. We would also enhance the existing myRA program to provide a base of coverage for those workers, such as part-time, seasonal, and low-earning workers, who are least likely to be offered a retirement savings plan.

Other workers have access to retirement savings plans but do not contribute. We propose an alternative to nondiscrimination testing along with new tax incentives to encourage employers to adopt automatic enrollment and escalate their employees' contributions over time.

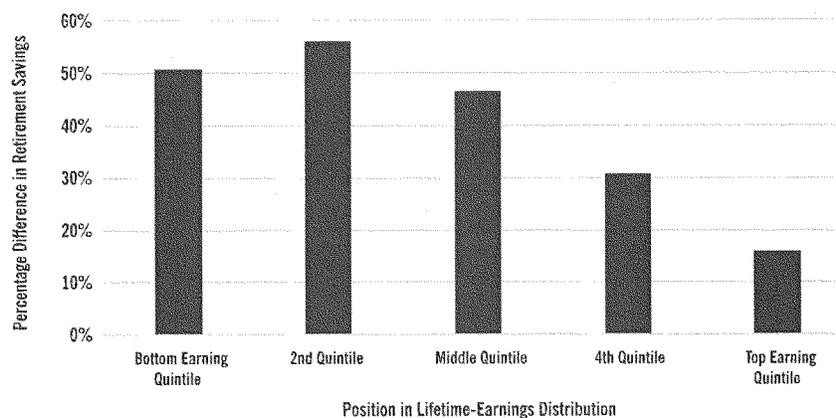
Once these reforms are in place, we recommend establishing a nationwide minimum-coverage standard to pre-empt the patchwork of state-by-state regulation that is already developing. Beginning in 2020, employers with 50 or more employees that do not already offer a retirement plan that meets certain minimal thresholds would be required to automatically enroll employees into a new Retirement Security Plan or myRA. This would ensure broad access to workplace retirement savings plans while minimizing the burden for employers. Employees would have the ability to change contribution amounts or opt out of contributing entirely.

A variety of additional reforms could support greater access to retirement savings plans and improve the experience of plan participants. We would encourage lower-earning individuals to save for retirement by improving the existing Saver's Credit for younger workers and by exempting some retirement savings from asset tests to qualify individuals for certain federal and state assistance programs. We also recommend several additional actions, including the creation of a Retirement Security Clearinghouse to help Americans consolidate their retirement savings, steps to limit over-exposure to company stock, and modest adjustments to retirement tax expenditures.

Multiemployer defined benefit plans, which are organized by more than one employer and a labor union, are experiencing financial challenges. We recommend the creation of *Lifetime Income Plans* — a new, more-sustainable retirement-plan design that could

Figure 1. Retirement Savings for Lower- and Middle-Earners Grow Significantly Under Minimum-Coverage Standard

Projected change in retirement savings among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings.



Note: Retirement savings include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets. Modeling assumptions and methods are discussed on page 47.

Source: The Urban Institute - DYNASIM3

be adopted on a voluntary basis. This new plan design would blend the strengths of defined benefit and defined contribution plans by incorporating elements of both approaches.

Promote Personal Savings for Short-Term Needs and Preserve Retirement Savings for Older Age

Americans need to increase their personal savings so that they are better positioned to handle emergencies and major purchases. Insufficient short-term savings can lead workers to draw down

their retirement accounts, incurring taxes and (often) penalties.

This “leakage” of retirement savings — while it might address an immediate financial squeeze — jeopardizes many Americans’ long-term retirement security. To address this issue, we recommend clearing barriers that discourage employers from automatically enrolling their employees in multiple savings accounts, one for short-term needs and another for retirement.

Some leakage of retirement savings results from system complexity and poorly designed regulation. We propose to ease the process for transferring savings from plan to plan, because many pre-retirement

withdrawals occur upon job separation. In addition, early-withdrawal rules and penalties for workplace plans and Individual Retirement Arrangements (IRAs) should be harmonized by raising IRA standards.

Reduce the Risk of Outliving Savings

Longevity risk, the possibility that retirees will outlive their savings, is a growing and significant threat to retirement security. Social Security, defined benefit pension plans, and life annuities from insurance companies all leverage the power and efficiency of mortality pooling to help individuals manage the risk of longevity. Yet many defined benefit plan participants choose a lump-sum distribution instead of monthly income for life, and few purchase life annuities with their retirement savings. While Social Security provides a form of lifetime income, Social Security benefits alone will not be adequate to meet all income needs for most retirees. For those who have accumulated sufficient savings, other lifetime-income solutions offer the security of an added, regular retirement income that they cannot outlive.

We recommend that plan sponsors integrate sophisticated but easy-to-use lifetime-income features within retirement savings plans. For example, it should be easy for plan participants to purchase a guaranteed lifetime-income product in automatic installments. Plan sponsors could establish a default lifetime-income option or offer an active-choice framework, in which participants are asked to choose options from a customized menu. In-plan tools could also help participants make an informed decision about when to claim Social Security benefits and then to schedule withdrawals from their retirement plan to facilitate later claiming of Social Security benefits. We believe employers need safe harbors to limit their legal risk as they offer these features and attempt to educate workers about longevity risk and lifetime income.

Additionally, we recommend clearing barriers to offering a wider array of choices for lifetime income in both retirement savings and pension plans. In defined contribution plans, participants aged 55 and older should be allowed to use their retirement savings to purchase

annuities that begin payments later in life. Workers with defined benefit pensions should be able to receive part of their benefit as a lump sum and the rest as monthly income for life, rather than the all-or-nothing choice most have today. Also, to encourage participants to work longer and provide more-consistent work incentives, we recommend allowing employer-sponsored retirement plans to align plan retirement ages with Social Security.

Facilitate the Use of Home Equity for Retirement Consumption

Housing is an important form of savings. Americans own more than \$12.5 trillion in home equity — a sum that rivals the \$14 trillion that Americans hold in retirement savings.^{1,2} For individuals or couples who lack substantial savings in a retirement plan but who own their residence, homeownership can be a major source of retirement security. A variety of mechanisms exist for tapping home equity to fund regular consumption needs in retirement; for example, homeowners can downsize, use a reverse mortgage, or sell their home and rent instead. These approaches have advantages and drawbacks; retirees with home equity should be aware of the available alternatives and have independent advice to make an appropriate choice for their circumstances.

Federal and state tax policy, however, actually subsidizes the use of home equity for pre-retirement consumption, leaving many retired homeowners burdened with debt and with less equity to support retirement security. We recommend ending these subsidies by eliminating tax benefits for borrowing that reduces home equity.

We also propose to strengthen programs that support and advise consumers on reverse mortgages, which can be a good option for some older Americans. Establishing a low-dollar reverse-mortgage option would facilitate smaller loans while reducing fees for borrowers and risk for taxpayers.

Improve Financial Capability Among All Americans

Financial capability — defined as having the knowledge, ability, and opportunity to manage one's own finances — is lacking among too many Americans.^{3,4} This is a troubling fact at a time when the nation's retirement system has transitioned toward greater individual control and responsibility.

Exposure to financial knowledge and planning should begin early in life, with schools, communities, employers, and federal and state governments all working to foster a culture of savings and to position individuals to make prudent financial choices. We support a variety of approaches, including implementing recommendations from the President's Advisory Council on Financial Capability, providing improved personal financial education through K-12 and higher-education curricula, and better communicating the consequences of claiming Social Security early. For example, renaming the earliest eligibility age, currently age 62, as the "reduced benefit age" would better highlight the lower monthly benefits that result from early claiming.

Strengthen Social Security's Finances and Modernize the Program

Social Security provides the income foundation for many older Americans, but to maintain that legacy, prompt adjustments to the program are needed. For decades, the program's trustees have affirmed the need for changes, noting that Social Security faces significant financial challenges. In 2015, the trustees recommended "that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes gradually and give workers and beneficiaries time to adjust to them."⁵ Moreover, Social Security has not been updated to reflect a 21st century workforce and society.

Uncertainty about Social Security's future magnifies the anxiety that many Americans experience as they plan and prepare for retirement. That is why any comprehensive effort to improve retirement security must shore up and modernize the program.

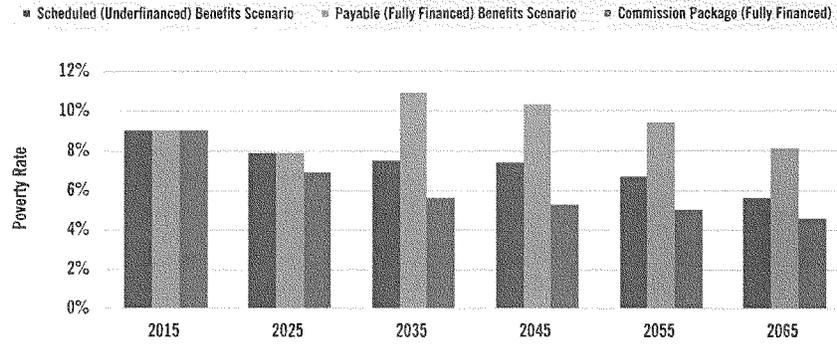
We recommend adjustments to Social Security's tax and benefit levels to 1) reflect changing demographics; 2) better target benefits on those who are most vulnerable in old age, including surviving spouses and workers in low-earning occupations; 3) preserve reasonable intra- and inter-generational equity; and 4) more fairly reward work. Americans ought to know what they stand to gain from extending their working lives and claiming benefits later — both of which are highly effective ways for individuals to raise their retirement income. Clearer work incentives in the Social Security program would increase understanding of these options and promote better decisions.

What Do "Payable" and "Scheduled" Mean?

Under current law, if Social Security's trust funds are empty, the program cannot spend more on benefits than it is collecting in revenues. The program's trustees project that savings in the trust funds will be depleted by 2034.⁶ Any proposal to adjust Social Security benefits is typically compared with two post-2034 scenarios: scheduled benefits and payable benefits. These terms are confusing to many. The payable scenario assumes that, once trust fund savings are depleted, benefits will be limited to levels that could be financed with funds from existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits will be paid according to the existing benefit formula despite insufficient Social Security tax revenues to finance these benefits. Under current law, such benefits cannot be paid.

Figure 2. Commission's Social Security Proposals Would Reduce Poverty Among Older Americans

Projected poverty rates among individuals aged 62 and older under various Social Security scenarios: benefits payable under current law, scheduled (but underfinanced) benefits, and the commission's proposals.



Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient Social Security tax revenues to finance these benefits.

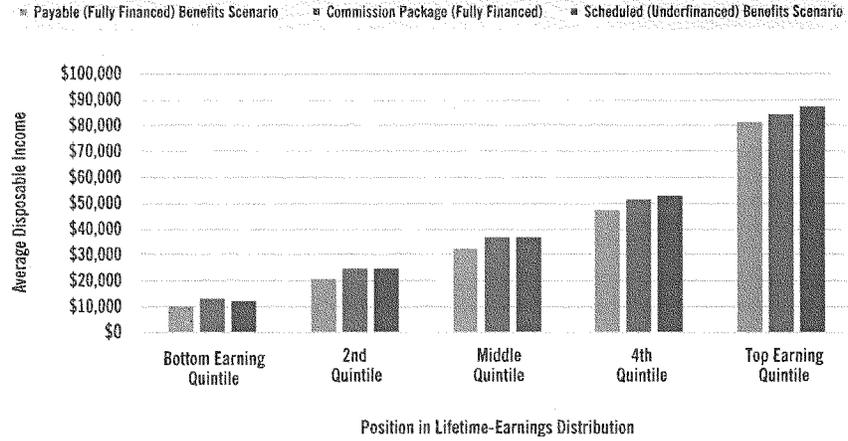
Source: The Urban Institute – DYNASIM3

The good news is that shoring up Social Security is feasible. But, taking the needed actions requires political leadership — and sooner rather than later. The cost of fixing the program grows as corrective action is delayed. A package of reforms that balances changes to scheduled benefits, which cannot be financed by current dedicated taxes, with changes to revenues would renew the promise of Social Security and reassure Americans that the program will remain strong for decades to come.

Our recommendations on Social Security, pensions, and other savings complement one another in a variety of ways. In particular, the measures that we have proposed to expand workplace retirement savings and to reform Social Security would maximize retirement-security outcomes. Taken together, our recommendations would achieve incomes for older Americans that are above payable-benefit scenarios throughout the lifetime-earnings distribution.

Figure 3. Commission's Proposals for a Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Achieve Incomes for Older Americans At or Above Scheduled Levels for Both Lower- and Middle-Earners

Projected average disposable income (in 2015 dollars) among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission's Social Security proposals.

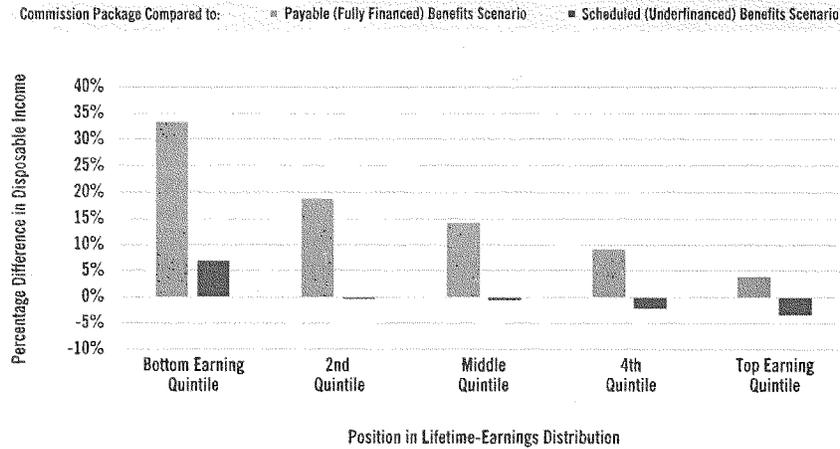


Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

Figure 4. Commission's Proposals for Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Increase Progressivity and Protect Lower- and Middle-Earners from Abrupt Changes

Projected change in disposable income for individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission's Social Security proposals.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

As **Figure 4** shows, these proposals would especially benefit lower earners and would protect Americans across the earnings spectrum from the damaging reductions in old-age income that would otherwise result if Social Security benefits were limited to levels that are payable with existing Social Security taxes.

Thus, our recommendations aim to bring peace of mind to Americans preparing for retirement by assuring the financial sustainability of the Social Security program and by significantly

expanding access to workplace retirement savings plans. Together, these changes would help many more workers take charge of their financial futures.

We understand that the problems discussed in this report will be challenging for policymakers to address. But, policymakers also have a compelling opportunity to improve the retirement security of all Americans. We hope that this report strengthens the impetus for action.

Mission Statement

The Commission on Retirement Security and Personal Savings seeks to forge a bipartisan consensus in support of policies to facilitate savings for retirement and other purposes and strengthen retirement security in the United States. All Americans should be able to retire with dignity — workplace retirement plans and other private savings should supplement a strong and reliable Social Security program to ensure that after a lifetime of hard work, no one has to spend their retirement years in poverty. To that end, the commission proposes a comprehensive package of policies to expand and improve private retirement savings plans, strengthen the finances of and increase the progressivity of Social Security, and establish a better savings culture by enhancing financial capability. If implemented, these reforms would renew the promise of a comfortable retirement, across the income spectrum, for current and future generations of Americans.

Introduction



America's savings and retirement security challenges are real, serious, long-standing, and complex. Nonetheless, they can be addressed in ways that would meaningfully improve outcomes.

Since the implementation of Social Security in 1937, the public and private sectors have made steady progress addressing these problems. More remains to be done, however, to help Americans reach old age with sufficient resources. Lower- and middle-earners make up a large share of those who are not on track to save enough for an adequate retirement, but some workers at higher earnings levels are also failing to prepare adequately. In addition to savings shortfalls, significant insurable risks — such as the risk of outliving savings or of needing expensive long-term care — can jeopardize

retirement security. Yet these risks are typically not addressed effectively.

Many of the most promising solutions to these problems have been vetted extensively and have attracted bipartisan support among stakeholders and elected officials. Some of these solutions also build on experience in the marketplace. Decades of continuous innovation by the designers and administrators of public programs and private-sector retirement plans are producing a growing evidence base for what works.

The intent of this report is not to reinvent the wheel, but rather to demonstrate broad support for a creative and thoughtful package

of reforms. Some of these approaches are favored by liberals, while others are favored by conservatives — many are supported by both. No one-size-fits-all solution will guarantee retirement security across the board. Different income levels and individual situations call for a variety of approaches, but every American should have the opportunity to retire with financial peace of mind.

Access to a supplemental workplace retirement plan is crucial for employees, so reforms must address the cost and regulatory barriers that discourage employers from offering such plans. Policymakers should streamline the process for offering employer-based plans to the greatest extent possible, while assuring the rights and protection of workers.

As recent experience has shown, plan design matters. More-widespread implementation of auto-features and new innovative approaches to lifetime income, facilitated by ongoing technological advances, could help millions to save more and enable those savings to last throughout retirement.

Savings for emergencies and other short-term purposes also deserve attention. Policymakers and employers should apply many of the lessons learned from retirement plans to better facilitate savings for rainy-day funds. Additionally, home equity is an important form of savings that has the potential to contribute more to retirement security.

Because individuals and families are ultimately responsible for their own retirement, a central purpose in any reform should be to improve opportunities, guidance, protections, and financial capability in ways that empower Americans to take actions that better prepare them for retirement.

Finally, the current financing outlook for Social Security is unsustainable. Dedicated revenues for the program are insufficient to finance scheduled benefits. The time to protect Social Security, the bedrock of the U.S. retirement system, is now. Significant changes to the program are unavoidable, and workers need to know what to expect in order to plan appropriately. This can be achieved with

balanced adjustments to the program that enhance progressivity, reduce poverty, and strengthen incentives to work.

Long-term problems demand commensurate solutions. These issues will not be resolved overnight; rather, they require ongoing attention and further adjustments as knowledge and circumstances change.

A variety of metrics are needed to ensure that the changes we have proposed meet our intended goals, such as reducing poverty and increasing the share of Americans who maintain their standard of living in retirement. Computer simulations conducted for the commission show that the solutions included in our recommendations hold promise for achieving substantial progress toward both these targets.

The potential to improve retirement security through near-term public policy measures is great. The biggest mistake — indeed, the worst outcome for savings and retirement preparedness — would be to do nothing. Elected officeholders and administration officials should commit to taking meaningful action to address these challenges by the end of 2017. Bipartisan cooperation and leadership from public officials, the business community, labor, and community organizations can build a better savings and retirement future for the nation.

Six Challenges for Retirement Security and Personal Savings



Social Security, private savings, and employer-provided pensions are often referred to as the “three-legged stool” of retirement security in the United States. The traditional story is that a person works a full career, earns a guaranteed Social Security benefit and an employer pension, sprinkles some retirement savings on top and voila — they’re all set! But the real world never was that simple, and today many Americans feel the legs of that stool crumbling beneath them. In fact, a recent Gallup poll found that not having enough money for retirement is the primary financial concern for most Americans.²

Many are right to worry. Various measures indicate that a large proportion of American workers will experience a lower standard of living in retirement.³ Some older individuals who might face financial

hardship have been poor throughout their working lives, but many who have been solidly middle class are similarly unprepared.

Numerous factors and decisions can contribute to retirement insecurity. Many workers do not have access to an employer-sponsored retirement plan. Others are offered a plan, but choose not to participate or make insufficient contributions. Some invest too conservatively and do not earn a sufficient return, or withdraw much of their savings early to meet non-retirement needs. Those who leave the workforce in their fifties or early sixties may find themselves funding a longer period of retirement with inadequate savings. Some Americans enter retirement with significant debt, raising their costs compared to retirees who have paid off their credit

cards and mortgage. Even people who have saved heavily, invested appropriately, and entered retirement debt-free may unexpectedly outlive their savings or confront the sudden need for costly long-term services and supports (LTSS). These risks are common, yet few take action to insure against them. Finally, changes to Social Security and Medicare could affect all Americans, depending on how policymakers address these programs' unsustainable finances. Uncertainty about future program benefits and taxes makes planning for retirement increasingly difficult.

Every American is responsible for making financial decisions and planning for retirement, but today's complex system can easily frustrate even motivated savers. Given that most hard-working Americans are not financial experts and have many other priorities competing for their resources, doing the "right" thing — or even figuring out what the "right" thing is — can be extremely daunting.

Before advancing solutions, it is important to understand the six overarching challenges that threaten retirement security and personal savings for Americans from all walks of life.

Too Many Americans Lack Access to Workplace Retirement Savings Plans

The past several decades have seen a paradigm shift in the retirement landscape, with *individuals* becoming increasingly responsible for their own retirement readiness. The challenges of financing defined benefit (DB) retirement plans have driven a long-term movement toward defined contribution (DC) plans.

Traditional DB plans guarantee covered employees (who meet a minimum-service requirement) a specified portion of their salary from the time they retire until the end of their life.⁹ Under a DB plan, the employee's income security depends on the employer setting aside and properly managing adequate funds. A DC plan is adequately funded by definition, but it shifts far more responsibility to employees. Typically, workers must decide whether to participate at all, how much to contribute to their individual account (often supplemented by an employer contribution or match), and how

to manage both the investment and the ultimate distribution of retirement funds. Not every American feels comfortable handling these decisions, or even understands all the risks and benefits involved.

Traditional DB plans provide great value for individuals who work under them for many years, retire, and qualify for benefits. But, these plans typically base benefits on a worker's average earnings toward the end of the period of plan coverage. This approach disadvantages DB-plan-covered workers who are laid off or leave their job many years prior to retirement eligibility, or who participate in a DB plan that is closed by their employer mid-career. These workers' benefits are almost always badly eroded relative to either wage gains or price inflation between the time when covered employment ends and the worker begins to actually claim benefits.¹⁰ Traditional DB plans have many positive features, but they also come with certain limitations and pose inherent problems for workers in many real-world situations.

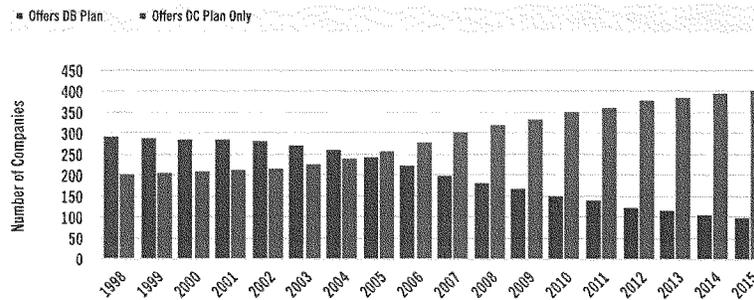
When 401(k) plans were introduced in 1978, they were designed to supplement DB plans, not replace them. Over time, however, employers realized that DC plans could help employees accrue significant retirement savings without the generally higher cost and risk to the employer of sponsoring a DB plan. The number of private-sector participants in active DB pension plans has dropped steadily since the early 1980s, while participation in active DC plans — like 401(k) and 403(b) plans — has risen sharply.¹¹ Today, the vast majority of plan participants are in DC plans.¹² Those plans now hold more than double the assets of private-sector DB plans: \$6.7 trillion compared to \$2.9 trillion.¹³

Making Sense of the Many Flavors of Defined Contribution (DC) Plans

Workers today are confronted by a bewildering array of DC plans, many of them with opaque names — like 401(k) — that refer to particular sections of the tax code. However, the common features of these plans outweigh their differences. All of them allow for employers and employees to contribute to a tax-advantaged retirement savings account. 401(k) plans are a form of workplace retirement savings plan offered by for-profit businesses. Not-for-profit entities and certain governmental employers may offer retirement savings plans to employees through a 403(b) plan. Other governmental employers are allowed to use 457 plans. There are differences, some subtle, but the main feature is the same — the ability to defer income taxes on savings for retirement.

Figure 5. Employers Have Transitioned to Defined Contribution Retirement Plans

Number of Fortune 500 companies offering plan type.



Note: "DB plan" includes companies that offer traditional defined benefit plans or cash balance plans. Many of these companies offer a DC plan in addition to a DB plan.

Source: Willis Towers Watson¹⁴

Many state and local governments still provide their employees with DB plans. These plans are not subject to federal funding requirements and benefits for participants are not insured. Many government-sponsored DB plans are severely underfunded, which has raised concerns about whether and how benefits will be paid.¹⁵

Unsurprisingly, access to a workplace retirement savings plan can be

a strong predictor of workers' financial preparedness for retirement. Take moderate-income Gen-Xers, for example. According to projections from the Employee Benefit Research Institute, 56 percent of those without ongoing access to a DC retirement plan will run short of money in retirement.¹⁶ In contrast, only 12 percent of those who will have access to a DC plan for at least 20 more years will run short.¹⁷ These projections are reinforced by survey data. The vast

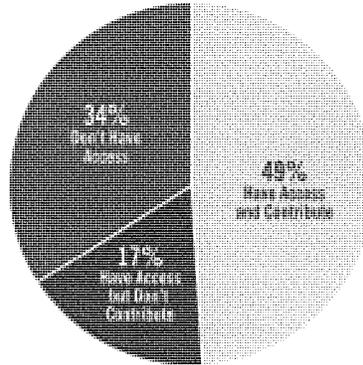
majority (74 percent) of Americans who have a workplace retirement savings plan or an Individual Retirement Arrangement (IRA) say they are either very or somewhat confident of having enough money to live comfortably throughout their retirement years. Only 39 percent of those who do not have such a plan or IRA are similarly confident.¹⁸

Yet, tens of millions of American workers lack access to retirement plans. Some employers choose not to sponsor plans, while others limit eligibility to certain employees. Even among workers who have access to a plan, many choose not to participate.

About two-thirds of private-sector workers have access to an employer-sponsored retirement plan of some sort. Among these workers, about three-quarters sign up, which means that only around half of all private-sector workers participate in a plan.¹⁹ As a result, for too many workers, the pension leg of the retirement security stool is either too short or simply does not exist.

Figure 6. Less than Half of Private-Sector Workers Participate in a Retirement Savings Plan

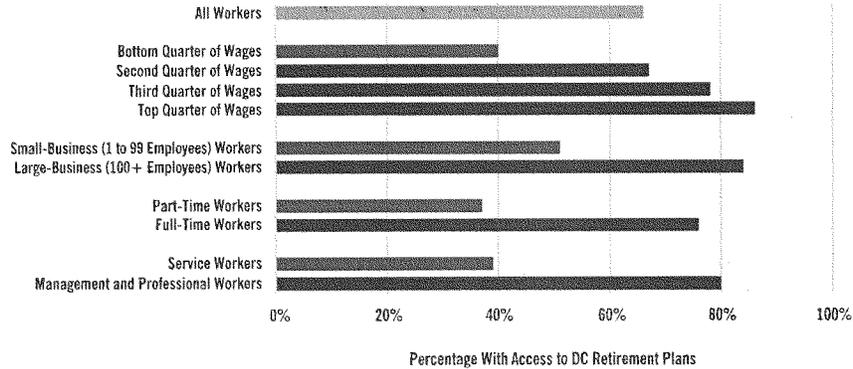
Access to workplace retirement savings plans among private-sector workers.



Source: U.S. Bureau of Labor Statistics²⁰

Figure 7. Some Workers Have More Access to Savings Vehicles than Others

Private-sector workers with access to DC retirement plans.

Source: U.S. Bureau of Labor Statistics²⁴

Certain types of workers — like those in the service industry, in part-time or low-wage jobs, or at small firms — disproportionately lack access to workplace DC plans.²¹ A 2012 study found that 71 percent of employees at relatively large private-sector firms (at least 100 employees) participated in a retirement plan, compared to just 42 percent at smaller firms.²²

Although workers who lack access to workplace DC plans can open an IRA, the fact is that few choose to do so. The vast majority of new retirement savings contributions go into workplace DC plans. In 2012, contributions to private-sector DC plans — at around \$329 billion — were roughly 10 times larger than IRA contributions, which totaled just \$34 billion.²³

One major reason for this lack of access is that retirement plans are complicated and burdensome to administer, which can discourage businesses from offering them. Red tape and increased costs await employers that choose to sponsor a plan. An employer must select from a variety of plan designs; document the plan;

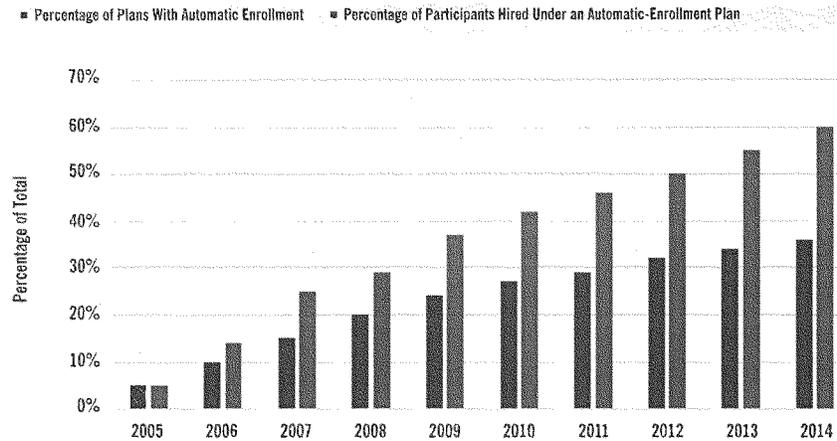
hire a trustee; establish a recordkeeping system; and accept a degree of fiduciary responsibility, which means the employer must act prudently and in the sole interest of participants. In addition, employers are responsible for negotiating and controlling the fees associated with their employees' accounts. Some of these administrative costs fall on the employer, while others are passed on to participants.

If this sounds like a lot for a business to take on, that's because it is. Firms with high worker turnover or firms that primarily employ part-time or lower-earning workers may be especially disinclined to offer a plan. These types of employees often prioritize higher wages, health insurance, or other benefits over a retirement plan.

Over the past decade, however, there have been significant innovations in DC-plan designs among employers that choose to offer them. The most important innovation has been the advent of automated features that build on the findings of behavioral economics. A recent survey of plan sponsors found that about

Figure 8. DC Plans Are Increasingly Adopting Automatic Enrollment

Plans with automatic enrollment and participants hired under an automatic-enrollment plan.



Source: Vanguard²⁶

three-fifths of large plans have adopted automatic enrollment, meaning that employees, by default, are initially enrolled in the retirement plan and must opt out if they do not want to participate. Smaller plans have been adjusting more gradually, with only one-quarter of them following suit thus far.²⁵ Administrative data show similar results. In the case of one large service provider, for example, 36 percent of the provider's DC plans now automatically enroll new plan entrants, up from 5 percent in 2005.^{26,27} Also, of the DC plans that have adopted automatic enrollment, the vast majority (over 80 percent) use a default fund that is diversified across multiple asset classes.²⁸

Automatic enrollment provides tangible benefits, sharply increasing the likelihood that employees will participate in a retirement savings plan. According to the large service provider mentioned previously,

only 61 percent of eligible employees participate in plans that require workers to take action to enroll, while the participation rate for automatic-enrollment plans has reached 89 percent.²⁹ The effects of automatic enrollment are especially pronounced for younger workers.

For many individuals, however, automatic enrollment alone is not enough. To accumulate sufficient savings to maintain their standard of living in retirement, these workers will need to contribute at higher rates as they progress through their careers. Thus, a similar trend in plan design is at work for automatic escalation, the practice of annually increasing the contribution rate of each participant up to a certain limit (unless the participant selects a different contribution amount). Roughly half of large plans, but only one-tenth of small plans, have implemented automatic escalation.³¹

An important caveat to these advances is that poorly designed automatic defaults can result in worse outcomes for some participants. Research shows that default contribution rates tend to be sticky, meaning that workers rarely opt to change their contribution after enrollment. In some cases, automatic escalation is available, but it can take years to move participants to contribution rates more appropriate for them.³² Many plans are automatically enrolling employees at a savings rate that is likely to be too low for most workers (although it might be too high for some). In 2014, the most common default savings rate for automatic-enrollment plans was 3 percent of pay.³³ Even with a generous employer match, that is far too low for most Americans who seek to maintain their standard of living in retirement.³⁴

Ultimately, the fundamental shift towards DC plans has put the onus on the employee to save for retirement. The evidence shows, however, that workers often struggle to save adequately without the support of a well-designed workplace retirement plan.

The United Kingdom Has Expanded Access Using Automatic Enrollment

The U.K. is using automatic enrollment and other policies to expand participation in workplace retirement savings accounts. As of October 2015, all employers with 30 or more workers were required to automatically enroll employees who earn at least 10,000 pounds per year into a retirement savings plan at a default contribution rate of 1 percent of pay.³⁵ Employees may change contribution rates or opt out entirely. By April 2017, the requirement will apply to all employers, and the minimum default contribution rate will increase to 4 percent of pay by October 2018. Employers are also currently required to contribute 1 percent of pay to these plans for workers who participate. Employer minimum required contributions are set to increase to 3 percent of pay, and the U.K. government will contribute another 1 percent of pay, beginning April 2019.

Many Americans Lack the Income or Resources to Save for Short-Term Needs — So They Raid Their Retirement Accounts

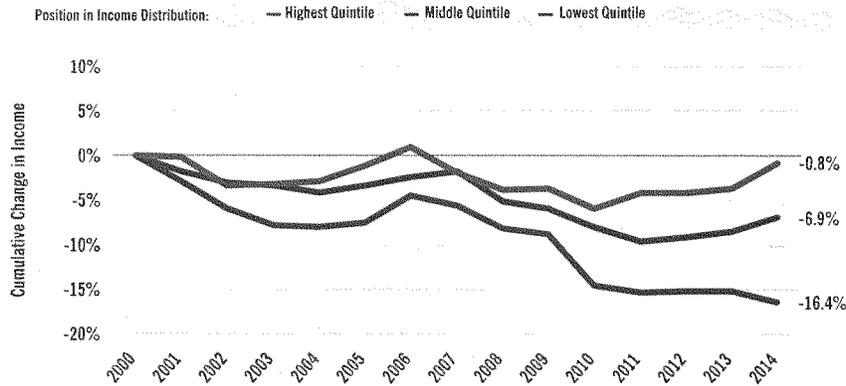
Saving for short-term needs can be just as important as saving for retirement. An emergency fund can serve as crucial protection from unexpected shocks — accidents, health problems, or even car repairs. Without short-term savings, individuals are more likely to rely on debt or tap into their retirement savings in the event of such a shock.

Unfortunately, many Americans are unable to save because they have low earnings, coupled with immediate demands that consume all of their income. But the problem is broader than that. Nearly half of individuals say that they could not come up with \$2,000 in 30 days without selling possessions or taking out payday loans.³⁶

A weak economy is, in part, to blame. Since 2000, real incomes have flat-lined or decreased for a majority of Americans. The need for greater employment and higher earnings is an important part of the retirement savings challenge, but one that is beyond the scope of this report.³⁷

Figure 9. Real Incomes Haven't Grown Since 2000

Cumulative change in income (in 2014 dollars) by income quintile, from 2000.



Note: Population is segmented based on income; for example, the bottom quintile represents those individuals whose incomes were in the lowest 20 percent of all Americans.

Source: U.S. Census Bureau³⁸

At the same time, higher-education and health-insurance costs are increasing, further restricting some families' ability to save for retirement or for short-term needs. Average health-insurance premiums for workers with employer-sponsored family coverage increased by 27 percent between 2010 and 2015, while inflation rose by just 9 percent. Annual deductibles have increased as well.³⁹ Similarly, higher-education costs have ballooned in recent years. The annual net cost of attendance for in-state students at public four-year universities increased by 66 percent between 2000 and 2015.^{40, 41} As a result, students increasingly rely on loans, which squeeze disposable income and limit the ability to save.

Policymakers have created a variety of good, tax-advantaged

accounts to encourage the accumulation of personal savings for purposes other than retirement. Examples include 529 savings plans to help Americans fund higher-education expenses, accounts to help people with disabilities save, and health savings accounts, which complement health plans that feature high deductibles.⁴²

Some state and local governments, as well as private-sector philanthropies, have offered incentives to help families build savings for children, typically in the context of saving for higher education. For example, many child savings accounts subsidize an initial deposit and then match subsequent contributions from family members, friends, and the child.⁴³ In addition to accumulating savings to finance further education, these programs are intended to build financial

knowledge and capability among young people and their families.

While efforts to establish a stronger culture of savings are important on their own, they also have the potential to positively impact retirement security. In many cases, individuals who experience a financial shock during their working years turn to retirement accounts because they have insufficient personal savings. These pre-retirement or early withdrawals represent a grave threat to retirement security.

Usually called “leakage,” pre-retirement withdrawals occur when savers withdraw their retirement savings before the age at which penalty-free withdrawals are allowed (i.e., at age 59 ½ for IRAs, and *at least* 59 ½ for DC plans, as the specific age can vary by plan).⁴⁴ Leakage can occur from both DC plans and IRAs, and can reduce the availability of assets during retirement.⁴⁵

Research suggests that between 1 and 1.5 percent of 401(k)-plan and IRA assets are lost to leakage each year.^{46, 47} While this may not seem like a large sum, the aggregate effect compounds over time and the impact on individuals who make early withdrawals can be large. These individuals tend to withdraw a high percentage of their retirement assets, averaging around 20 percent.⁴⁸ Similarly, from 2004 to 2010, for every dollar contributed to retirement accounts among individuals under age 55, between 29 and 40 cents were withdrawn as taxable distributions.⁴⁹ The bottom line

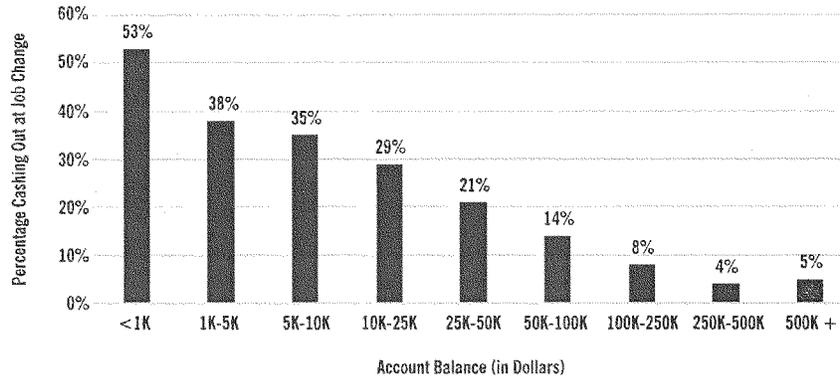
is, of the \$14 trillion of retirement savings, hundreds of billions leak away each year to pre-retirement withdrawals.⁵⁰

Workplace DC retirement plans and IRAs have different sets of rules for early withdrawals. It is generally harder to withdraw funds early from a workplace retirement plan than from an IRA. DC plans have three different mechanisms for participants to access savings during working years: cash-outs, hardship withdrawals, and in-service loans.

Cash-outs are, by far, the most common and serious form of leakage. They occur when participants withdraw their entire DC account balance upon leaving their job. Cash-outs — which are subject to income tax and, in most cases, a 10-percent early-distribution tax — comprise around half of withdrawn assets for those under the age of 59 ½.^{51, 52} Participants with balances under \$1,000 may be forced by their former employers to withdraw funds upon termination.^{53, 54} In other cases, these funds are allowed to remain in the plan. Between 2004 and 2012, an estimated 29 percent of DC-plan participants cashed out upon leaving their employer, though it should be noted that because workers who cash out tend to have less in savings, cash-outs comprise a much smaller share of overall account assets.⁵⁵

Figure 10. Workers With Smaller Balances Are More Likely to Cash Out Their Retirement Accounts

Participants cashing out at job change in 2014, by account balance.



Note: A worker is considered to have cashed out if they do not remain in the plan, complete a rollover, or set up an installment payment plan (for current retirees).

Source: Vanguard⁶⁵

The high prevalence of cash-outs is in part due to complexities in the system. Workers leaving their jobs face a dizzying array of red tape if they attempt to either roll over their employer plan to an IRA or transfer the funds to a new employer plan. Many simply give up and opt for the cash-out.

Hardship withdrawals from a workplace plan allow participants to withdraw funds for an “immediate and heavy” financial need. Like cash-outs, these withdrawals are subject to income tax and, in most cases, a 10-percent early-distribution tax.⁵⁷ Additionally, participants who take hardship withdrawals are suspended for six months from making further contributions to their DC plans. Plan sponsors are not required to allow hardship withdrawals. If they are permitted, the employer can specify allowable reasons. Many plan sponsors adhere to a list suggested by the Internal Revenue Service (IRS), which includes purchasing a home; preventing foreclosure or

eviction; and covering medical-care, tuition, or funeral expenses for the employee or their spouse, child, or beneficiary.^{58, 59}

Plan loans are another common method for active participants to access plan funds. Like hardship withdrawals, employers are not required to allow plan loans, but many do. Around 90 percent of plan participants have the option of borrowing a portion of their DC account balance. Generally, they can borrow up to 50 percent of it (or \$50,000, whichever is lower).⁶⁰ Borrowers must pay this money back over the course of five years, plus interest (at a relatively low rate).

Although 9 out of 10 borrowers do in fact pay back plan loans, defaults often occur when the participant terminates employment.⁶¹ Upon separation, outstanding loan balances are typically due. If the participant does not repay the loan, the balance is treated as a cash-out, subject to taxes and penalties. Indeed, research indicates that borrowers are likely to default on plan loans when they leave their

jobs. Examining a three-year period, one study found an 80-percent default rate for 401(k) participants who terminated employment with an outstanding loan.⁶²

Because the rules for IRA withdrawals are less strict, IRAs are more prone to leakage than employer-sponsored plans. Owners of traditional IRAs can withdraw funds at any time and for any reason. Funds withdrawn before age 59 ½, however, may be subject to both income taxes and an additional 10-percent penalty. In contrast to hardship withdrawals from 401(k) and other DC plans, which are usually subject to early-withdrawal penalties, the IRA early-withdrawal penalty is waived in many situations, including for higher-education expenses and first-time homebuyers (up to \$10,000).⁶³

Balancing pre-retirement savings objectives with post-retirement aspirations is no easy task. Ultimately, individuals who are able to accumulate retirement savings and keep them intact during

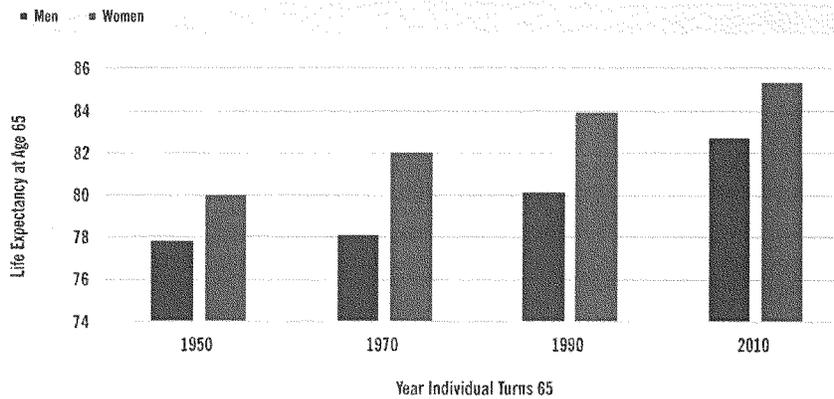
their working years are far more likely to leave the workforce in a strong financial position. Preserving savings over the course of a retirement that could last decades, however, is no small challenge under today's circumstances.

Americans Are Increasingly at Risk of Outliving Their Savings

Americans, on average, are living longer than ever before. A male born in the year 2000, upon reaching age 65, can expect to live until age 85, six years longer than a 65-year-old man born in 1900. For women, life expectancy at age 65 is even higher: around 88 for those born in 2000, compared to 83 for those born in 1900.⁶⁴ This is simultaneously an achievement to celebrate and a source of strain for the nation's retirement system. Today, working Americans who want to retire at the same age as was typical of previous generations must save more to cover additional years of consumption in retirement.

Figure 11. Americans Are Living Longer

Life expectancy at age 65, by gender.



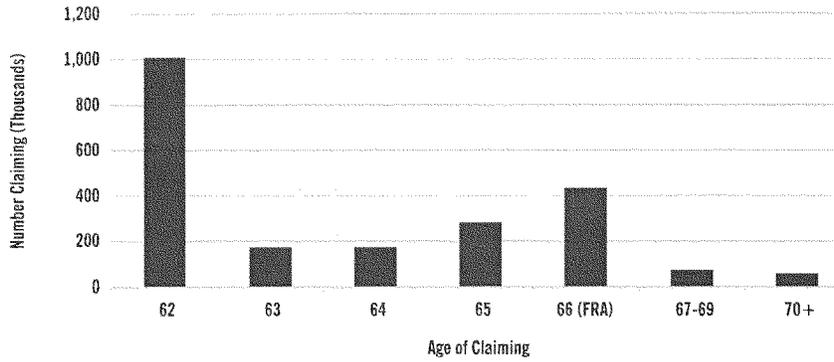
Source: U.S. Centers for Disease Control and Prevention⁶⁵

Despite increased life expectancy, the average retirement age has been stagnant. Between 1962 and 1996, the average retirement age among men declined from 65 to 63. Though the average retirement age increased for women — along with workforce participation — it remains relatively low, at 62 in 2013.^{66, 67} While the trend for men has been mildly positive in recent years (with the average retirement age nearly reaching 64 by 2013), many Americans are trying to fund ever-longer retirements without extending their time in the workforce — a combination that can be financially toxic.

Furthermore, a majority of beneficiaries claim Social Security benefits well before the full retirement age (FRA). In 2014, roughly three-fourths of individuals claiming Old-Age and Survivors Insurance (OASI) benefits did so at an age below the FRA.⁶⁸ Early claimers in 2016 see their monthly payment reduced by up to 25 percent from what it would be if they claimed at the current FRA of 66. A smaller regular stream of income from Social Security compounds the problem of having fewer years in the workforce to save for retirement. This combination is especially concerning for the large number of older Americans who depend on Social Security for the overwhelming majority of their income.

Figure 12. Most Older Americans Claim Social Security Before the Full Retirement Age

Distribution of Social Security (OASI) claiming ages in 2014.



Source: U.S. Social Security Administration^{69, 70}

Finally, retirees who have accumulated savings to supplement Social Security face the challenge of ensuring that those savings last, a task complicated by the daunting fact that no one knows how long they will live or what the future returns on their assets will be. With the marked shift away from DB plans to a world where DC plans are much more prevalent, the responsibility of planning for retirement security increasingly lies with the individual.

Everyone Has a Chance of Living Longer than Average

Most Americans who are nearing or in retirement underestimate average life expectancy, which suggests that they might also underestimate their personal life expectancy.⁷¹ Many Americans will outlive the average life expectancy — some, by quite a bit. For example, 31 percent of women will live until at least age 90, as will 20 percent of men. For couples, the probability that at least one spouse lives until age 90 is 45 percent.⁷² Moreover, these percentages themselves are averages — the probability of living to a certain age will be higher for those who enter retirement in better-than-average health. Individuals who do not realize how long they could live might not think to prepare for that possibility until it is too late.

The need for expensive long-term services and supports (LTSS) in old age can also drain retirement savings. A small group (17 percent) will ultimately spend more than \$100,000 of their own or family funds on such services.^{73, 74} While most people will not have such a high level of need, LTSS expenses can be ruinous to the retirement finances of individuals who do experience catastrophic needs — especially for those who lack insurance. Although the commission did not address this topic, BPC's [Long-Term Care Initiative](#) has recommended better ways to finance LTSS risk.⁷⁵ Furthermore, BPC's Task Force on Senior Health and Housing has recommended policy solutions to improve Americans' ability to age in their homes and communities.⁷⁶

Indeed, the longevity challenge facing older Americans is stark, but public policy could better employ insights from behavioral economics to nudge individuals towards remaining in the workforce. This can protect against longevity risk and have a doubly positive impact on older Americans' retirement security. Additional working years mean greater retirement savings and fewer years of post-retirement consumption. In 2014, 32 percent of Americans aged 65 to 69 participated in the workforce.⁷⁷

Even experts disagree over how to ensure that personal savings will last. Some suggest that individuals withdraw at annual rates no greater than 3 to 5 percent of their accrued savings at the beginning of retirement, assuming that the initial withdrawal amount rises with inflation in subsequent years.⁷⁸ Others argue that even a 4-percent initial withdrawal rate using this method runs the risk that people will outlive their savings in a low-interest-rate environment.⁷⁹ The IRS actually requires that DC account participants and IRA owners aged 70 ½ and older take Required Minimum Distributions each year, which usually start at 3.65 percent of the account balance and increase annually.⁸⁰

An alternative or complement to managing withdrawals from retirement savings on a year-to-year basis is to purchase a lifetime annuity contract, in which an insurance company provides a stream of monthly payments that are guaranteed for life (and optionally also for the life of a surviving spouse) in return for a single or periodic premium payment. This predictable monthly income can supplement Social Security for as long as a beneficiary lives. Retirees who purchase annuities or who receive monthly, lifetime benefits from a DB pension effectively transfer longevity risk, as well as the risk of poor investment returns, to the insurance company or the retirement plan.

When given the choice, however, many DB participants take their benefit as a single-sum distribution instead of monthly income for life. Moreover, few retirees decide to purchase a lifetime annuity. One survey found that only two out of every ten retirees either have selected or plan to select an annuity or benefits from a DB pension

in the form of monthly income for life.⁸¹ Relinquishing control of a large amount of savings is a daunting proposition for many retirees, given that it usually means neither they nor their families can access the money if faced with a large expense or if they die shortly after purchasing the annuity. While some lifetime-income products allow continued access to funds, these arrangements can be very complex, as well as expensive.

As the private-sector retirement system has largely moved away from the DB structure, much of the focus has turned to providing participants in DC plans with attractive options that can supplement Social Security benefits. Annuities distributed through DC retirement plans generally have more-favorable pricing for retirees, compared to those purchased through the individual market. Plan sponsors, however, have experienced low demand for in-plan lifetime-income solutions, and those employers that do wish to offer such options must confront a variety of barriers, including concerns about fiduciary responsibility.

Home Equity Is Underutilized in Retirement — if it Lasts ‘Till Then

Americans own more than \$12.5 trillion in home equity, a sum that rivals the \$14 trillion held in retirement savings.^{82, 83} Just like retirement savings, housing assets are built slowly over most people's working life, making home equity a crucial stock of wealth for many older Americans. In 2015, median home equity among Americans aged 62 and older stood at around \$79,000 on a per-capita basis (meaning that total home equity is divided in half for a household of two), while the 75th percentile had about \$179,000 in per-capita home equity.⁸⁴ For many retirees, home equity represents a significant portion of their assets: 50 percent of all homeowners aged 62 and older are “home-rich, cash-poor,” in the sense that more than half their net worth is held in home equity.⁸⁵

Homeownership carries a variety of benefits for retirees. Not only can it lower recurring living expenses and enable aging in place, but it can also serve as a retirement asset. Notably, more than half of individuals aged 62 and older with no retirement savings or pension

are homeowners, meaning that many of these older Americans will have to rely on home equity to supplement their Social Security benefits.⁸⁶

There are several ways homeowners can tap into their home equity to support retirement consumption. Though the most obvious option is to downsize to a less-expensive home, homeowners can also borrow against the value of their home through a second mortgage, a home equity line of credit (HELOC), or a reverse mortgage.

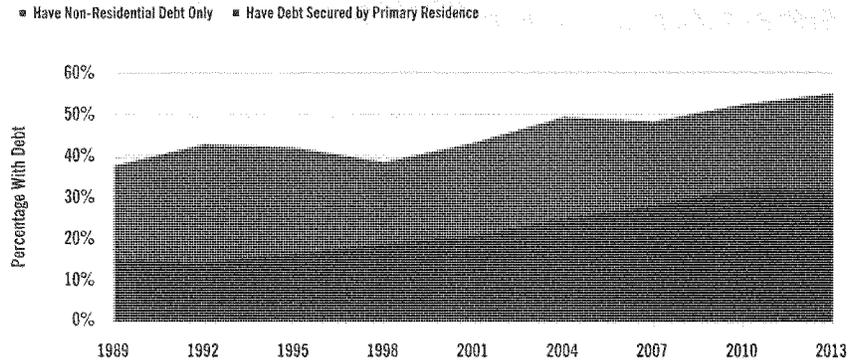
Whereas second mortgages and HELOCs require homeowners to make regular payments, reverse mortgages are different in that they require no mortgage payments until the owner passes away or sells their home. Interest accrues throughout the life of the loan, and most reverse mortgages are federally backed through the Home Equity Conversion Mortgage program. The reverse-mortgage market is currently small, and the product carries some risks. Nonetheless, it can be a valuable tool for some retirees who have significant home equity.

Unfortunately, the past several decades have seen increasing indebtedness among older Americans, which in turn poses a unique threat to retirement security. Growth in old-age debt has many potential causes and may have been exacerbated by both easy credit before the financial crisis along with job losses among those nearing retirement during the Great Recession. Shouldering debt in one's later years can force individuals to draw down their savings prematurely. Federal tax policy also promotes mortgage debt, as mortgage interest payments are usually deductible for taxpayers who itemize. This tax benefit, which applies not only to traditional mortgages, but also to HELOCs and second mortgages, ultimately rewards home borrowing by lowering mortgage-interest costs.

The share of American families headed by a person aged 65 or older and holding debt has increased from 38 percent in 1989 to 55 percent today.⁸⁷ This trend has largely been driven by increases in home borrowing. The share of older households holding any form of housing-related debt has more than doubled over this span from 15 to 32 percent.^{88, 89}

Figure 13. Older Americans Are Increasingly in Debt

Families headed by individuals aged 65 or older with residential and non-residential debt.



Source: Survey of Consumer Finances⁸⁰

As the percentage of older Americans who hold debt has grown, so has the amount of debt that retirees are shouldering. The median amount owed by older homeowners carrying a mortgage increased by 82 percent between 2001 and 2011, from around \$43,000 to \$79,000, in inflation-adjusted dollars.⁸¹

No matter the cause, growing indebtedness poses a threat to retirement security. This is especially true for retirees who have few assets outside of their home and who might need to access their home's value for consumption purposes. Holding mortgage debt in retirement limits retirees' ability to tap home equity and is just one of many considerations that Americans need to understand as they make decisions about their own savings and retirement.

Many Americans Lack the Basic Knowledge to Manage Their Personal Finances and Prepare for Retirement

A crucial factor that connects every one of the issues discussed in this report is financial capability. Ultimately, retirement security is a personal matter that depends heavily on the decisions made by individuals and families. Personal finance is a complex web that includes not only retirement-related concerns but also choices about managing debt, building an emergency-savings fund, establishing and maintaining a budget, and a host of other components.

Unfortunately, research also indicates that many Americans display low levels of financial understanding. A 2014 study found that 23 percent of Millennials and 19 percent of Gen-Xers spend more than they earn, and only about one-third of each group has set up a rainy-day fund.⁸²

The National Financial Capability Study (NFCS) also demonstrates that Americans lack basic financial capability.⁹³ Last conducted in 2011, the study asked a broad array of questions on financial readiness, and included a five-question quiz on concepts such as interest and mortgages. As summarized in **Table 1**, the results were lackluster. No question was answered correctly by more than 75 percent of respondents, and a majority answered the third and fifth questions incorrectly, which is worse than random guessing!

Furthermore, too few individuals understand proper investment allocation for their retirement savings. For example, investing in a healthy mix of stocks and bonds is crucial to both generate returns

and mitigate risk. A large service provider, however, found that 24 percent of its DC-plan participants had unbalanced portfolios with equity allocations of either more than 90 percent or less than 10 percent.⁹⁴

Many Americans are also unfamiliar with the important fact that high fees can significantly reduce investment returns. For example, take two investment options that both achieve a 4-percent annual return, but the first charges a 1-percent annual fee while the other charges a 0.25-percent annual fee. An investment of \$100,000 in the higher-fee fund will be worth \$30,000 less after 20 years compared to an investment in the lower-fee fund.⁹⁵ While most

Table 1. Many Americans Lack Basic Financial Knowledge

Question	Correct Answer	Answered Correctly
1. If you have \$100 in a savings account and the interest rate is 2% per year, how much will you have in the account after five years?	Over \$102	75%
2. Imagine that the interest rate on your savings account is 1% per year and inflation is 2% per year. After one year, how much can you buy with the money in this account?	Less than today	61%
3. If interest rates rise, what will typically happen to bond prices?	They will fall	28%
4. True/False: A 15-year mortgage requires higher monthly payments than a 30-year mortgage, but the total interest paid over the life of the loan will be less.	True	75%
5. True/False: Buying a single company's stock usually provides a safer return than a stock mutual fund.	False	48%

Source: National Financial Capability Study. Shows combined results from the 2009 and 2011 surveys.

respondents to the Health and Retirement Survey, which includes a sample of Americans aged 55 and older, appeared to realize the importance of fees for long-term investing, most also struggled to find funds with fees less than 1 percent of assets.⁹⁵

Unsurprisingly, research indicates that financial capability can have a positive impact on financial outcomes, specifically investment performance. A 2014 study analyzed the 10-year performance of 401(k) plans held by 2,763 employees at a major financial institution. The study found that risk-adjusted returns were 1.3 percentage points higher among plan participants with high NFCS scores.^{97, 98}

Basic knowledge of how to invest is crucial in today's world. Employer-plan sponsors assume a fiduciary role in which they are required to act in the sole interest of participants and manage the plan in a way that is free of conflicts. But the same is not necessarily true with IRA providers. Since most IRA assets are accumulated when individuals roll over savings from an employer-sponsored plan, many savers can be caught by surprise. Their new service provider might not be an advisor who is required to put the interests of clients first, and fee arrangements can create conflicts of interest.

In the retail market, two kinds of service providers offer IRAs. Registered investment advisors serve as fiduciaries and are held to a similar standard as employers who sponsor retirement plans. Broker-dealers, however, have usually been held to a "suitability" standard, which only requires them to reasonably believe that their recommendations are appropriate for clients' objectives, age, and means. The rules are complex; there are some circumstances in which brokers are also held to a fiduciary standard, and the enforcement processes and resources also differ between the two types of providers. Thus, in many cases, when an individual rolls savings over from a 401(k) plan to an IRA, that person might have

to shoulder the responsibility of picking a smart investment mix and avoiding poor-value financial products.

In April 2016, the Labor Department finalized a rule that would effectively require most broker-dealers to agree to serve as fiduciaries for their IRA customers and to take other steps to manage potential conflicts of interest, such as providing additional disclosures of fees at the time of sale.⁹⁹ This is an important, but complicated and ongoing policy issue for which we did not develop specific recommendations.

The fact that so many Americans have not learned basic concepts of personal finance illuminates the need for further investments in financial capability. A solid foundation of financial knowledge is crucial to empower Americans to take charge of their own retirement security.

Social Security Is at a Crossroads

Social Security has been the bedrock of retirement security in America for over 80 years. In 1940, the first year that the program paid monthly benefits, Social Security served just over 222,000 beneficiaries — including older Americans who qualified on their own work record, as well as their spouses, dependents, and survivors.¹⁰⁰ Social Security has operated primarily as a "pay-as-you-go" system, in which payments to current beneficiaries are mostly financed by taxes collected from current workers.¹⁰¹ At its inception, individuals and their employers each owed a 1-percent payroll tax (2 percent total) on earnings up to \$3,000 (about \$51,000 in 2015 dollars) to pay for these benefits.

Wide segments of the workforce initially were excluded from Social Security, but the program has since been expanded to cover the vast majority of American workers with the exception of certain state

and local government employees.¹⁰² Social Security also now covers individuals who experience a work-limiting disability (as well as their dependents).

In the initial decades of the program, Congress acted on many occasions to increase benefits for new claimants and current beneficiaries. Most significantly, in the 1970s, policymakers adopted a wage-indexed benefit formula and base, and established an automatic cost-of-living adjustment for current beneficiaries.^{103, 104}

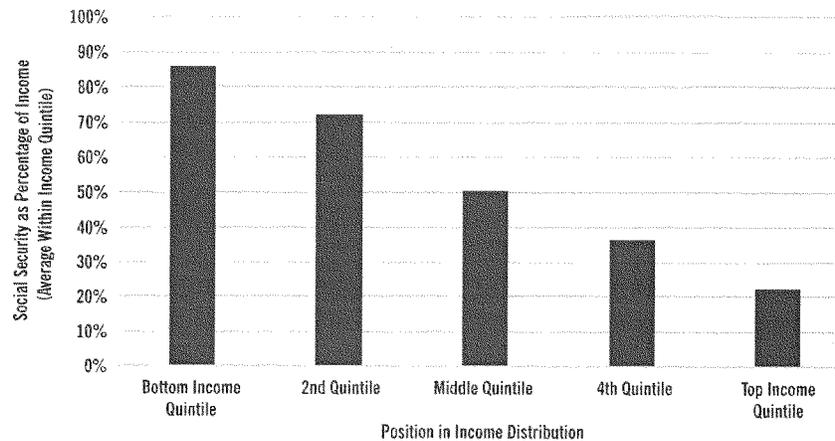
Such expansions, combined with demographic changes, have grown the program substantially over its lifetime. In 2014, 48 million beneficiaries collected \$707 billion in benefits from Social Security's OASI program.¹¹⁰ The Social Security payroll tax, now at 6.2 percent

for both employer and employee (12.4 percent total), applies to annual earnings up to a threshold of \$118,500, which escalates every year with average wage growth.¹¹¹

The program provides the foundation upon which most Americans build their retirement plans. Social Security provides over 70 percent of disposable income for older Americans in the bottom 40 percent of the lifetime-earnings distribution.¹¹² Despite the critical support that Social Security provides, 10 percent of Americans over the age of 65 still live in poverty.¹¹³ Social Security was not designed to be the sole source of income for older Americans; even when a minimum benefit existed between 1939 and 1981, the level was set below the poverty threshold for a single individual.¹¹⁴

Figure 14. Social Security Is the Main Source of Income for Many Older Americans

Social Security benefits in 2015 as a percentage of disposable income for individuals aged 62 and older.



Note: Estimated percentage of income is calculated by dividing the average Social Security benefit by disposable income, which includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute — DYNASIM3, BPC staff calculations

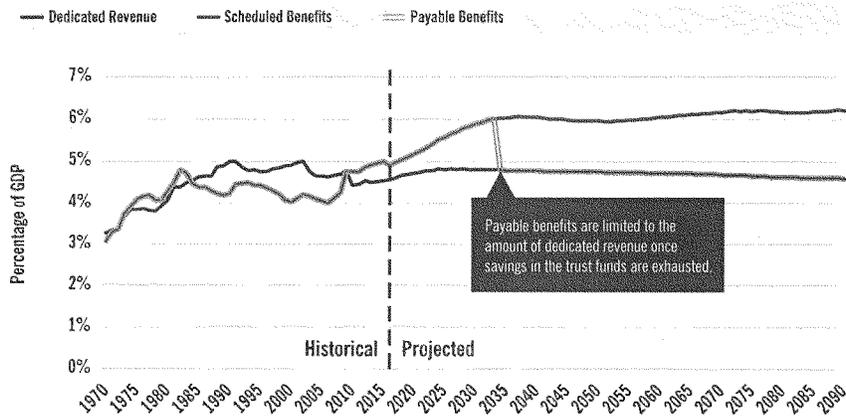
Unfortunately, the Social Security system faces major financing challenges. Today, the program is paying out more in benefits each year than it collects in dedicated revenue.^{115, 116} This shortfall is being met by redeeming the Treasury securities that the program has built up in the Social Security trust funds and by using the interest paid on the trust fund balances. But this is a temporary solution that will run its course in less than 20 years. In fact, the program's trustees project that the trust funds will be exhausted by 2034 (and much sooner than that for the DI program).¹¹⁷ At that point, incoming revenue will only cover 77 percent of the obligations for OASI, necessitating abrupt benefit cuts, tax increases, or the abandonment of the program's historical financing mechanism.¹¹⁸ Furthermore,

the program currently faces a substantially larger 75-year shortfall than the one corrected in the landmark reform legislation that Congress passed in 1983 — the currently pending shortfall has been anticipated for over 20 years.^{119, 120, 121, 122, 123}

Demographics are working against the program's finances. Over the last 50 years, the ratio of covered workers paying into the system has dropped relative to the number of older Americans drawing benefits from roughly 4-1 in 1965 to just under 3-1 in 2015.¹²⁰ The ratio is projected to drop to just over 2-1 by 2030 as Baby Boomers continue to retire.¹²⁷ This demographic trend also stems from increases in average life expectancies that have not been accompanied by longer working lives.

Figure 15. Social Security Faces Significant Funding Challenges

Social Security revenue and cost as a percentage of gross domestic product (GDP), under scheduled-benefits and payable-benefits scenarios.



Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them.

Source: U.S. Social Security Administration^{124, 125}

In addition to the financing challenge, Social Security largely looks like a system created for a 20th century workforce. The current benefit structure falls short of achieving many retirement security objectives, such as incentivizing work and minimizing poverty.

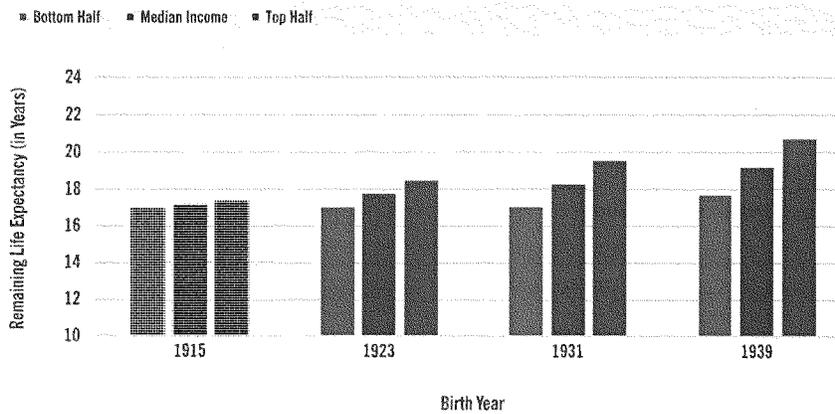
Social Security benefits are linked to earnings. After many years of work, however, the program provides less incentive to stay in the workforce, because workers still owe full payroll taxes but receive little or no additional benefits. The lack of additional benefits for working more years encourages individuals to retire earlier, counteracting the retirement security goal of longer working lives.

Because the program is designed as an earnings-based benefit, Social Security in isolation fails to adequately support individuals who have lower lifetime earnings. While the progressive benefit formula

ensures that lower-earning workers receive a higher return in benefits relative to their contributions than higher-wage earners, many retirees near the bottom still struggle. This is especially the case if they had unstable employment, stopped working at a relatively early age, or both. Beneficiaries in the bottom lifetime-earnings quintile have average incomes of less than \$1,000 per month after deducting Medicare premiums.¹²⁸ Realistically, many of these retirees had insufficient earnings during their working years to accumulate any significant savings to supplement their Social Security benefits. Even among middle-income workers who enter retirement with outside assets, those who claim Social Security benefits early at a reduced level and live unexpectedly long lives may find their monthly income inadequate.

Figure 16. Lower-Income Americans Have Shorter Life Expectancies

Cohort life expectancy at age 65, by lifetime income.



Note: The "Median Income" bar represents the life expectancy for an individual at age 65 in the middle of the income distribution; the "Top Half" bar represents the average life expectancy for an individual at age 65 in the top half of the income distribution, and the "Bottom Half" bar represents the average life expectancy for an individual at age 65 in the bottom half of the income distribution. Data shown are the average of male and female life expectancies at age 65 for each birth cohort.

Source: Gada, Shoven, and Slavov¹²⁹

An added factor to consider is that not all Americans have seen longevity gains over the past several decades. Life expectancy at age 50 for the lowest-income quintile has actually decreased in recent years, while high-income individuals have experienced large increases. This dynamic has a significant effect on the distribution of benefits within the system.¹²⁹

Spousal and survivors benefits are other aspects of the Social Security program that seem outdated or ineffective at ensuring income adequacy. Spousal benefits, for example, were developed in the context of early-20th century assumptions about family structure. In 1950, just one-third of women over the age of 16 participated in the workforce (compared to more than 86 percent of men), making Social Security benefits a necessary source of support for spouses throughout much of the income distribution. Today, in contrast, workforce participation of women has nearly doubled to roughly 57 percent while the rate has dropped to 69 percent for men.^{131, 132} Yet, even as women have far more opportunities for employment today, the benefit structure for non-working spouses remains the same.

Survivors benefits were also designed for a workforce in which one-earner couples were predominant. As a result, many widows and widowers now struggle to support themselves after the death of a spouse. After that moment, household Social Security benefits can fall by as much as half, but household costs rarely decline commensurately.¹³³ Thus, survivors benefits often do not provide adequate income to maintain a widow's or widower's standard of living, and the sudden loss of income can even push some below the poverty level.

For most Americans, Social Security benefits provide the critical foundation, both in planning for and realizing a secure retirement. Yet, those who rely on the program do not know what changes to expect in the context of the program's troubled financial future. Importantly, Social Security should provide a base, but should not be the only source of financial security for retirees, most of whom will need additional forms of income to maintain their standard of living.

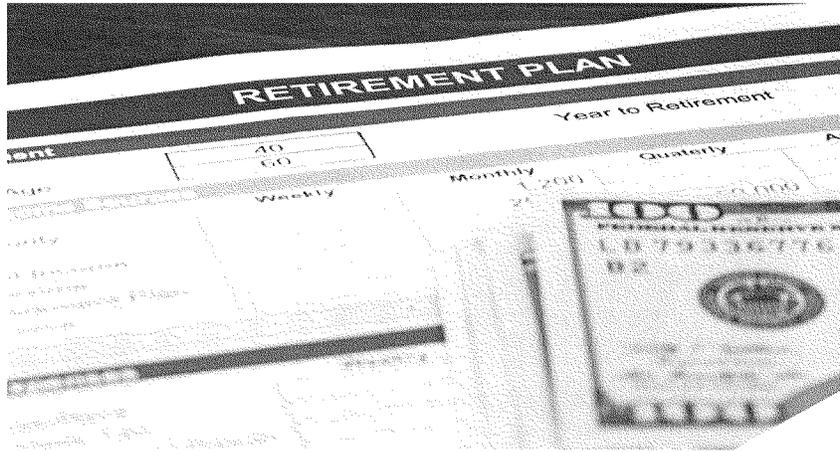
Social Security Is More than Just an Old-Age Income Program

Many people associate Social Security with the old-age benefits that are the foundation of retirement income in the U.S. Social Security also offers a variety of other benefits across two separate but related programs that are funded by payroll taxes.

Old-age benefits are part of the Old-Age and Survivors Insurance (OASI) program, which also provides survivors benefits to widow(er)s and children of deceased workers. These survivors benefits are not only available to older widow(er)s, such as a person whose spouse passes away when they are in their seventies or eighties, but also, in many cases, for younger widow(er)s and children. For example, survivors benefits through the OASI program are paid to a widow(er) of any age who is caring for a child of the deceased worker, as long as the child is younger than age 16 or has a disability. This aspect of Social Security is similar to a life-insurance benefit.¹⁰⁵

In addition to the OASI program, Social Security operates a separate Disability Insurance (DI) program. In 2015, there were about 49 million OASI beneficiaries and 11 million DI beneficiaries, including dependents.¹⁰⁶ The DI program provides cash benefits and access to Medicare for Americans who experience a work-limiting disability that is expected to last for more than one year or result in death.¹⁰⁷ The average monthly benefit for disabled-worker beneficiaries is \$1,166, which is lower than the average monthly OASI retired-worker benefit of \$1,345.¹⁰⁸ Our recommendations focus mostly on the OASI program. A separate BPC working group made recommendations pertaining to the DI program in 2015.¹⁰⁹

Recommendations:
**I. Improve Access to Workplace
 Retirement Savings Plans**



**Modifications to Retirement
 Savings Structures**

About one-third of private-sector workers do not have access to a workplace retirement savings plan.¹³⁴ Many of them are small-business employees and those who work on a part-time or seasonal basis. Employers often face formidable competition and cannot afford to provide a plan if their competitors do not. Employers are also subject to administrative and fiduciary responsibilities that discourage them from offering a retirement savings plan. For many small enterprises — particularly those with low-wage employees — the time, effort, costs, and liability involved in providing a plan under the current system can outweigh even the best of intentions.

Furthermore, even among workers who do have access to a workplace retirement savings plan, many are not saving sufficiently. Realistically, improving access to savings plans is no panacea. Many individuals will still choose not to save or will be unable to afford to participate. Greater access and improved plan design, however, have the potential to enhance retirement security for millions of Americans.

In an ideal world, all workers would be able to save for their own retirement through payroll deduction. The decision to forego immediate spending for consumption decades down the road is difficult enough. A well-designed system should make this choice easier through consistent and automatic payroll deductions. Similarly, small employers that offer a retirement savings plan should face minimal burden and hassle for doing so.

Increasingly, workplace retirement savings plans are incorporating best-practice defaults, like auto-enrollment, auto-escalation of contributions, and balanced and low-fee investment vehicles. Our recommendations aim to further these trends. They reflect our view that it is possible to move beyond the days when workers frequently didn't enroll, or struggled to allocate or invest their contributions appropriately.

The Pension Protection Act of 2006 was the last major federal legislation to address these challenges. It paved the way for greater adoption of automatic enrollment and appropriate default investments by pre-empting state wage-garnishment laws and encouraging the use of qualified default investment alternatives (QDIAs). QDIAs are default investment options that meet certain standards of diversification and appropriate asset allocation.

Since then, members of Congress have offered a variety of legislative proposals. Few have been adopted. The most sweeping proposal would require employers that do not sponsor a retirement plan of their own to automatically enroll their employees in an alternative plan or IRA.¹³⁵ Other bills would encourage employers to offer workplace retirement plans or encourage employers with existing plans to adopt automatic enrollment.¹³⁶

In the absence of broad federal action to improve access to retirement savings plans, state governments are beginning to fill the void. California, Illinois, and Oregon have enacted laws that will require most employers to automatically enroll their employees in some form of retirement savings account.¹³⁷ (Employees could opt out if they so choose.) To facilitate the implementation of these initiatives, the Labor Department has proposed a regulation to clarify that employers that follow state requirements to auto-enroll employees will not be subject to regulation by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA establishes many obligations on employers that sponsor retirement plans.^{138, 139}

The Obama administration has promoted retirement savings in other ways, including by launching the myRA savings product, which

is directed at lower earners. Some additional changes have been technical. For example, the Treasury Department issued guidance in 2015 to encourage employers to implement automatic enrollment by offering them relief from penalties if mistakes are corrected in a timely manner.^{140, 141}

The time is ripe for policymakers to address long-standing challenges in this area, including the absence of workplace retirement savings plans for many employees and the overwhelming complexity for employers that do offer a plan. Our approach would simplify the process for smaller businesses to offer their employees a retirement savings plan, implement a nationwide minimum-coverage standard, enable employees to transfer savings more easily among workplace retirement plans and IRAs, and create a new plan design for multiemployer defined benefit (DB) plans that incorporates the best features of defined contribution (DC) and DB plans. Such changes would greatly increase Americans' retirement savings.

1. Recommendation: Create Retirement Security Plans to serve any business with fewer than 500 employees.

Improving access to retirement savings plans requires a focus on smaller employers, because existing options often do not meet their needs. Consequently, their employees often face the largest retirement savings challenge.

We recommend creating Retirement Security Plans that would enable employers to band together and utilize economies of scale to offer their workers low-cost, well-designed options. The new plans would be covered by ERISA and would include its important consumer protections. This new option would be a better alternative for many smaller business than the existing multiple employer plan (MEP) structure, which has many drawbacks. For example, only closely related businesses, such as those in the same industry, can form MEPs. This so-called "commonality requirement" would be waived for Retirement Security Plans.

Fiduciary and most administrative responsibilities would be

transferred from the employer to the Retirement Security Plan provider. The provider would be required to pass a certification process to prevent bad or unprepared actors from entering this market. Employers would not have any fiduciary responsibility for the selection or ongoing monitoring of the plan provider, so long as the provider passes the certification process.

Employers that choose to adopt a Retirement Security Plan would allow, at minimum, all full-time employees over the age of 21 with at least three months of service to participate. The Retirement Security Plan provider could use a safe-harbor plan design, which would enable participating employers to avoid nondiscrimination and top-heavy testing. For example, a Retirement Security Plan could be developed in accordance with an automatic-enrollment contribution safe harbor, which would facilitate the use of automatic enrollment for all participating employers. (For more on testing and safe harbors, please see the box on page 41.) With all of these features, the responsibilities of adopting employers would be limited to enrolling their employees during an annual open-enrollment period and forwarding data and contributions to the provider.

Employers that adopt existing MEPs retain significant fiduciary and administrative responsibilities. Many larger employers are sophisticated and capable of discharging these obligations, either with in-house staff or by hiring experts. Smaller employers, however, typically do not have experience in the design of retirement plans or the selection and monitoring of service providers. Further, these businesses usually do not have the resources to pay for outside expertise.

Many smaller employers that have not established retirement savings plans might be encouraged to do so if they could transfer these responsibilities to another, better-prepared, party. Retirement Security Plans would do just that. They would likely be more efficient, with better economies of scale, than the operation of many smaller plans today. Access to professional management would also make them more likely to incorporate advanced features, such as automatic enrollment, automatic escalation, and lifetime-income elements.

ERISA consumer protections remain essential for participants of Retirement Security Plans. Thus, the organizers of these plans would be covered by ERISA and serve as fiduciaries, legally responsible to act in the sole interest of plan participants and to operate the plan in a way that is free of conflicts. Financial services companies, payroll processors, local or regional associations of unrelated businesses, and state or local governments are among the types of institutions that might organize a Retirement Security Plan.

Any new plan must also protect enrollees from unscrupulous or unprepared service providers. We recommend that Retirement Security Plans be subject to oversight by a new certification board established by the Labor Department and Treasury Department. Many of the existing restrictions on MEPs resulted from previous malfeasance in the health-care benefits sector, in which swindlers organized health plans for multiple employers and stole employer and participant funds.¹⁴² Taking a lesson from this history, prospective organizers of Retirement Security Plans would have to pass initial certification and then periodic recertification processes. This would ensure that the sponsors are prepared to accept and discharge their responsibilities appropriately as organizers and fiduciaries. To enhance these protections, entities handling participant funds would be restricted to insured organizations, including banks, credit unions, insurance companies, and broker dealers. Retirement Security Plan organizers that do not qualify could partner with service providers that do.

The certification board would have final authority over certifying and, if necessary, decertifying Retirement Security Plans, based upon published criteria. It would also establish procedures for transferring participant assets from a decertified plan to an alternative plan that is certified. Additionally, the board would give preference to Retirement Security Plan proposals that include retirement-income features. (For more on retirement-income features, please see the section beginning on page 61.) The Labor and Treasury Departments would publish basic information about all Retirement Security Plans, including information about plan design, investment options, and

plan-wide fees. This information would be available on a central website so that employers could easily compare offerings.

These recommendations aim to clear the way for small employers to provide their workers with retirement savings arrangements while simultaneously ensuring that such plans are well designed and relatively low cost. Over time, Retirement Security Plans would expand access, giving more Americans the opportunity to save for their future. (For detailed specifications, please see the appendix.)

2. Recommendation: Establish an enhanced, more-flexible, automatic-enrollment contribution safe harbor that would improve access to well-designed workplace retirement savings plans.

ERISA requires most plan sponsors to either pass annual nondiscrimination and top-heavy tests or adopt a safe-harbor contribution scheme. Testing is intended to ensure that the benefits of retirement savings plans are shared broadly among the employee population and are not concentrated among highly compensated employees. Testing is complex, however, and it can deter employers that would otherwise offer a retirement savings plan.

Existing contribution safe harbors that allow employers to avoid testing are very prescriptive and require the employer to offer a contribution. This requirement may be appropriate for larger businesses, which typically already offer retirement plans with an employer contribution, but it might also explain the reluctance of many smaller employers to sponsor a plan. Some of these employers might be willing to offer their workers a payroll-deduction retirement savings plan, but are not prepared to offer an employer match. Thus, they do not sponsor a plan at all because of the burdens of testing.

What Are Safe Harbors? Why Does the Commission Recommend New and Expanded Ones?

ERISA and the Internal Revenue Code apply numerous complex requirements to employers that sponsor retirement plans. Safe harbors grant various kinds of relief to plan sponsors that take certain actions. For example, many plan sponsors are subject to annual nondiscrimination testing to ensure that plan benefits are not overly concentrated among highly compensated employees. Safe harbors are available that exempt employers from testing if they offer a contribution that meets certain standards and implement automatic enrollment. In other cases, safe harbors limit the liability of plan sponsors if participants sue them. For example, plans that adopt certain default investment options (i.e., QDIAs) can use a safe harbor as a defense if participants sue and claim that the default investment was inappropriate.

Safe harbors do not eliminate all employer responsibilities nor do they shield employers from all legal risks. For example, plan sponsors that adopt a safe-harbor default investment option are still responsible for prudently selecting the specific fund and provider, considering such factors as performance and fees. Federal agencies, such as the Labor Department and Treasury Department, have initiated some safe harbors using regulatory authority. In other cases, Congress has provided for safe harbors by statute or by directing agencies to establish them.

While ERISA allows for creativity in retirement-plan design, high standards of liability for plan sponsors sometimes discourage employers from implementing advanced or innovative features. Safe harbors can address these concerns and promote the wider adoption of good practices. Hence, our approach includes many proposals to expand the existing set of safe harbors.

To address this barrier, we recommend a more-flexible alternative in the form of a new contribution safe harbor that would exempt employers from testing if they automatically enroll eligible new and existing (non-participating) employees in a plan that follows certain guidelines. These include: 1) enrolling participants at a default contribution rate that is at least 3 percent of pay and not higher than 10 percent of pay, 2) automatically escalating contribution rates by 1 or 2 percent of pay each year, and 3) continuing automatic escalation until a participant's contribution rate reaches a minimum of 8 percent of pay or a maximum of 15 percent of pay. Any plans with parameters within these ranges would qualify for the exemption from testing. In addition to automatically enrolling new hires, employers that adopt this new safe harbor would have to automatically enroll non-participating employees once every three years. Employees could select a different contribution rate or opt out entirely.

Unlike the existing automatic-enrollment safe harbors, which prohibit matching contributions above 6 percent of pay, this new safe harbor would allow employers to match employee contributions up to 15 percent of pay. This could encourage participants to make larger contributions.

Larger employers, with 500 employees or more, would be required to offer an employer contribution to qualify for the new safe harbor. Smaller employers could adopt the safe harbor regardless of whether they contribute, but lower contribution limits would apply to small-employer plans that do not feature an employer contribution.

This approach would provide flexibility to businesses, remove the burdens of testing, retain strong incentives for employers to contribute, and increase the prevalence of employer-sponsored retirement plans with automatic enrollment. (For detailed specifications, please see the table on page 43 and the appendix.)

Table 2. Comparison Between Current Automatic-Enrollment Safe Harbor and Recommended Enhanced Safe Harbor¹⁴³

	Current Automatic-Enrollment Safe Harbor	New Enhanced Automatic-Enrollment Safe Harbor
Automatic Enrollment into Plan	Required for newly eligible employees.	Required for both newly eligible participants and already eligible non-participating employees (once every three years).
Employer Contributions	Required. Must be structured as a 3-percent non-elective contribution or a match worth at least as much as a dollar-for-dollar match on the first percent of pay contributed plus 50 percent of the next 5 percent deferred. No scheme may increase the matching rate as the employee's deferral rate increases, and no matching is allowed above 6 percent of pay.	Required for employers with 500 or more employees (as either a matching contribution of 3 percent of pay or a non-elective contribution of 2 percent of pay), not required for smaller employers. Must be structured as a match of a flat percentage starting at the first dollar contributed and ending no later than the 15th percent of pay contributed, a non-elective contribution structured as a flat percentage of pay, or a combination of the two.
Initial Deferral Rate	At least 3 percent and no more than 10 percent of pay.	Same.
Automatic Escalation	Minimum automatic deferrals are 3 percent of pay in the first year of participation, 4 percent in the second year, 5 percent in the third year, and 6 percent in the fourth and later years.	Required at rate of 1 or 2 percentage points of pay each year up to at least 8 percent and no more than 15 percent of pay (at the employer's discretion).
Default Investments	Must choose a default investment. Liability for investment losses limited by selecting a QDIA, such as life-cycle or balanced funds.	Same.
Contribution Limits	Full 402(g) limits (\$18,000 plus a \$6,000 catch-up for participants over age 50 in 2016).	For employers that offer- <i>A matching contribution of 3 percent of pay or a non-elective contribution of 2 percent of pay: full 402(g) limits (\$18,000 plus a \$6,000 catch-up for participants over age 50 in 2016).</i> <i>No contribution: 40 percent of 402(g) limits (\$7,200 plus a \$2,400 catch-up for participants over age 50 in 2016).</i> Sliding scale for employers that offer a matching contribution of 1 or 2 percent of pay or a non-elective contribution of 1 percent of pay.

3. Recommendation: Enhance the existing myRA program to provide a base of coverage for workers who are least likely to have access to a workplace retirement savings plan.

Even with the introduction of Retirement Security Plans, the private sector may not be able to provide retirement savings plans for some workers. To begin with, saving for retirement can be especially challenging for workers who have low earnings, who work limited hours or seasonally, or who change jobs frequently. Even if these workers have some capacity to save, the administrative costs of maintaining many small accounts, including those for former employees, can be prohibitive.

The existing myRA program offers a promising approach to provide these workers with basic coverage at minimal cost to employers. Nonetheless, the program would be more effective if it were brought under a statutory framework and enhanced.

The Treasury Department launched myRA (the acronym stands for “my Retirement Account”) in 2015 using its regulatory authority. Employers can now offer myRAs to their employees as a new retirement savings option.¹⁴⁴ The only costs to employers are administrative: informing employees about the option and facilitating the payroll deduction.

The myRA product is a Roth IRA that can only be invested in a special type of Treasury security.¹⁴⁵ This security cannot lose value and earns interest at a rate keyed to long-term government bonds. Individuals also have the option of directing a portion or all of their federal tax refund into a myRA.¹⁴⁶

myRA accounts are subject to the same contribution limits as any other IRA. In 2016, for example, the limit is \$5,500 per year plus an additional \$1,000 catch-up contribution for Americans aged 50 or older. Unlike other Roth IRAs, myRA accounts are subject to a balance limit of \$15,000. Account owners who exceed this limit will be required to roll their savings over to a private-sector IRA. The Treasury Department has not yet established procedures for this mandatory rollover.

Two aspects of the myRA program especially limit its effectiveness: neither automatic enrollment nor employer contributions are allowed.

We recommend that the myRA program be established in statute and enhanced to allow for both automatic enrollment and employer contributions. In our proposal, employers could choose to automatically enroll employees in myRAs with default contribution rates no lower than 2 percent and no higher than 6 percent of pay. Automatic escalation would be allowed up to 8 percent of pay. Employers could also make either a matching or non-elective contribution of up to 3 percent of pay, which would count toward the annual contribution limit.

The Treasury Department should also ease the process for employers to adopt and offer myRAs. Employers should have the option to contribute to their workers’ myRA accounts directly or through existing payroll tax forms and payment processes. These accounts would not be covered by ERISA, but employers could subsequently convert to an ERISA-covered plan, such as a Retirement Security Plan.

Finally, the Treasury Department should establish an automated rollover process for myRA accounts that exceed the \$15,000 account cap. Owners of such accounts should be able to select a particular IRA provider and investment funds. For myRA owners who do not make an election, the Treasury Department should use a competitive process to select default IRA providers for automated rollovers. Vendors eligible to bid for the rollovers would agree to serve as a fiduciary and would offer an appropriate default investment selection with an age-appropriate asset allocation.

Why Are Both myRA and Retirement Security Plans Needed?

These proposed options to expand access to workplace retirement savings have some features in common, but the two structures would likely appeal to different workforces. Both could attract smaller employers that want to offer a plan but are discouraged by the complexity and responsibilities of plan sponsorship. A Retirement Security Plan would be well suited for a relatively stable workforce of middle-earning employees, who are more likely to benefit from higher contribution limits. myRA is better suited for lower earners who change jobs frequently; consolidating their savings in myRA would avoid a multitude of accounts with small balances.

A statutory grounding for the myRA program would give it permanence and enable new features to improve the functionality and effectiveness of the product. An enhanced myRA platform could also encourage better functioning of the retirement system as a whole, expanding access to underserved populations. (For detailed specifications, please see the appendix.)

4. Recommendation: Introduce a nationwide minimum-coverage standard to pre-empt a disjointed patchwork of state-by-state regulation.

Working Americans should have the opportunity to save for retirement with every paycheck. Broader access to and participation in retirement savings plans would especially improve retirement security for middle-class Americans.

Three states have enacted laws to require that employers automatically enroll workers in some form of retirement savings account, and several additional states seem prepared to follow. Because they use different savings vehicles and have different rules, these state actions could frustrate efforts to implement

national retirement employee-benefit policy that provides workers with strong consumer protections while offering uniform regulation to employers, many of which conduct business in multiple states.

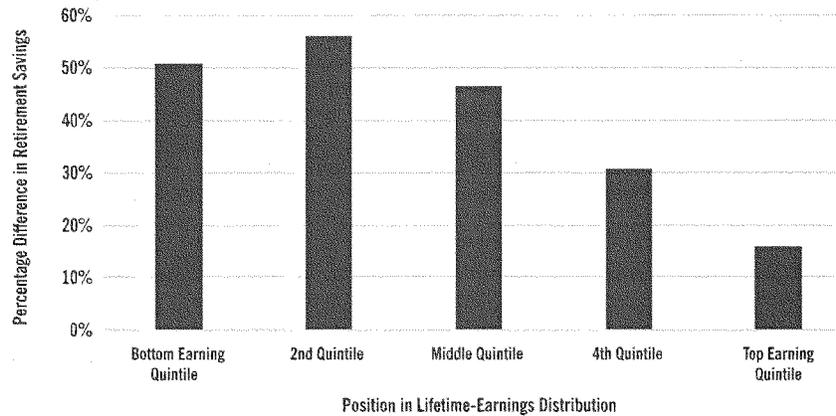
We recommend a nationwide minimum-coverage standard that would expand access to workplace retirement savings in a manner that would be less burdensome for employers. The standard would take effect in 2020, after the simpler alternatives for employers (Retirement Security Plans and an enhanced myRA) have been implemented. Once it is in effect, employers with 50 or more full-time-equivalent employees would have to do one of the following: 1) offer a fully qualified ERISA plan, such as a 401(k) plan or a DB plan; 2) automatically enroll employees into a Retirement Security Plan, as described above; or 3) automatically enroll employees into an enhanced myRA, as described above. Employees would have the ability to change contribution amounts, up or down; they could also opt out of contributing entirely. Policymakers should carefully monitor implementation of this requirement and adjust the coverage threshold accordingly.

Employers that prefer not to select a plan for their employees could simply forward contributions along with their payroll taxes. Those contributions would be separated and directed into a default Retirement Security Plan. Providers could apply to serve as a default Retirement Security Plan, either nationwide or in a particular region, and would be selected by the board as part of the certification process.

Near-universal access to workplace retirement savings plans with automatic enrollment would increase per-capita retirement savings for older Americans who had been middle earners by about one-half, or roughly \$54,000 (in 2015 dollars), by 2065.¹⁴⁷

Figure 17. Retirement Savings for Lower- and Middle-Earners Grow Significantly Under Minimum-Coverage Standard

Projected change in retirement savings among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings.



Note: Retirement savings include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets. Modeling assumptions and methods are discussed on page 47.

Source: The Urban Institute - DYNASIM3

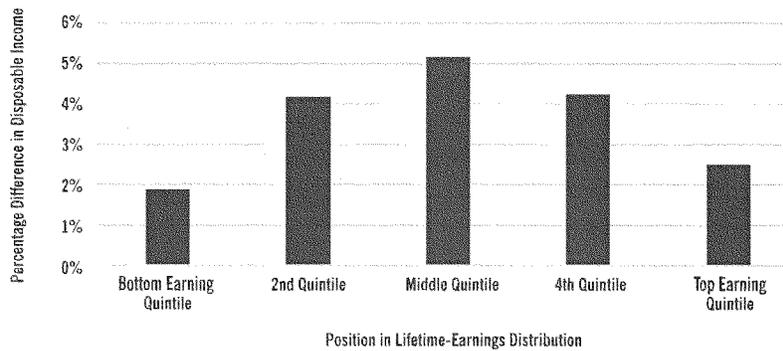
Increased retirement savings would translate into higher incomes during retirement. Per-capita net cash income — which includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums — is projected to increase 5.1 percent by 2065 for older Americans who had been middle earners.¹⁴⁸ In percentage terms, this increase may appear small, but the impact would be significant for two reasons: 1) The 5.1-percent figure represents a sustained increase for all years of retirement and 2) the average includes some individuals who are saving steadily through existing retirement savings vehicles and who would be unaffected by the

minimum-coverage standard. This means that the impact of the policy on other individuals who are not already saving could be much greater than 5.1 percent.

The projected percentage increase in retirement income would be greatest for middle earners and lowest for the highest earners. High-income earners typically already participate in workplace retirement savings plans. The lowest earners generally have less income to save and are more likely to withdraw savings before retirement.

Figure 18. Middle-Class Americans Would Benefit Most from Minimum-Coverage Standard

Projected change in disposable income among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income. Modeling assumptions and methods are discussed below.

Source: The Urban Institute - DYNASIM3

How Did the Modelers Simulate a Nationwide Minimum-Coverage Standard?

We wanted to understand how near-universal access to auto-enrollment retirement savings plans would affect retirement outcomes.

The Urban Institute made projections using a microsimulation model, a powerful tool that allows researchers to simulate how a policy would affect the population over many years.

Developing these estimates required assumptions by the modelers. Specifically, the modelers assumed that all workers (who are covered by Social Security, are not self-employed, and are not participating in an employer-sponsored retirement plan) are automatically enrolled in a DC retirement savings plan. The default contribution rate is assumed to start at 3 percent of pay and escalate annually by 1 percent of pay until the contribution rate reaches 10 percent of pay. Employees could change to a different contribution rate or opt out entirely. Among workers who are offered coverage for the first time, the assumed opt-out rate (i.e., the percentage of individuals whose contribution rate is equal to zero) varies by age and cohort. For example, the assumed opt-out rate is roughly 60 percent for workers in their twenties and 40 percent for workers in their forties. Among workers who do not opt out, 60 percent are assumed to stay with the default contribution rate and 40 percent are assumed to switch to a different contribution rate, some higher and some lower. The model assumes that workers who opt out will not be automatically enrolled again until they change jobs.

In sum, policymakers must address the coverage gap in workplace retirement savings plans to achieve substantial gains in retirement security for middle-class Americans. Near-universal coverage cannot be achieved under a system in which the decision to offer a plan is completely voluntary for all employers. On the other hand, simply requiring all employers to offer a plan under existing policy would either create unreasonable burdens for employers or leave workers without important consumer protections. The approach we recommend significantly expands coverage while avoiding these pitfalls, thereby leaving workers and employers better off.

5. Recommendation: Craft policy to encourage plan sponsors to help participants diversify and appropriately allocate their investments.

Workers who participate in retirement savings plans often retain the asset allocations from their initial enrollment for many years, even when these allocations are no longer prudent. This inertia can expose participants to unintended risk.

We recommend a new safe harbor to limit legal liability for plans that automatically reallocate participant investments into a qualified default investment alternative (QDIA). For example, many plans have default investment options that gradually adjust toward a more-conservative asset allocation (e.g., investing a greater proportion of funds in bonds and less in equities) as the participant nears a typical retirement age. Participants would be notified in advance and could choose to opt out of the reallocation.

6. Recommendation: Clarify plan sponsors' ability to establish different default tax treatments to benefit both lower- and higher-earning employees.

Employers that automatically enroll employees into retirement savings plans may use tax-deferred or after-tax (Roth) arrangements. Existing regulation, however, is unclear on whether employers must

use the same default tax treatments for all employees. Furthermore, Roth automatic-enrollment arrangements are rare. As a result, some workers might not gain much or any tax advantage when contributing to their retirement account.¹⁴⁸ Lower-earning employees, for instance, may owe little or no income taxes, and therefore would benefit more from Roth arrangements.

We recommend modified regulations and a new safe harbor to clarify that employers may establish tax-deferred accounts as a default for some employees and Roth accounts as a default for others. For example, this new safe harbor would limit legal risk for an employer that automatically enrolls lower earners into Roth savings plans and higher earners into tax-deferred savings plans, as long as participants retain the option to switch.

7. Recommendation: Create Lifetime Income Plans as a new, more-sustainable retirement-plan design that would be available for multiemployer DB plans to voluntarily adopt.

Although private-sector employers that sponsor DB plans are subject to minimum-funding requirements under federal law, plans can become underfunded. If a DB plan fails, such as when an employer goes out of business and leaves behind a plan that lacks sufficient funds to pay benefits, federal pension insurance may cover part or all of the shortfall in benefits for plan participants.

The Pension Benefit Guaranty Corporation (PBGC), which operates the pension insurance program, has successfully paid benefits for failed plans since it was authorized in 1974. Nevertheless, serious financial challenges exist. In particular, one of PBGC's insurance funds covers multiemployer DB plans, which involve arrangements between more than one employer and a labor union. PBGC's multiemployer fund is at significant risk of insolvency in the next decade, endangering the retirement security of millions of workers.¹⁵⁰

Total Confusion: Multiemployer Plans vs. Multiple Employer Plans

Two completely different forms of retirement plans have very similar names. Multiemployer plans (multis) are DB plans jointly sponsored by a labor union and more than one employer. Multiple employer plans (MEPs), which are entirely unrelated to multis, are typically DC retirement plans that are sponsored by multiple related employers and do not necessarily involve a labor union in the operation of the plan. Our proposal to reform MEPs and rebrand them as Retirement Security Plans would help resolve confusion between the names of these structures.

In 2014, a bipartisan coalition in Congress passed the Kline-Miller Multiemployer Pension Reform Act to address the dire financial condition of some multiemployer DB plans.¹⁹¹ While this law provides a pathway for severely underfunded plans to right their finances, none of the provisions would prevent plans from becoming underfunded in the future.

We recommend a solution in the form of Lifetime Income Plans, which would blend the strengths of DB and DC retirement plans. This type of structure has functioned well in the Netherlands for many years, although these plans, sometimes referred to as collective DC plans, have reduced benefits lately.¹⁹² The Canadian province of New Brunswick also recently implemented this model. In 2013, the National Coordinating Committee for Multiemployer Plans published *Solutions, Not Bailouts*, a study developed by a consensus labor-management process. It recommended that the United States allow a similar plan structure, which multiemployer DB plans could voluntarily adopt for future accruals.¹⁹³

Common features of collective DC plans include:

- Contribution rates that are stable for employers (i.e., no wild swings from year to year),
- Asset pooling with professional management,
- Mortality pooling,
- Benefits in the form of a monthly income for life,
- A requirement that plans be very well funded, and
- Mechanisms to ensure that decisions are made in advance regarding how to adjust contributions and benefits if a plan's funded status drops below a certain level.

Lifetime Income Plans would have many advantages. High funding standards and the ability to adjust benefits would make these plans highly sustainable compared to alternatives, while offering participants a benefit in the form of regular income that they cannot outlive.

Such plans should have a target funded ratio (i.e., assets over liabilities) of 120 percent for a 15-year horizon, the level recommended in the *Solutions, Not Bailouts* report. If this threshold is not met, plans should be required to take prompt corrective action. Lifetime Income Plans must maintain a contingency plan at all times that specifies how adjustments would be made. Potential actions include reducing future accruals, increasing contributions, and when necessary, reducing accrued benefits. Plans that exceed the target threshold would have the option to increase benefits or reduce contribution rates, if doing so would not cause the plan to drop below the 120-percent-funded ratio.

Benefits would only be available in the form of a monthly payment for life. Lump-sum distributions, loans, and hardship withdrawals would not be permitted. These plans would be treated as DC plans by PBGC and hence would not be covered by federal pension insurance. To ensure sustainability, sponsors of Lifetime Income Plans would be required to demonstrate to the Treasury Department that, under a range of reasonable assumptions, the plan could meet or exceed the

120-percent funded-ratio target for the next 15 years. The Treasury Department would establish standards for demonstrating that plan sponsors have met these funding requirements or are taking corrective action to meet them and would take enforcement action if underfunded plans do not make required adjustments promptly. This structure is designed to detect and address problems early on, such that corrections have only a modest impact on participants and employers. The approach effectively shares risk among retirees, active employees, and employers, providing a high degree of security but no absolute guarantees.

The Lifetime Income Plan structure would be especially well suited as an option for the voluntary evolution of existing multiemployer DB plans, making them more sustainable and reducing taxpayer liability. Lifetime Income Plans should initially be limited to multiemployer applications, but once an evidence base exists, policymakers might consider expanding their availability as an option for single-employer plans and Retirement Security Plans.

8. Recommendation: Create a private-sector Retirement Security Clearinghouse to help individuals consolidate retirement assets.

America's decentralized retirement system has many advantages, but it also has some clear drawbacks. For individuals who would like to consolidate their retirement assets — either by transferring funds between employer plans or rolling over into an IRA — the process can be cumbersome, if not impossible. As a result, workers who change jobs several times often accumulate a variety of small accounts, which are tedious to track. A survey found that more than one-third of individuals have three or more retirement accounts.¹⁵⁵ Further, the Government Accountability Office reports that, over the course of a decade, 25 million Americans changed jobs and left at least one account behind.¹⁵⁶ Retirement finances are already difficult for many individuals to understand and manage. This dispersion of accounts only exacerbates the challenge.

We recommend the creation of a private-sector Clearinghouse, which would streamline transfers and rollovers among ERISA DC plans and IRAs. This entity could also perform additional functions, such as distributing the proposed Starter Saver's Match (see page 53 for details) directly to participant accounts and retaining information about a participant's most recent contribution rate. The latter might enable more-sophisticated automatic-enrollment systems when participants change employers.

To help facilitate the Clearinghouse, the Labor and Treasury Departments would convene stakeholders to agree on data interchange standards for service providers. Labor and Treasury would support the new standards. For example, the agencies would accept electronic filings that use the new standards. Adoption would be voluntary for single-employer plans. Other plans, including myRA and Retirement Security Plans, would be required to adopt the standards.

This approach is similar to a 2014 recommendation from the ERISA Advisory Council, which called on the Labor Department to encourage industry to develop technology standards aimed at streamlining data transmission and facilitating account consolidation.¹⁵⁷ The council noted that other countries, such as Australia, have implemented comparable initiatives.

The new Clearinghouse would help solve the problem of orphaned accounts and move the private-sector retirement system towards a more-cohesive network.

9. Recommendation: Establish new limits on company stock in DC plans to help protect employees from potentially catastrophic investment risk.

Shares in individual companies are among the most volatile investment options. Some experts contend that company stock, in particular, should never be included in DC plans because it leaves workers with undiversified portfolios and because major drops in company value often correlate with the risk of job loss.

Provisions in the Pension Protection Act of 2006 and various lawsuits have caused the role of company stock in DC plans to decline over the years.¹⁵⁸ In general, company stock is not an appropriate investment for a significant portion of an individual's retirement savings; thus, if company stock is offered, we believe it should be limited to a modest percentage of each account to reinforce the importance of diversification.

We recommend that participants who are invested in company stock should be notified of the risks posed by this investment option and should be required to make an annual affirmative election to continue contributions to company stock funds. Further, the amount of company stock allocated to workers' retirement accounts should be limited to no more than 25 percent of the account balance. In the event that an account exceeds this limit, company stock funds would be automatically reinvested in a QDIA, unless the participant selects a different investment option.

Modifications to Retirement Tax Expenditures and Federal Asset Tests to Support Expanded Savings

Tax law affects retirement savings in important ways. For traditional DC accounts, income tax on contributions and investment earnings is deferred from the account holder's working years to a later date, usually during retirement. In contrast, after-tax contributions to Roth-style accounts allow workers to withdraw savings, including earnings, free of income tax during retirement. These tax treatments function similarly for contributions to IRAs, which are available in tax-deferred and Roth versions, and for DB plans, which allow for the deferral of income tax. Lower earners who contribute to a DC plan or IRA may also be eligible for a tax credit, known as the Saver's Credit.

Efforts to analyze the size and distributional effects of tax provisions for retirement savings have generated considerable disagreement. Some view retirement tax policy as favoring higher earners, who are more likely to contribute to DC plans and IRAs and who are likely subject to higher marginal tax rates during their working years than during retirement.^{159, 160} Others view these provisions of the tax code

as correcting a disincentive for savings that would occur if both contributions to and withdrawals from retirement accounts were taxed. Another contention is that tax benefits for retirement should be considered within the context of broader U.S. retirement policy, including Social Security benefits.¹⁶¹

The existing tax treatment may not facilitate adequate retirement saving by lower earners who face counteracting barriers in the form of asset tests for many public programs, such as Medicaid. Savings, including those in retirement accounts, may threaten eligibility for the means-tested programs on which low-earning workers depend.

Our approach includes improving the way that costs are estimated for retirement tax expenditures. We also advance changes to the tax code and to asset-test rules that would promote access to workplace retirement savings plans, encourage saving for retirement among lower earners, and limit tax benefits for individuals who have accumulated many millions of dollars in DC plans and IRAs.

10. Recommendation: Change congressional budget-estimation rules to use a more-accurate, long-term approach for evaluating retirement tax expenditures.

To make informed decisions about tax and spending policy, lawmakers need projections of budgetary impacts. Current methodology for analyzing retirement tax preferences, however, is problematic.

Official budget estimates of legislation involving retirement plans and IRAs consider the impact on tax revenues over only a 10-year period. This approach overstates the cost of tax deferral, since the exclusion or deduction for any given year's contributions occurs within the 10-year period, but much of the tax revenue (from withdrawals that occur decades in the future) is not included. Conversely, this methodology understates the budgetary cost of contributions to Roth accounts, because significant tax-free withdrawals of earnings occur outside the 10-year projection window.

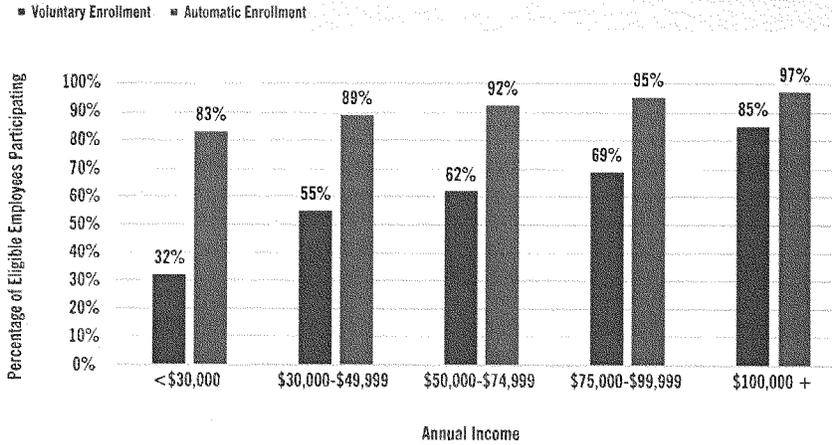
We recommend that Congress direct the Congressional Budget Office and the Joint Committee on Taxation to estimate retirement-related tax expenditures using a long-term approach based on the discounted net present value of the projected revenue changes. Better cost estimates would help lawmakers appropriately consider the longer-term impacts of legislation that affects retirement tax expenditures.

Precedent exists for this kind of change in scorekeeping methodology. In 1990, Congress passed, and President George H.W. Bush signed into law, the Federal Credit Reform Act. This law changed cost estimates for federal credit programs, such as federal student loans and some farm credit programs, from a cash basis to a net-present-value basis.¹⁶²

As with retirement savings, budget-scoring methodology is especially important when effects beyond the traditional 10-year window might be significantly different in magnitude and direction from short-term impacts. If the long-term revenues associated with tax deferral are recognized in cost estimates, then efforts to expand access and increase retirement savings could be easier to offset (i.e., these efforts would be seen as less expensive). A more-accurate projection method might also discourage policymakers from pursuing policies that seem to achieve federal budget savings in the near term, but that are, in reality, likely to result in higher long-run deficits.

Figure 19. Workers Are More Likely to Participate With Automatic Enrollment

Participation rates, by plan design and income.



Source: Vanguard¹⁶⁴

11. Recommendation: Promote well-designed workplace retirement savings plans by increasing the new-plan-startup tax credit for employers and offering a new tax credit for employers that add auto-enrollment.

As we have already noted, access to and participation in employer-sponsored retirement plans is critical to retirement security. Evidence shows that automatically enrolling new employees in retirement plans dramatically boosts participation rates. A 2001 study of several different companies found that participation rates rose to 85 percent or higher following the adoption of automatic enrollment (compared to less than 50 percent prior to adoption).¹⁶³

To encourage more employers to offer well-designed plans and adopt automatic enrollment, we recommend expanding tax incentives for businesses that take these steps. Currently, employers with fewer than 100 employees can take a tax credit of up to \$500 for 50 percent of the cost of starting up a retirement plan. The maximum startup credit should be increased to \$4,500, but the credit should also be limited to employers that implement an automatic-enrollment safe harbor, as we propose above. This would maximize the impact of the tax credit in terms of increasing retirement savings.

Encouraging new plans to utilize automatic enrollment, however, is not enough — automatic features should be added to existing plans as well. To encourage the adoption of opt-out designs by currently operating plans, we recommend a new \$1,500 tax credit for existing small plan sponsors that adopt an automatic-enrollment safe harbor for the first time.

12. Recommendation: Change the present Saver's Credit into a refundable Starter Saver's Match to provide better incentives for younger savers.

The Retirement Savings Contribution Credit (commonly referred to as the "Saver's Credit") is a tax credit designed to encourage retirement savings among low- and middle-income households. It resulted from

a bipartisan agreement in 2001 between Senators Rob Portman (R-OH) and Ben Cardin (D-MD), then both representatives in the House. The credit ultimately became part of that year's Economic Growth and Tax Relief Reconciliation Act, which also increased contribution limits for DC retirement plans and IRAs.

The Saver's Credit subsidizes a percentage of an individual's DC-plan or IRA contributions up to \$2,000 for a given year (or \$4,000 for joint filers). The exact percentage varies: lower-income savers are eligible for a tax credit equal to as much as 50 percent of their contributions, while higher-income savers receive a decreasing proportion until the credit phases out.¹⁶⁵ One of the most common criticisms of the Saver's Credit is that it is non-refundable, meaning that an individual must have a positive income-tax liability to receive the credit. This excludes many low earners who, due to deductions and other credits, have no income-tax liability.

Some have urged Congress to expand the existing Saver's Credit and make it refundable. These changes may be unlikely given their cost. Policymakers interested in expanding and reforming the credit should consider focusing initially on younger Americans, who are less likely to save on their own and have more time until retirement for savings to grow.

For workers aged 18 through 35, we recommend replacing the Saver's Credit with a Starter Saver's Match that would match contributions to an IRA or DC plan on a dollar-for-dollar basis up to a maximum of \$500 per year (\$1,000 for joint filers). The match would phase out between \$25,000 and \$30,000 of adjusted gross income (AGI) for single filers and between \$50,000 and \$60,000 of AGI for joint filers. The existing Saver's Credit would continue to be available for workers aged 36 and older.

Unlike the Saver's Credit, the Starter Saver's Match would be fully refundable, ensuring that it is available to those who would benefit most. Additionally, the match would go directly to a saver's retirement account, ensuring that the policy serves its intended purpose of enhancing retirement savings.

Initially, our modeling shows that about 10 percent of workers who are no older than 35 and who are offered a DC plan would receive the Starter Saver's Match.¹⁶⁶ That proportion is projected to decline as wages grow faster than the eligibility cap. The cost of this proposal to the federal budget would be approximately \$8.4 billion over the first 10 years of implementation (2017–2026).¹⁶⁷

13. Recommendation: Establish an overall limit on the total assets an individual can hold in tax-advantaged savings accounts to reduce taxpayer subsidies to wealthy Americans.

Under current law, no overall limit exists on the assets that individuals may accumulate in tax-advantaged retirement savings accounts. While the account balances of most individuals are fairly modest, the Government Accountability Office estimates that 314 taxpayers have more than \$25 million in IRAs, 791 have between \$10 million and \$25 million in IRAs, and 7,952 have between \$5 million and \$10 million in IRAs.^{168, 169} Allowing individuals to accumulate such large amounts in tax-advantaged accounts is an inefficient use of taxpayer resources and goes well beyond the policy's original intention of promoting retirement security.

These large balances are likely the result of unusual situations, such as when an individual invests IRA or DC-plan assets in shares of an early-stage start-up company before the company goes public and provides large income returns. Using a Roth IRA for this purpose would result in very large tax savings, disproportionately favoring wealthier individuals who may use their accounts as a tax shelter, rather than to fund consumption needs in retirement. For this reason, policymakers should impose limits on retirement tax expenditures, but do so in a way that is simple to operate and affects only the largest accounts.

To that end, we recommend applying a new limit to individuals who accumulate aggregate retirement savings, including all DC plans

and IRAs, in excess of \$10 million. (This threshold should be indexed to grow annually with average wages.) Individuals who exceed the \$10-million cap would be prohibited from making additional contributions to their IRAs or DC plans. This proposal would affect a relatively small number of households and would result in a more-equitable and efficient use of taxpayer subsidies.

14. Recommendation: End the "stretch" IRA estate-planning loophole.

Retirement plans are meant to provide for consumption during retirement, but an unintended consequence of giving these plans generous tax treatment has been the creation of new estate-planning tactics. Under current law, children, grandchildren, and other non-spousal beneficiaries can keep assets inherited from IRAs and DC plans in tax-advantaged accounts for decades after the original owner passes away.

We recommend that non-spousal beneficiaries be required to distribute inherited IRA and DC-plan assets over no more than five years. In addition to the spousal exception, we also support an exception for beneficiaries with disabilities. The Joint Committee on Taxation estimates that this proposal would increase federal revenues by \$5.3 billion over a decade.¹⁷⁰

15. Recommendation: Exempt small DC-plan and IRA balances from Required Minimum Distribution (RMD) rules, thereby simplifying requirements for many individuals.

Minimum distribution rules, which require individuals to regularly withdraw savings from retirement accounts beginning at age 70½, try to ensure that large retirement accounts are used to provide income during old age and not as indefinite tax shelters.¹⁷¹ Many workers with lower lifetime earnings, however, use Social Security and/or pension benefits to cover their recurring expenses and might retain small sums in DC plans and IRAs to use for emergencies or

one-time expenses. RMD rules unnecessarily impede this approach by forcing periodic withdrawals.

We recommend that individuals with fewer than \$100,000 in aggregate DC-plan and IRA balances be exempt from RMD rules. This change would enable older Americans with modest retirement savings to preserve these assets for emergencies or unexpected needs, such as to pay for long-term services and supports.

16. Recommendation: Exclude modest retirement-account balances from asset tests to remove disincentives to saving for lower-income Americans.

Individuals and couples who accumulate savings that exceed certain thresholds are ineligible for many means-tested public programs. These programs include Medicaid; Supplemental Security Income (SSI), which provides a modest cash benefit (no more than \$733 per month for an individual or \$1,100 for a couple) to older Americans and people with disabilities who have very low incomes and few assets; and the Supplemental Nutritional Assistance Program (SNAP), also known as food stamps.¹⁷²

Asset tests can be so strict that they even disqualify individuals of very modest means. In some states, households with savings as low as \$2,000 are ineligible for programs like food stamps and Temporary Assistance for Needy Families, a cash welfare program.^{173, 174} The asset limit for SSI, which is also used for some categories of Medicaid eligibility, has been fixed at \$2,000 for individuals and \$3,000 for couples since 1983.^{175, 176}

Asset tests like these force lower earners into punitive positions. Individuals who are otherwise eligible for these programs must choose between saving even modest amounts for retirement and qualifying for needed benefits, such as food and housing assistance. The restrictions effectively make saving impossible or self-defeating for these Americans.

In 2014, Congress passed and President Obama signed into law the ABLE Act, which helps certain people with disabilities save more without jeopardizing their program eligibility.¹⁷⁷ In addition to creating a new class of tax-advantaged savings account (called 529-ABLE), the law exempted savings in these accounts from asset tests for SSI and Medicaid, which provide cash benefits, health care, and long-term services and supports to many Americans with disabilities. Policymakers should extend a similar opportunity to lower-income workers and Americans with disabilities who do not qualify for 529-ABLE accounts.

Specifically, we recommend excluding the first \$25,000 of savings in retirement accounts (IRAs and DC plans) from asset tests for all public programs. Our modeling projects that this exemption would modestly increase participation in SSI, from 3.0 percent to 3.2 percent of Americans aged 62 and older in 2025.¹⁷⁸ Implementing this recommendation would empower more Americans to save and would provide those receiving cash or in-kind benefits with a greater opportunity to plan for a secure retirement.

II. Promote Personal Savings for Short-Term Needs and Preserve Retirement Savings for Older Age



Retirement is not the only savings challenge facing the nation. Many Americans exhibit low levels of basic financial security. Saving is undoubtedly difficult for many low-income families, who lack the leeway in their limited budgets to save for either short- or long-term purposes. These individuals are less likely to hold bank accounts and often rely exclusively on Social Security, which replaces much of their pre-retirement earnings, for income during old age.

The problem of financial insecurity, however, is not limited to households near the bottom of the income distribution. Some

individuals who have the means to save either were never taught the vital importance of personal savings or lack the ready-made opportunity and information to carry through even if they intend to save.

Research indicates that 57 percent of individuals are not financially prepared for an unexpected shock to their finances.¹⁷⁸ Facing an unexpected expense, individuals with insufficient short-term savings often take early withdrawals from retirement plans and IRAs. Alternatively, households may rely on expensive forms of credit, like payday loans.

One federal initiative designed to boost savings among low-income Americans who lack bank accounts is the Tax Time Savings Bond program, which gives workers the opportunity to receive up to \$5,000 of their federal tax refund in the form of paper Treasury bonds. This program has been in place since 2010 and has produced more than \$70 million in savings.¹⁸⁰ The Treasury Department, however, has only committed to extend the program through the 2016 tax season. Bipartisan legislation introduced in Congress would direct the Treasury Department to preserve the Tax Time Savings Bond program through 2020, enabling low-income savers to continue investing in paper Treasury bonds.¹⁸¹

Polymakers should do more to promote access to efficient short-term (or “rainy-day”) savings vehicles. Many individuals would likely benefit from diverting a portion of their paycheck into a personal savings account, but federal law contains barriers that prevent employers from automatically enrolling workers in these types of saving arrangements. Promoting a culture of saving — where more Americans understand the importance of saving — is vital for improved financial security and, ultimately, improved retirement security.

Critically, Americans who accumulate greater personal savings might be less likely to rely on retirement plans and IRAs in the face of financial emergencies. The purpose of retirement accounts is to build savings to provide income and meet consumption needs during retirement. In many circumstances, however, individuals can and do withdraw retirement savings before they reach a typical retirement age.

Pre-retirement withdrawals, known as “leakage,” are a clear threat to retirement security. While some of these early withdrawals may be unavoidable — for example, in the event of prolonged unemployment — others are not. Leakage often occurs unnecessarily, as the result of poor decision-making, misguided government regulations, or excessive red tape. In addition to directly reducing retirement income, early withdrawals can lead to steep penalties.

Transferring assets between DC plans when an individual changes jobs can be a daunting challenge. Participants often face confusing and duplicative paperwork, and the rules that guide transfers and rollovers can vary by plan type and employer. Some firms allow former employees to remain enrolled in their plan after job termination — but others do not. There is no guarantee that an individual’s new employer will even provide access to a retirement plan.

Federal policy does too little to help facilitate rollovers, especially with regard to low-balance accounts. Separation from employment is the time at which most leakage occurs. More broadly, rules for early withdrawals are confusing and misguided, and are inconsistently applied to IRAs and workplace DC plans. A more-cohesive system would solve many of these leakage issues and prevent damaging outcomes for savers.

Americans need the appropriate tools and information to preserve their retirement savings. Our plan would simplify, standardize, and strengthen the rules that apply to early withdrawals, and enact other changes to reduce leakage from retirement accounts.

1. Recommendation: Introduce new regulations to harmonize early-withdrawal rules for IRAs and 401(k)-type plans.

Currently, separate rules apply to early withdrawals from IRAs vs. DC plans. Early withdrawals from traditional IRAs are permitted under any circumstance, whereas early withdrawals from DC plans must be due to death, disability, or hardship. Hardship withdrawals from DC plans must satisfy an “immediate and heavy” need, a term that is narrowly defined by the IRS and typically limited to medical expenses, home purchases, education expenses, and funeral expenses.¹⁸⁵ Another contrast is that early withdrawals from DC plans usually trigger a 10-percent early-distribution tax, whereas IRAs allow many exemptions to this penalty.¹⁸⁶ These rules send mixed messages and are confusing to boot.

Moreover, federal policy can have the perverse effect of discouraging retirement saving by individuals who take hardship withdrawals from their workplace DC account. On taking the withdrawal, these workers are barred for six months from making additional contributions to the plan.¹⁸⁷ This restriction is intended to penalize early withdrawals, but the net result is an impediment to savers who are trying to get back on track. (Please see Table 3 on page 60 for further details on early withdrawals.)

We recommend harmonizing the rules for early withdrawals such that IRAs are held to the higher standards of DC plans.¹⁸⁸ Early IRA withdrawals should be limited to the narrow list of “immediate and heavy” needs that the IRS prescribes for DC plans, plus two additional circumstances: involuntary unemployment and health- and disability-related expenses.¹⁸⁹ These additional circumstances are already allowed under DC plans.

In addition, IRA owners should be allowed to self-certify, meaning that IRA providers need not collect further evidence to verify the hardship. Finally, we support eliminating the six-month ban on contributions following a hardship withdrawal.

More generally, the aim of policy should be to preserve retirement savings for their intended purpose. The reforms we propose

would produce a set of rules that provides a clear and consistent message to Americans saving for their retirement.

2. Recommendation: Simplify the process for transferring retirement savings from plan to plan.

Too many plan participants cash out their DC employer plans. In fact, one in three 401(k)-plan participants has cashed out of a plan before age 59 ½.¹⁹⁰

Cash-outs frequently happen — either voluntarily or involuntarily — when workers leave their jobs. The byzantine complexity that faces those who wish to roll over funds is partly responsible for this leakage. Another problem is that employers have the right to exercise a “mandatory cash-out” for accounts with balances up to \$1,000.¹⁹¹ This means that if a terminated employee has \$1,000 or less in their 401(k) plan and has not taken action to transfer the funds to a new plan or roll them into an IRA, the former employer can require them to cash out their savings. The terminated employee must then pay any taxes on the distributed funds, likely including an additional 10-percent penalty.

The regulations that guide DC-plan loans also unintentionally promote cash-outs. Many plans allow participants to borrow from their plan balance (at relatively low interest rates). In most cases, loan repayment must occur within five years. Unfortunately, if borrowers leave their job, any outstanding balance is due immediately and, if it is not repaid, is treated as a cash-out and becomes subject to the 10-percent penalty and income taxes.

We recommend reducing this complexity as a way to dissuade plan participants from cashing out. Within five years, all large DC plans (with at least 1,000 participants) should be required to provide a simple online form that enables participants to transfer their savings to another large DC plan or to any voluntarily participating IRA provider. Smaller employers should be encouraged, but not required, to offer their participants this service. The new

Retirement Security Clearinghouse we propose could facilitate this process.

Furthermore, we support new regulations to prohibit employers from forcing cash-outs of retirement savings accounts with balances of \$1,000 or less. If participants do not elect to transfer or cash out their assets, their savings should be automatically transferred to a myRA account. Finally, DC-plan loans should be transferrable to an IRA, so that repayment can occur according to the original terms after a job change.

These changes would help savers avoid the headaches of the current rollover process and preserve more funds in retirement savings accounts.

3. Recommendation: Make technical adjustments to enable transfers and rollovers from all 457 plans.

Governments and not-for-profit organizations may offer retirement benefits through 457 plans, which are very similar to 401(k) plans, except that they have different contribution limits and early-withdrawal rules. There are two types of 457 plans: governmental plans and nongovernmental plans sponsored by tax-exempt organizations.

Historically, 457-plan assets could not be transferred to another qualified plan type, such as a 401(k) plan, nor could they be rolled over into an IRA. In 2001, the law was changed to allow participants in *governmental* 457 plans to transfer assets to a different plan type or roll over assets to an IRA. This change, however, did not apply to nongovernmental 457 plans.

We recommend extending the same flexibility to nongovernmental 457 plans so that participants in these plans can likewise consolidate their retirement assets in a single plan or IRA.

4. Recommendation: Clear barriers to automatic enrollment in multiple savings accounts.

If individuals suffer a financial shock — like a large hospital bill or prolonged unemployment — they should not be forced to draw down retirement savings, endangering their retirement security. Workers would ideally accrue “rainy-day” savings, held in a standard savings account, for these purposes. Indeed, lower earners often need emergency savings more than retirement savings. Unfortunately, many Americans, particularly those with low incomes, struggle to save at all — and some do not even have bank accounts.

Presently, cumbersome regulations apply to employers that wish to automatically enroll their employees into multiple savings accounts — one specifically for retirement and one for shorter-term needs. Many large businesses are interested in offering both kinds of accounts, and clearing away these regulatory barriers would encourage them to move forward.

To better facilitate short-term savings, we recommend clearing red tape so that employers can automatically enroll employees via payroll deduction into multiple accounts. Specifically, contributions could be split between a tax-advantaged retirement plan and a standard savings account covered by deposit insurance.¹⁹² The savings account would not be tax-advantaged or designated for retirement. Funds in this account would be accessible without penalty at any time, and every employee would have the right to opt out. This type of arrangement could reduce pre-retirement withdrawals by providing workers with a convenient vehicle for saving for emergencies.

Table 3: Current and Proposed Rules Governing Withdrawals from DC Plans and IRAs

	Tax-Deferred DC Plans ¹	Traditional IRAs	Proposed Rules
Pre-Retirement Withdrawals	<p>Only allowed for reasons that the plan may specify (so long as they constitute an "immediate and heavy financial need").² The IRS has a list of circumstances that automatically qualify as immediate and heavy:</p> <ol style="list-style-type: none"> 1. Certain medical expenses 2. Tuition and related educational fees 3. Burial or funeral expenses 4. Purchase of a principal residence 5. Payments to prevent eviction from or foreclosure on a principal residence 6. Certain expenses for the repair of damage to a principal residence 	Always allowed.	<p>Follow current DC-plan regulations, with added exemptions for early withdrawals in the cases of involuntary unemployment and health/disability-related expenses.</p> <p>Clarify that for both DC plans and IRAs, the employer or IRA provider would not have to verify the "hardship" beyond a signed statement by the account holder.</p>
Taxation of Withdrawals	Individuals must pay income tax on withdrawals and an additional 10-percent early-distribution tax. ³ The penalty is waived in the case of the death or total and permanent disability of the participant, as well as other limited exceptions.	Individuals must pay income tax on withdrawals and usually must pay an additional 10-percent early-distribution tax. The penalty is waived in the case of the death or disability of the IRA owner, as well as for several other reasons, including for qualified higher-education expenses, up to \$10,000 for first-time homebuyers, and for health-insurance premiums paid while unemployed.	Eliminate exemptions that apply only to IRAs; apply 10-percent penalty to all early withdrawals, other than in cases of death, total and permanent disability, and limited other exceptions.
Suspension of Contributions	Individuals cannot make contributions to their plan in the six months following a hardship withdrawal.	No suspension of contributions.	Follow current IRA regulation.

¹Tax-deferred DC plans allow individuals to delay their income-tax liability until the time of withdrawal. Conversely, Roth plans receive after-tax contributions, and withdrawals are usually tax-free after age 59 ½. Withdrawals of earnings from Roth accounts before age 59 ½ are subject to taxation and the early-distribution tax — principal may always be withdrawn free of taxes from Roth accounts.

²A withdrawal is only permitted for these purposes if the individual has already exhausted certain other possibilities, including available plan loans.

³A few limited exceptions exist: for distributions made after the participant's death, for cases when the participant is totally and permanently disabled, for annual distributions that are substantially equal in amount and made over the life expectancy of the participant and any beneficiaries, for medical bills that exceed 10 percent of the account holder's adjusted gross income (AGI), for an IRS levy, and for some reservists called up to active duty.

III. Facilitate Lifetime-Income Options to Reduce the Risk of Outliving Savings



Longevity risk, the possibility that retirees will outlive their savings, is one of the most significant threats to retirement security. Social Security, DB pension plans, and life annuities from insurance companies all leverage the power and efficiency of mortality pooling to help individuals manage the financial risks of longevity. Since Social Security alone will not meet all retirement-adequacy needs for most individuals, other lifetime-income solutions offer those households who have accumulated sufficient savings the promise of an additional, regular retirement income that they cannot outlive.

Yet, many DC retirement plans do not include any guaranteed lifetime-income features or other functions to help manage the challenges of the financial drawdown phase of retirement. For these

plans that do offer retirement-income features, participant uptake historically has been low, despite the efforts of plan sponsors to add tools, advice options, and educational resources focused on the retirement phase.⁶¹

All DB plans must offer participants at least the option of receiving benefits in the form of a monthly payment for life. When given the choice, however, DB-plan participants too often elect a single- or lump-sum distribution, which they typically transfer to a DC plan or roll over into an IRA. In short, most Americans find themselves financially unprepared for the possibility of an especially long life, even if they have had access to good retirement plans.

This preference for lump-sum distributions among both DB- and DC-plan participants has many possible explanations, including: retirees' uncertainty and fear about losing control of their assets; the attraction of a large, immediate payout; as well as misjudgments about the value of lifetime-income features. Americans nearing retirement are often unaware of their chances of living well into their eighties and nineties. Moreover, insurance products can be complex and bewildering to consumers, some of whom might feel that existing products do not meet their needs. Others might conclude that their need for recurring income is met adequately by Social Security and would rather save DC-plan assets for emergencies and other one-time purchases.

Perhaps present retirement plans simply do not offer the retirement-income functionality that participants would find useful. Plan sponsors and policymakers could try a variety of approaches to help Americans meet their income needs in retirement. For example, instead of an all-or-nothing choice between a lump-sum distribution and an annuity, participants might respond better to properly explained options in between.

Many tools to address longevity risk are available in the marketplace; they include insurance products that guarantee regular payments for life as well as options that are not guaranteed, but instead aim to generate a sustainable regular payout that keeps up with inflation. These options could be presented to participants in simpler, more-engaging ways. An underutilized lifetime-income approach is to rely on retirement savings as a bridge to delay claiming Social Security benefits, thereby allowing for a larger monthly Social Security payout later in life. Because Social Security is a life annuity that increases annually for inflation, a rare feature in the private market, this strategy has significant potential to improve retirement security.

Regulators have made important efforts to encourage innovation in lifetime-income products. In 2014, the IRS issued final regulations that cleared barriers to the use of qualifying longevity annuity contracts (QLACs), essentially long-deferred annuities, in DC retirement plans.¹⁹⁴ Under this new rule, participants can use

a small portion of their account balance, but no more than 25 percent, to purchase a longevity annuity that begins fixed monthly payments as late as age 85 and continues for the life of the participant and/or a surviving spouse.¹⁹⁵ This could be a lower-cost method for addressing longevity risk, allowing consumers to maintain control over most of their assets with the more-manageable goal of making those savings last until payments from the longevity annuity begin.¹⁹⁶

The IRS has also clarified that plan sponsors may include longevity annuities as part of a target-date fund.^{197, 198} This action provides plan sponsors with an important avenue to include a guaranteed lifetime-income product as part of their plan's default investment option, potentially increasing take-up.

What Is a Target-Date Fund?

"Target-date fund" is a marketing term, but it appears in regulation and is commonly used in the context of DC retirement plans. A target-date fund refers to an investment option that gradually adjusts toward a more-conservative asset allocation as the participant approaches an intended retirement date. For example, a target-date fund would direct most of the savings of a younger employee into stocks, while the portfolio of an older employee would be shifted toward bonds. Many automatic-enrollment plans designate an age-appropriate target-date fund as the default investment option for participants who do not make their own selection.

These developments are important steps to help retirement-plan participants manage longevity risk, but much more can be done. Policymakers and employers should build on their ongoing efforts to improve lifetime-income options and increase uptake among retirement savers. Effectively addressing these challenges requires further innovation in both plan design and engagement with participants. New tools to help participants combine guaranteed

products with other strategies to generate retirement income could help as well. Finally, any features should be presented in a straightforward, understandable manner and should be easily customizable to accommodate the preferences of participants.

Our approach envisions statutory and regulatory changes to build a new emphasis on lifetime income within retirement plans. The goal is to encourage action by plan sponsors to better support participants during the retirement phase of plan participation. The proposals below are designed to give employers options, with the flexibility to add features over time.

Nobody knows how long they will live in retirement. Thus, longevity is an unpredictable factor in nearly every American's financial planning. For this reason, policymakers and regulators ought to do all they can to facilitate and encourage lifetime-income solutions that employers and retirees can fit to their circumstances.

1. Recommendation: Encourage plan sponsors in general to integrate easy-to-use, sophisticated lifetime-income features.

Including lifetime-income options can be a complex endeavor that entails concerns about fiduciary liability; in addition, businesses often have to invest significant time and resources to develop lifetime-income features.

We recommend providing new safe harbors, modifying regulations, and giving additional guidance to plan sponsors that wish to incorporate lifetime-income options within a DC plan.¹⁹⁹ No plan sponsors would have to include these options. The availability of new safe harbors, however, would promote the inclusion of lifetime-income features by limiting legal risk to plan sponsors if they follow certain specifications. Such provisions should allow substantial flexibility, within limits, to design a tailored solution for participants.

These developments could have a similar effect for lifetime-income solutions as the Pension Protection Act of 2006 had for retirement plan auto-features. Removing barriers to auto-enrollment and auto-

escalation, as well as providing limited protection from fiduciary liability for the use of QDIAs, increased substantially the number of plan sponsors that implemented auto-features. The lifetime-income field is ripe for comparable changes.

We encourage leadership from plan sponsors to help their workers address longevity risk. But our recommendations also reflect a recognition that policymakers will need to address some of the reservations that are holding plan sponsors back from offering lifetime-income features.

2. Recommendation: Implement specific policy changes that would enable more plans to offer automatic installment purchases (i.e., laddering) of guaranteed lifetime-income products.

Individuals who purchase an annuity contract risk buying at the wrong time, such as right after a drop in the market or when interest rates, and therefore annuity payouts, are low. Purchasing an annuity on an installment basis over a period of years, an approach known as "laddering," can reduce timing risk. In practice, however, it can be difficult for individuals to make installment purchases of annuities. Retirement-plan participants would benefit from access to a feature that makes laddering simple.

We recommend a new safe harbor, along with any necessary regulatory changes and guidance, to grant limited protection from fiduciary liability to DC-plan sponsors that offer their participants the use of a service that automates laddering for purchases of a guaranteed lifetime-income product. The installment purchases could use either all or a portion of the participant's account balance over a period of years.²⁰⁰ (For background on safe harbors, please see the box on page 41.)

This safe harbor would not be product-specific and would apply broadly to insured products that include lifetime guarantees. For example, the laddering safe harbor could apply to:

- 1) Products that are purchased with an irrevocable, one-time premium and that guarantee, in exchange, a stream of regular payments for the life of the participant beginning either immediately after purchase or at some future date;²⁰¹
- 2) Products that guarantee a lifetime stream of withdrawals from an account balance to which the participant has continued access;²⁰² and
- 3) New products that might become available, as long as they include lifetime guarantees that are insured obligations.

The laddering safe harbor would also accommodate opt-in approaches, in which the participant has the opportunity to affirmatively select an option; opt-out approaches, in which a subset of participants, such as those meeting age and plan-asset-level thresholds, are notified in advance that they will be enrolled into the option by default unless they affirmatively opt out; and active-choice approaches (described in the next recommendation). Additionally, the Treasury Department should clarify that these laddering features do not violate nondiscrimination rules.

Participants might use only a portion of their retirement account to purchase a guaranteed lifetime-income product. A systematic-withdrawal method can be a prudent approach for drawing down the remaining assets. These methods allow participants to make regular withdrawals from a retirement account in amounts that are likely to be sustainable over the long term. Notably, such amounts are only *expected*, and not guaranteed, to last for the life of the participant.

Thus, the safe harbor for guaranteed lifetime-income products should also encourage plan sponsors to make systematic-withdrawal methods available to participants. The plan sponsors that adopt this safe harbor should receive limited protection from fiduciary liability if they offer participants the use of an automated service to implement periodic (such as monthly) withdrawals using a method that is likely to be sustainable, but lacks a guarantee. The regulation should identify systematic-withdrawal methods that would qualify for the safe harbor.

Assuring employers that these lifetime-income products and methods are permissible would pave the way for greater integration of these features in DC retirement plans.

3. Recommendation: Implement specific policy changes to promote active-choice methods of selection among retirement-income features.

An active-choice framework requires individuals to make a decision. Whereas an opt-out policy auto-enrolls those who take no action, and an opt-in policy requires individuals to take initiative, an active-choice framework lays out several options and allows individuals to choose their preference. Active-choice policies have shown particular promise in the area of public health: studies have shown, for example, that active choice can increase the uptake of flu shots as well as people's willingness to serve as organ donors.²⁰³ In the area of retirement planning, an active-choice approach has shown promise in boosting 401(k)-plan enrollment when compared to a standard opt-in policy, although active choice does not boost enrollment quite as much as an opt-out framework.²⁰⁴

We recommend a safe harbor for DC-plan sponsors that wish to utilize an active-choice approach for retirement-income features. Under such an approach, participants of a certain age, perhaps 10 years before the expected retirement age, would be offered a simplified menu of retirement-income options, potentially including those encouraged by the proposals above. Before taking any withdrawals from the plan, participants would be required to make an affirmative election of whether and how to use retirement-income features. Participants could choose to decline all such features and independently manage withdrawals from the plan.

For example, participants nearing retirement age might respond to a series of basic questions, such as: "What percentage of your benefit would you like in the form of guaranteed monthly income for life?" Based on these responses, participants would review a simplified menu that might include some or all of the following options:

- 1) Use the entire retirement-account balance in installments over the next several years to purchase a product that guarantees a lifetime stream of withdrawals from an account balance to which the participant has continued access.
- 2) Use a portion of the retirement-account balance over the next several years to purchase an irrevocable product that guarantees a stream of regular payments for the life of the participant beginning at a certain age.
- 3) Combine a version of the second option with automated, systematic withdrawals from the remaining account balance beginning at a certain age.
- 4) Decline any retirement-income features and take withdrawals on an as-needed basis.

These options should be presented in a manner that is easily accessible to consumers, accurately describes the consumer's choices, and discloses important product features, including whether a certain option is reversible. Participants should be able to select one of the menu options as presented or customize certain parameters (such as what portion of the account would be devoted to a guaranteed lifetime-income product or a systematic-withdrawal method).

This innovative approach to retirement-income decision-making could encourage participants both to consider their future finances and select an individualized solution. A combination of appropriate guidance and easy-to-use tools would empower workers to make decisions that improve their retirement security.

4. Recommendation: Encourage plan sponsors to offer information and features designed to lessen the risk that workers will claim Social Security benefits early.

For each year between ages 62 and 70 that individuals wait to claim Social Security benefits, their monthly payments increase by between 5 and 8 percent. For many retirement-plan participants,

claiming Social Security benefits later, up to the maximum benefit age (currently age 70), would improve retirement security by offering better protection against longevity risk. Working longer or temporarily taking larger distributions from retirement accounts are both ways to facilitate later claiming. This is especially valuable because Social Security benefits are updated annually for inflation — a feature that is rare in the private market.

We recommend providing plan sponsors with a safe harbor to implement features that help participants make informed decisions about when to claim Social Security benefits and that assist participants in using their retirement-plan savings to enable later claiming. These features should include the ability to generate customized analyses based on plan data and participant-supplied information. For example, an online tool could guide participants to select appropriate investments and schedule a series of plan withdrawals that would approximate forgone Social Security benefits for a certain period, such as the eight years between ages 62 and 70.

Later claiming of Social Security is an underutilized but potentially powerful approach for improving retirement security. Encouraging plan sponsors to inform participants and support tools that facilitate use of this option could significantly improve uptake.

5. Recommendation: Develop new guidance and rules to encourage plan sponsors to better engage participants in decisions about lifetime income.

Lifetime-income features can be complex, and individual needs and preferences are complicated and varied. Many participants would benefit from a better understanding of their options and the ability to select a solution that is appropriate for their particular circumstances. To address this need, the Labor Department has been developing guidance to encourage plan sponsors to communicate with participants about lifetime income and lifetime-plan participation.

On a related and more-specific note, although participant-directed

DC retirement plans issue quarterly statements showing individuals' account balances and investment performance, participants may have little sense of how much income their savings could generate during retirement. Plan sponsors have been reluctant to include such estimates out of fear that participants might interpret them as a promise and that the sponsor might then become liable if a participant's actual retirement income falls short of the estimates.

The Department of Labor also has a rulemaking process underway to include lifetime-income illustrations on quarterly plan statements. In 2013, the department issued an Advanced Notice of Proposed Rulemaking to require that plan sponsors include a lifetime-income illustration in regular account statements and to establish safe harbors for such estimates that would protect plan sponsors from liability if actual experience differs.²⁰⁵

We recommend that the department finalize and publish guidance for plan sponsors on communicating with participants about aspects of lifetime income. For example, plan sponsors should provide participants with plain-language explanations of longevity risk and options to address that risk. These explanations could use examples that are tailored to the solutions available within the plan. The examples could be customized for each participant based on known information (e.g., account balance, age, and marital status), as well as participant-supplied information.

We also recommend that the Labor Department finalize its lifetime-income illustration rule to allow individualized projections using a range of reasonable, disclosed assumptions. Expressing potential lifetime income as a range would more effectively communicate to participants that actual results can vary depending on a variety of factors.

6. Recommendation: Clarify the role of the plan sponsor in assessing the financial strength of insurance carriers when selecting in-plan annuities.

Current safe-harbor guidance leaves plan sponsors that seek to

offer a guaranteed lifetime-income distribution option with too much uncertainty about how to evaluate the solvency of potential carriers. Insurer solvency is a complex topic that is outside the expertise of many employers. Requiring plan sponsors to carefully evaluate the appropriateness of particular investment and distribution options is reasonable, but sponsors should be able to look to others for guidance on the financial strength of the carrier. Members of Congress from both parties, including Sen. Orrin Hatch (R-UT) and former Sen. Tom Harkin, have offered proposals to amend the existing carrier-selection safe harbor to make it clearer and more functional.²⁰⁶

We recommend that policymakers seriously consider these approaches and enact a new standard that offers plan sponsors more clarity about how to assess solvency. Any new approach must still require plan sponsors to conduct a thorough analysis to evaluate the cost and benefits of products under potential annuity contracts.

This new, more-objective approach to assessing carrier solvency might consider several factors: the license and accreditation status of the annuity provider; whether the annuity provider is in good standing with the insurance regulator in the state of domicile and the state where the contract is to be issued; audited financial statements of the annuity provider; and insurer-financial-strength ratings from third-party analysts.

7. Recommendation: Allow participants aged 55 and older to initiate in-service rollovers for the purchase of annuities that begin making payments later in life, and improve the portability of in-plan annuity contracts.

Many DC plans do not incorporate in-plan guaranteed lifetime-income distribution options. Participants in these plans must wait until at least age 59 ½ to obtain a guaranteed lifetime-income product, such as an annuity. This limits workers' ability to purchase lifetime-income products using an installment approach (also known as laddering) to mitigate timing risk.

Relatedly, the Treasury Department has already established rules to encourage the use of QLACs (see page 62), which are insurance products that guarantee a monthly payment for life starting no later than age 85. Compared to immediate annuities, QLACs can be a lower-cost method to address longevity risk.

We recommend that ERISA be revised and new regulations be developed, as needed, to enable DC-plan participants aged 55 and over to initiate special in-service rollovers exclusively for purchasing QLACs. Longevity annuities can particularly improve retirement security for retirees who go on to live especially long lives. New regulations should aim to encourage the development of the market for QLACs and eliminate the potential for leakage. Over time, policymakers should consider extending this rollover option to other irrevocable, guaranteed lifetime-income products.

Plan sponsors and participants also face special challenges related to the portability of lifetime-income products that are offered within DC retirement plans. For example, if a plan sponsor offers an in-plan lifetime-income product and then later discontinues it (e.g., the plan sponsor decides to offer a different product or switches to a recordkeeper that does not support the old product), inactive or retired participants may be able to roll the discontinued product over to a different retirement plan or an IRA. Active participants, however, may be prohibited from doing so and could be forced to liquidate the product, potentially incurring fees or forfeiting a portion of its value.

Both Sen. Orrin Hatch (R-UT), Chairman of the Senate Finance Committee, and President Obama have proposed to allow in-service distributions (i.e., plan-to-plan transfers or rollovers to an IRA) for participants who purchase an in-plan lifetime-income product that is subsequently discontinued. This change would facilitate better portability of lifetime-income products. In addition to benefiting individuals who participate in plans that already include lifetime-income products, this step might encourage plan sponsors to offer lifetime-income products within their plans in the first place.

We recommend that Congress adopt the approach Sen. Hatch and

President Obama have proposed.²⁰⁷ Doing so would improve access to lifetime-income products for DC-plan participants and make these products more portable. The low prevalence and low uptake of retirement-income products in DC plans is unlikely to be addressed by any single reform, but steps including those proposed in this section could build significant momentum toward increased use of these products.

8. Recommendation: Allow DB plans to offer additional lifetime-income distribution options in order to provide employees with more flexibility and discourage lump-sum distributions.

When receiving benefits, most DB-plan participants must make an all-or-nothing decision: they can either take their entire benefit as a monthly payment for life or as a single-sum distribution. The Treasury Department has issued a proposed rule to clear regulatory barriers that currently discourage DB-plan sponsors from offering partial annuities.²⁰⁸ For example, participants should be able to receive half their benefit as a monthly payment for life and the other half as a single-sum cash distribution.

We recommend finalizing Treasury's proposed rule to encourage DB plans to give participants flexibility in choosing what portion of their benefit to take as a monthly payment and what portion to take as a lump sum. In accordance with this change, per-participant PBGC premiums, which are now paid by plan sponsors, should be prorated when participants opt to take a partial lump sum. For example, if a participant elects to receive half of his or her benefit in the form of a lump-sum distribution and half in the form of a monthly payment for life, the PBGC premium for that participant would be halved. This change recognizes that the partial lump-sum distribution results in fewer liabilities for the PBGC to insure and might encourage employers to offer the partial lump-sum option.

Additionally, we recommend a second regulation to allow DB plans to offer longevity annuities. This rule could align with the existing

QLACs that plan sponsors may now offer to DC-plan participants. For example, DB participants could receive part of their benefit as a monthly payment for life beginning no later than age 85 and the rest as a single-sum distribution. As above, per-participant PBGC premiums should be prorated accordingly.

9. Recommendation: Improve work incentives by allowing qualified retirement plans to align plan retirement ages with Social Security.

Currently, qualified DC and DB retirement plans cannot designate a plan retirement age greater than 65. Allowing plan sponsors to align plan retirement ages with the Social Security full retirement age (FRA) could encourage participants to work longer and provide more-consistent work incentives across Social Security and employer-sponsored retirement plans.

We recommend modifying ERISA to allow plans to transition to a retirement age equal to the Social Security FRA. To ease the transition, this change should be limited to plan participants who are at least 10 years younger than the current plan retirement age.

IV. Facilitate the Use of Home Equity for Retirement Consumption



For many older Americans, home equity is their largest single asset. Among families with assets and headed by an individual aged 75 or older, median financial assets stand at about \$29,000, while median net worth (including home equity) is around \$217,000.²⁰⁹

Homeownership has many benefits for older Americans, especially for individuals and couples who have paid off their mortgages. Not only does homeownership lower recurring living expenses, but home equity can also serve as a valuable source of retirement savings. Retirees can downsize and move into a less-expensive home, and use the extra funds to supplement their retirement income. Homeowners can also tap into their existing home equity without selling their home, through home equity lines of credit (HELOCs) or reverse mortgages.

(Both of these options are detailed in the following pages.)

Unlike tax-advantaged retirement accounts, homeowners suffer no penalty if they use home equity to fund pre-retirement consumption, for example, by taking out a home equity loan. In fact, the federal government actually subsidizes this behavior. The mortgage interest deduction allows borrowers to reduce their taxable income by the value of the interest payments made on all home-secured loans. Borrowing against home equity during one's working years, however, is likely a poor choice for many homeowners, as doing so can lead to greater debt and related expenses during retirement, when income is typically lower.

Accessing home equity wealth in one's retirement years can also pose challenges, especially for retirees who wish to remain in their home. They might use a HELOC, which offers revolving credit with home equity serving as collateral. These products are underwritten, however, meaning that eligibility is limited to homeowners with good credit and sufficient income to service the debt. Another option for homeowners is a reverse mortgage, a little-understood and rarely used product that allows Americans aged 62 and older to tap into their home equity while remaining in their home or, in preparation for downsizing, to buy a smaller home. (Please see the box on this page and the following page for details.)

Currently, too many individuals choose to tap into their home equity for pre-retirement consumption, while large numbers of older Americans do not understand how to utilize this asset in retirement. Given the prevalence of "home-rich, cash-poor" retirees, we believe that public policy, at a minimum, should not encourage working-age adults to deplete their home equity assets. Our approach would create a new alternative for retirees to tap into home equity while also increasing efforts to inform homeowners of the various options available to utilize home equity in retirement.

What is a Reverse Mortgage?

Reverse mortgages allow homeowners aged 62 and older to borrow against their home. A distinction between reverse mortgages and home equity loans is that the former require no regular payments. The loan is not due until the home is sold or both the homeowner and any spouse passes away, though interest accrues throughout the life of the loan.

The vast majority of reverse mortgages use the Federal Housing Administration's (FHA) Home Equity Conversion Mortgage (HECM) program, which backs reverse mortgages originated by private lenders.²¹⁰ Under the HECM program, borrowers can receive payments in a lump sum, regular installments, or a combination of the two.²¹¹ Alternatively, an older homeowner can take out a HECM line of credit (HECM LOC), which allows individuals to tap into their home equity on an as-needed basis. Unlike the drawdown of a traditional IRA or employer DC plan, HECM LOC withdrawals are not taxed.

The amount of home equity accessible under the HECM program depends on the age of the borrower, interest rates, and the value of the home.²¹² For example, a 72-year-old homeowner in a 5-percent interest-rate environment can leverage around 58 percent of his or her home value.²¹³

The HECM program has also tightened lending standards in recent years, largely due to the losses that resulted from the 2008 housing market crash. These changes reduced the risk, and therefore the cost, of such losses to the federal government, both by tightening principal limits and by requiring new borrowers to demonstrate their ability to cover typical homeownership expenses, and thus avoid foreclosure.²¹⁴ As a result, the HECM portfolio is currently valued at \$7.9 billion, up from -\$1.2 billion in 2014.²¹⁵

Product complexities and expenses have discouraged the use of reverse mortgages. The market for such mortgages is small, at around 1 percent of the size of the traditional mortgage market, and fewer than 3 percent of eligible homeowners participate.²¹⁶ The retirees who are most likely to seek a reverse mortgage are "home-rich" and "cash-poor" in the sense that they typically have little to no savings besides their home equity and rely disproportionately on Social Security for their retirement income.

What Is a Reverse Mortgage? (continued)

Prior to accepting a loan, prospective HECM borrowers must receive financial counseling, which is subsidized by FHA and designed to ensure that homeowners understand their options and make decisions with full understanding of the implications.²¹⁷ Counselors are required to accurately convey the relative advantages and disadvantages of different payment plans. Furthermore, regulations stipulate that lenders must provide a clear explanation of the various features and options available to borrowers.^{218, 219}

Reverse mortgages can be risky and are not appropriate for everyone. Homeowners risk losing their home to foreclosure if they borrow too much upfront and do not reserve some credit availability to pay for property taxes, insurance, and home maintenance.

Moreover, reverse mortgages are expensive, as lenders and the government charge high fees and interest to account for potential losses that may occur upon selling the home. Specifically, HECM borrowers are required to pay both an upfront and annual mortgage insurance premium (MIP) that can be costlier than the insurance offered for FHA-backed traditional mortgages.²²⁰ For example, a person who is financing much of the cost of a typical home purchase would likely pay 1.75 percent of the loan in the upfront MIP, plus 0.8 percent annually.²²¹ If this same person pays off his or her home and chooses to initiate a HECM upon reaching retirement age, he or she could pay up to 2.5 percent initially and 1.25 percent annually in MIPs, though these fees would not be due until the home is sold. Despite these costs, however, reverse mortgages can be an especially useful tool for retired homeowners who wish to age in place.

1. Recommendation: End subsidies that encourage the use of home equity for pre-retirement consumption.

The portion of older Americans holding mortgage debt has more than doubled in recent years. This increase in borrowing to fund pre-retirement consumption poses a threat to retirement security, especially for individuals who hold a high percentage of their wealth in home equity. Debt service can sap limited retirement income, leaving retirees with less to spend on consumption needs. Part of the blame lies with federal policy, which encourages home debt by making mortgage interest tax deductible.

We recommend limiting these tax deductions, as the federal government should not encourage individuals to borrow against their homes for pre-retirement consumption. Tax deductions should no longer apply to mortgage interest when home equity decreases, such as through HELOCs, mortgage debt for second homes, second mortgages that reduce home equity, and refinancing transactions.²²² Removing current tax subsidies would increase the incentive for homeowners to preserve their home equity for retirement. This, in turn, would boost retirement security among households with a disproportionate amount of wealth locked up in their homes.

2. Recommendation: Strengthen programs that support and advise consumers on reverse mortgages.

Despite the risks and costs outlined above, a reverse mortgage can be a prudent option for some retirees, especially for those who wish to remain in their homes and who have high levels of home wealth but lack sufficient retirement savings and income. In addition, these products can protect against longevity risk. Undrawn HECM LOCs in particular can provide older Americans with additional liquidity by allowing them to tap into their home equity as needed. Ultimately, many homeowners could benefit from a reverse mortgage in retirement, but have not considered the possibility or are unaware that advice is available from FHA-sponsored independent counselors. These counselors can help homeowners develop a budget, assess

their resources, and determine whether a HECM reverse mortgage is an appropriate option.

We recommend providing additional resources to FHA to administer the HECM reverse-mortgage program. A portion of the funds should enhance the existing financial-counseling program. FHA should also promote awareness among retirees by increasing advertising for this program. Since the retirees who could benefit most from a reverse mortgage are unlikely to have a financial advisor, spreading the word about low- or no-cost counseling is important.

Furthermore, we recommend that FHA engage a variety of agencies that are focused on retirement security, including the Treasury Department, the Labor Department, PBGC, the Social Security Administration (SSA) and the Consumer Financial Protection Bureau (CFPB), to develop a strategic plan for how reverse mortgages can play the most appropriate role in retirement security. This plan should include consumer education. For example, PBGC and the Labor Department could both encourage plan sponsors to promote FHA-sponsored counseling options and contact participants directly. Similarly, SSA could include information about counseling options on the Social Security statement, through separate communications with beneficiaries, or during the application process for Social Security benefits.

Coordinated efforts across government agencies to strengthen the role of home equity in providing retirement security could help to increase awareness of reverse mortgages. Such coordination could also improve FHA's existing counseling program, providing new perspectives and fresh insight.

3. Recommendation: Establish a low-dollar reverse-mortgage pool for retired homeowners.

The current HECM reverse-mortgage program allows older homeowners to access a large portion of their home equity for consumption purposes. This makes HECM reverse-mortgage products risky, and therefore expensive, as the vast majority of

borrowers opt to take the maximum amount allowable. Along with an origination and monthly-servicing fee, borrowers owe an initial mortgage insurance premium (MIP) that can cost up to 2.5 percent of the maximum claim amount (typically, the value of the home), as well as an annual MIP of 1.25 percent of the outstanding balance, not including any undrawn line of credit.^{223, 224, 225} These funds go to FHA in exchange for backing the program. For example, if the proceeds from the sale of a home are insufficient to repay the loan balance, FHA covers the difference with MIP revenues, ensuring full repayment to the lender. Thus, high MIPs are a reflection of the risk that the federal government assumes through the HECM program.^{226, 227} But high costs ultimately make the program unsuitable for individuals who want to borrow smaller amounts.

We recommend offering a low-dollar reverse-mortgage pool that would operate alongside the current system as a way to allow retirees to tap into smaller amounts of their home equity. For example, FHA could limit borrowing from this pool to no more than 30 percent of a home's value. These mortgages would operate in a separate, lower-risk pool, which would remain backed by FHA. With tighter borrowing limits, homeowners would be less likely to take on high levels of debt, and the federal government would face less risk from a housing market downturn. This would allow FHA to charge a lower MIP — hopefully less than 1 percent each for upfront and annual premiums.

Between 2010 and 2013, FHA did in fact offer a lower-dollar reverse-mortgage product, called the HECM Saver. At the time, the HECM Saver provided lower loan proceeds in exchange for a lower upfront MIP. The program remained risky and costly, however, as some borrowers were able to tap into large amounts (over 50 percent) of their home equity. Because of this, the annual MIP remained identical to the standard HECMs.²²⁸

Our proposed low-dollar reverse-mortgage pool would be structured differently than the HECM Saver, further limiting the amount of equity accessible to borrowers. This, in turn, would further reduce risk, allowing FHA to charge even lower fees.

Compared to the current system, a scaled-down HECM might appeal to a different type of borrower — a retiree who faces a non-recurring consumption need, for example, rather than someone who has long-term, serious financial issues. Reverse mortgages in the new pool could help fund home modifications to facilitate aging-in-place, finance a grandchild's college education, or pay uncovered medical expenses. A lower-dollar pool would broaden the market for reverse mortgages, giving "home-rich, cash-poor" retirees the ability to tap into a smaller amount of their home value at a more-affordable cost.

V. Improve Financial Capability Among All Americans



Financial capability refers to the knowledge, ability, and opportunity to manage one's own finances.²²⁹ It is a crucial aspect of both retirement security and personal savings, and it touches broadly on all of the challenges and recommendations that we have put forth in this report. Without a basic knowledge of personal finance and budgeting, Americans cannot effectively navigate a path to secure retirement.

The widespread decline of DB retirement plans has forced workers to be largely responsible for their own retirement savings. This means that financial capability is a precondition for success in today's economy. Uninformed decisions — like choosing not to save, drawing down savings in imprudent lump sums, or investing disproportionately in a single company stock — can have serious

repercussions in retirement.

Unfortunately, too many Americans possess low levels of financial capability. This is especially true of younger people. Research from the Financial Industry Regulatory Authority (FINRA) indicates that 23 percent of Millennials and 19 percent of Gen-Xers spend more than their income. Shockingly, 12 percent and 7 percent, respectively, remain unbanked (that is, without access to banking services).²³⁰

While we believe that individuals must attain the understanding and exhibit the motivation to take charge of their financial futures, local institutions and government have roles to play as well. To improve financial capability, schools and businesses should focus

on boosting financial education. Public schools that offer financial-capability courses find that their graduates have much greater confidence in financial matters and are able to make better choices later in life. Research from FINRA has found that including financial-education coursework in a state's K-12 curricula is associated with improvements in average credit scores and a reduction in credit card delinquencies.²³¹ Many workers also want to boost their financial capability: in surveys, more than 80 percent say they would participate in a financial-education program at their workplace.²³²

Federal programs could do a better job harnessing behavioral responses to loss aversion and improving "just-in-time" interventions, which seek to inform individuals at times when they are making major financial decisions, such as when to claim Social Security. Ultimately, a combination of commonsense reforms and investments in financial education would improve financial capability for all Americans.

1. Recommendation: Implement the recommendations of the President's Advisory Council on Financial Capability.

In 2010, the White House convened the President's Advisory Council on Financial Capability, which ultimately put forth a host of recommendations designed to improve financial education in the United States.²³³ The council called for better use of technology in promoting financial capability and advocated increased engagement by key community organizations and institutions, such as libraries and community colleges. The council also developed a set of recommendations for employers, including a Workplace Financial Capability Framework that describes best practices for employers interested in designing and implementing initiatives to promote financial capability.²³⁴

We urge relevant stakeholders to adopt the council's recommendations. Implementing these recommendations has the potential to directly impact personal savings and retirement security by empowering individuals to make financial decisions that are in their own best interest.

2. Recommendation: Improve personal financial education in K-12 and higher-education curricula.

Financial capability is particularly lacking among younger Americans, who lag behind their international peers in financial knowledge. In fact, only 17 states require high school students to take a course on personal finance.^{235, 236} Survey results seem to reflect this lack of preparation. According to *Money Matters on Campus*, in a survey of 43,000 college students, just 58 percent of respondents indicated that they felt prepared to manage their money.²³⁷ Twelve percent stated that they refuse to check their bank-account balances out of nervousness.²³⁸ While many universities offer courses on personal finance, very few include these courses in their general education curricula.

We recommend incorporating personal finance as a regular part of the country's basic education curriculum. Coursework should start in K-12 schools, possibly as part of the Common Core State Standards Initiative. Indeed, the President's Advisory Council proposed a host of recommendations along these lines.²³⁹ Among the council's recommendations are initiatives called "Money as You Grow," an online platform that provides children and families with educational resources to boost financial capability, as well as "Money as You Learn," a companion site to help educators integrate personal finance into the Common Core standards.²⁴⁰

In addition, we encourage institutions of higher education to adopt more-comprehensive financial-capability coursework requirements. Graduation could be dependent upon either passing a course or a financial capability test.

Integrating personal finance into the nation's education system would provide young Americans with a firmer grasp on financial capability and empower them to make responsible decisions about retirement and personal savings throughout their lives.

3. Recommendation: Better communicate the advantages of claiming Social Security benefits later.

Too few older Americans understand that their Social Security monthly benefit will increase if they claim later. Forty-six percent of those claiming OASI benefits in 2014 claimed their benefits at age 62 — the earliest opportunity.^{241, 242} Moreover, a significant majority of eligible individuals claim before the full retirement age. For many, this decision is likely to be unwise, costing them thousands of dollars per year in foregone Social Security benefits during their later years.²⁴³

Fortunately, many opportunities exist within the Social Security program to inform workers about the benefits of claiming later. One important avenue is the Social Security benefit statement, which SSA periodically mails to workers. It displays a projection of benefits if Social Security is claimed at age 62, at the full retirement age, and at age 70.²⁴⁶ Recipients, however, often find the information confusing and difficult to interpret.

We recommend better communication with current and future Social Security beneficiaries to explain the advantages of claiming benefits later.²⁴⁷ One way to achieve this is by redesigning the Social Security statement to stress the higher monthly benefits that come from both continuing to work and claiming benefits later. For example, SSA could leverage behavioral insights by emphasizing in the statement how much workers stand to gain in benefits if they continue to work for steady earnings and claim at the full retirement age rather than at age 62, or at age 70 instead of at the full retirement age.²⁴⁸ Seeing this comparison in their SSA statement many times over their career could help workers incorporate the information into their retirement planning before they make the decision to claim.

How Does the Age of Claiming Affect an Individual's Social Security Benefits?

An individual's monthly Social Security benefit varies greatly based on when they claim. Beneficiaries who claim at the full retirement age (FRA), which is currently 66, receive the normal benefit amount. Beneficiaries who claim after the FRA are awarded a higher monthly benefit to account for the fact that they are expected to collect benefits for fewer years, while those who claim before the FRA see a reduction in monthly benefits to adjust for the expectation that they will receive additional years of Social Security income.²⁴⁴

Under the current formula, an individual's monthly benefit is permanently reduced by 6 and 2/3rds percent per year for each of the first three years between the age that they claim benefits and their FRA. If an individual claims more than three years before the FRA, the benefit is further reduced by 5 percent for each additional year. Conversely, if a beneficiary claims after the FRA, the benefit is increased by 8 percent per year (up to age 70).²⁴⁵

The FRA is currently scheduled to rise to age 67 by the year 2022. At that point, individuals who claim benefits at age 62 (the earliest age of eligibility) will receive a monthly benefit that is 30 percent smaller than they would be entitled to if they claimed at the FRA. In contrast, individuals who wait until age 70 to claim benefits will be entitled to a monthly benefit that is 24 percent larger than their benefit would have been had they claimed at the FRA. Furthermore, the increased benefits for later claiming can be even greater than the percentages above if an individual continues to work in the intervening years.

4. Recommendation: Rename the Social Security claiming ages to provide more information about the benefits and consequences of claiming later vs. earlier.

The way SSA currently refers to different Social Security claiming ages fails to clearly reflect the trade-offs involved in claiming earlier or later, which can translate to smaller or larger monthly benefits. In fact, the title “early eligibility age” sounds like special treatment, falsely indicating to some individuals that they are being encouraged to claim benefits at a younger age.

We recommend renaming the Social Security claiming ages to clearly convey the benefit implications of the decision. The earliest eligibility age, currently age 62, should be renamed the “reduced benefit age” and what is currently age 70 should be renamed the “maximum benefit age.” The FRA, which is currently scheduled to rise to age 67, should be renamed the “normal benefit age.” These changes should be stressed in communications with beneficiaries and in the public discourse concerning Social Security.

Emphasizing the distinction between the decision to claim benefits and the decision to stop working is important. Nonetheless, many view these two decisions as one joint determination. The nominal changes we have proposed could encourage older Americans to more carefully consider when to claim Social Security benefits and how long to remain in the workforce.

5. Recommendation: Ensure that prospective applicants at Social Security field offices receive accurate information about claiming options.

SSA is officially neutral about when Americans should claim Social Security benefits. However, anecdotes about individuals being pressured to claim early, such as at the time of Medicare enrollment, are common.

We recommend ensuring that front-line Social Security workers give prospective claimants accurate information about the implications of

the claiming decision. This should include an estimate of their benefit if they claim today and the benefit levels they could expect to receive if they claim later. Additionally, the sponsoring organizations for chartered financial analysts and certified financial planners should be encouraged to address the issue of claim timing with professionals who take their qualifying exams.

6. Recommendation: Rename the Retirement Earnings Test (RET) and effectively communicate its purpose to working Americans who have claimed Social Security benefits.

For workers who are younger than the FRA and who have already claimed Social Security benefits, the program withholds benefits if earnings exceed \$15,720.²⁴⁹ The withholding occurs at a rate of \$1 for every \$2 that the worker earns above that threshold.²⁵⁰ Any benefits withheld due to the RET, however, are returned in the form of a permanently increased benefit level when the beneficiary reaches the FRA. The intent of the RET is to discourage premature claiming of benefits and preserve income for post-retirement consumption.

Many beneficiaries, however, are confused about how the RET works and mistakenly believe that it causes them to lose benefits outright. As a result, some beneficiaries may suppress their earnings or leave the workforce entirely to avoid what they perceive to be a reduction in benefits.

We recommend renaming the RET as the “benefit-deferral feature” or using a similar label that conveys its actual purpose. This step, along with more-effective communication about how the RET works, could strengthen work incentives for beneficiaries who might otherwise fear that they would lose benefits if they continue to work.

VI. Strengthen Social Security's Finances and Modernize the Program



Social Security provides the foundation of retirement income for Americans of all economic circumstances. In order to plan and prepare appropriately for retirement, today's workers need to know what they can expect from the program.

Currently, projected Social Security revenues are insufficient to cover full scheduled benefits and, without changes to address this shortfall, future benefit levels will be lower than scheduled. This situation poses a serious threat to many Americans' retirement security. Predictable and adequate Social Security benefits are especially important for older Americans who have lower or middle earnings over their lifetimes. These Americans are likely to have fewer savings and to rely on Social Security for the vast majority of their retirement income. With the changes we recommend, Social Security can

continue to play the central role in providing Americans with a secure retirement.

Even setting aside the program's financial challenges, scheduled Social Security benefits by themselves are inadequate for many Americans. Despite a progressive benefit structure that replaces a larger share of earnings for beneficiaries who worked for lower wages, benefits can be quite modest and insufficient to keep some older Americans from falling into poverty. In December 2014, the average monthly Old-Age and Survivors Insurance (OASI) benefit for retired-worker beneficiaries was roughly \$1,330.²⁵¹ Moreover, for one-third of these beneficiaries, monthly Social Security income was less than \$1,050.²⁵²

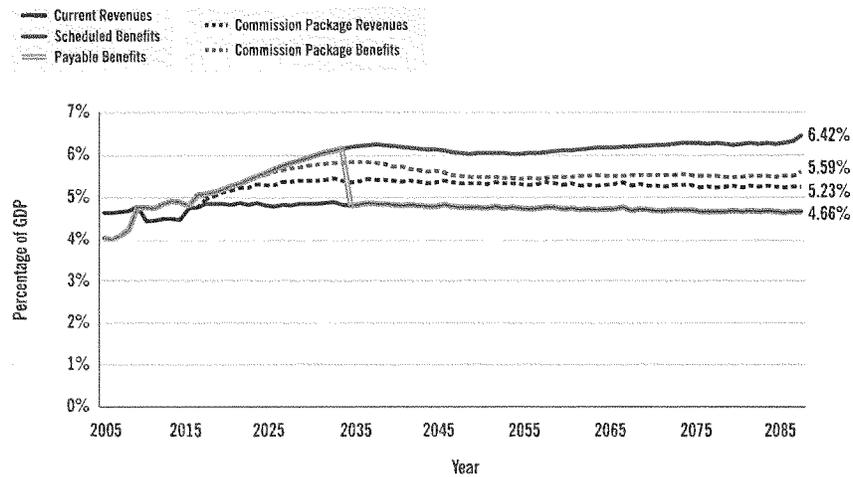
Social Security also provides weak marginal work incentives toward the end of an individual's working life. As workers near retirement, they continue to pay taxes on earnings to support the program, yet often accrue little or no additional benefits as a result. This sends the wrong message to workers. The program should be recalibrated to encourage work at older ages. Working longer allows more time to accumulate savings, shortens the period of retirement consumption that must be financed by savings, and facilitates later claiming of Social Security benefits (which results in larger monthly payments). On top of these advantages for personal retirement security, a longer average working life yields additional payroll-tax revenue for the Social Security program and benefits the broader economy. Thus,

better work incentives within Social Security would improve both retirement security and the financial condition of the program.

The program's struggling finances present an opportunity to address these issues while preserving Social Security as the foundation of the U.S. retirement system for generations to come. Our approach makes several important improvements to the program while retaining its historical financing structure. Specifically, the package of recommendations detailed in this section enhances benefits for vulnerable populations, reduces poverty among older Americans, improves work incentives, strengthens program finances, and maintains a reasonable balance between tax burdens on workers and

Figure 20. Commission's Social Security Proposals Significantly Improve Program Financing

Projected Social Security revenue and spending (as a percentage of GDP) for individuals aged 62 and older under various Social Security scenarios: benefits payable under current law, scheduled (but underfinanced) benefits, and the commission's proposals.



Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them.

Source: The Urban Institute - DYNASIM3

income support in retirement.

Any set of proposals to adjust Social Security benefits is typically compared with two scenarios: scheduled benefits and payable benefits. The payable scenario assumes that, once trust funds are depleted, benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula even if they cannot be financed by current dedicated revenue sources.

The Urban Institute and the Social Security Administration (SSA) analyzed our Social Security reforms, including their interactions, compared with the payable and scheduled scenarios. The results of their analyses show that the commission's package of recommendations would extend Social Security's ability to pay benefits without abrupt reductions through the end of the 75-year projection period. Moreover, the program's chief actuary found that this package successfully meets the criteria for "sustainable solvency," meaning that Social Security would be financially sound beyond the end of the 75-year projection period.²⁵³ **Figure 20** shows the projected impact of our package of proposals on program finances.

What Is the Difference Between Social Security's Scheduled-Benefits and Payable-Benefits Scenarios?

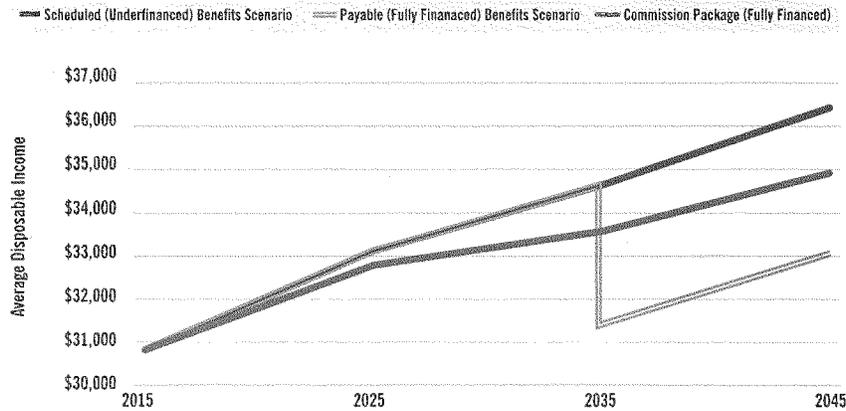
Under current law, if the Social Security trust funds are empty, Social Security cannot spend more on benefits than it collects in program revenues. The OASI Trust Fund is projected to be depleted in 2035.²⁵⁴

We examine the impact of our proposal relative to two different scenarios after 2015. In the **scheduled-benefits scenario**, we assume that Social Security continues to pay benefits as prescribed under the current formula even though they cannot be financed by trust fund savings and dedicated revenue sources.

In the **payable-benefits scenario**, we assume that current law is enforced and that benefits are limited to the amount that can be financed by dedicated tax revenue. This implies a roughly 23-percent reduction in total Social Security benefits paid relative to scheduled levels in 2035, when the OASI Trust Fund is exhausted, and each year thereafter. We assume that this reduction in benefits is applied evenly to all Social Security beneficiaries.²⁵⁵

Figure 21. Commission's Social Security Proposals Would Allow for Substantial Future Benefit Growth and Avoid Abrupt Changes to the Incomes of Older Americans

Projected average disposable income (in 2015 dollars) for individuals aged 62 and older under various Social Security scenarios: benefits payable under current law, scheduled (but underfinanced) benefits, and the commission's proposals.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. These estimates assume no change in earnings or retirement account withdrawals. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

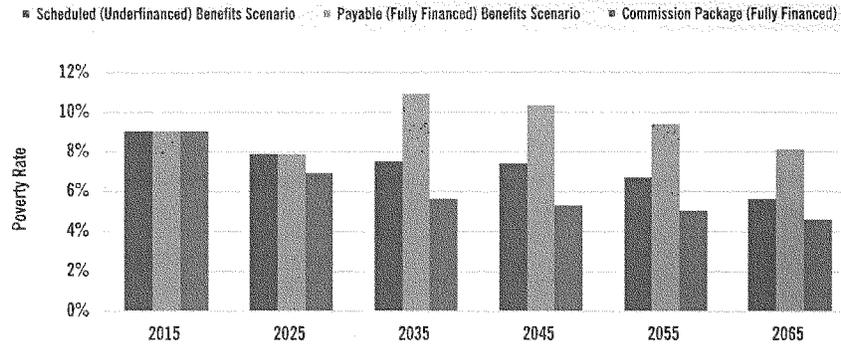
Importantly, we call for a gradual phase-in of these reforms, as shown in **Figure 21**, to provide time for future beneficiaries to adjust their plans accordingly. This would result in average benefit levels that initially track closer to scheduled levels and move gradually closer to a mid-point between scheduled and payable levels.

The Urban Institute also analyzed the impact of our package of recommendations on retirement-security outcomes. While improving Social Security's finances, our recommendations would actually increase incomes, compared to both payable and scheduled scenarios, for those program beneficiaries who are most at risk of

poverty. Under our proposals, the poverty rate among individuals aged 62 and older would decrease by 1.9 percentage points (a 25-percent reduction) in 2035 relative to a scenario in which benefits are paid as currently scheduled. The poverty reduction is much greater (5.3 percentage points, or 49 percent) when compared to the scenario in which benefits are limited to levels payable by dedicated program revenues or when compared to today's levels (3.4 percentage points, or 38 percent).²⁵⁶ These dramatic poverty reductions, shown in **Figure 22**, are achieved by making Social Security's benefit distribution more progressive and by enhancing benefits for widows and widowers.

Figure 22. Commission's Social Security Proposals Would Reduce Poverty Among Older Americans

Projected poverty rates for individuals aged 62 and older under various Social Security scenarios: benefits payable under current law, scheduled (but underfinanced) benefits, and the commission's proposals.



Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient Social Security tax revenues to finance these benefits.

Source: The Urban Institute - DYNASIM3

To better understand how the system would look if all of the commission's recommendations were fully implemented, the modelers also developed detailed projections showing how benefit changes would affect select groups of beneficiaries in future decades.

The impact of changes to Social Security benefits can be evaluated either at a defined point in time for all beneficiaries or over the lifetime of hypothetical households — both metrics are important to consider, as the results can be different. **Figure 23** shows projections of average incomes for older Americans in 2065 under the commission's proposals and compares these outcomes to the

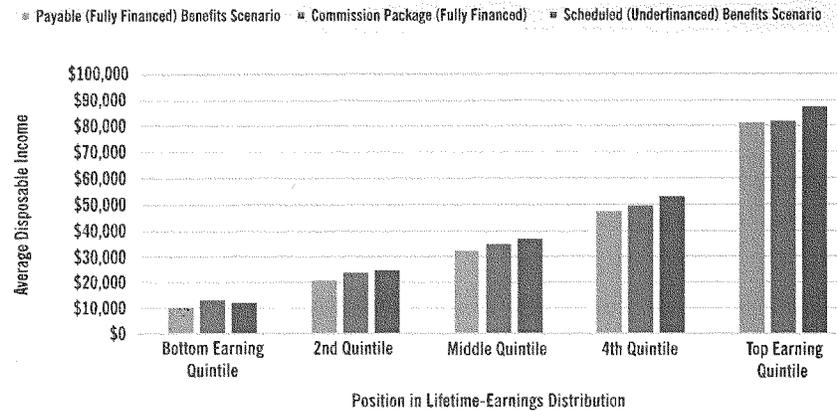
scheduled-benefits and payable-benefits scenarios.

Similarly, **Figure 24** shows the impact of the commission's recommendations as a percentage increase or decrease in disposable income relative to the scheduled-benefits and payable-benefits scenarios. This chart highlights the package's progressivity.

Under our proposals, older Americans from across the lifetime-earnings spectrum would have higher incomes, in many cases much higher, than under the payable scenario. While beneficiaries in the middle of the lifetime-earnings distribution would have

Figure 23. Commission's Social Security Proposals Would Provide Higher Incomes to Older Americans than They Would Receive at Payable Levels Under Current Law, Near Scheduled Levels for Middle Quintiles

Projected average disposable income (in 2015 dollars) for individuals aged 62 and older in 2065 under commission proposals and in two reference Social Security scenarios: benefits payable under current law and currently scheduled (but underfinanced) benefits.

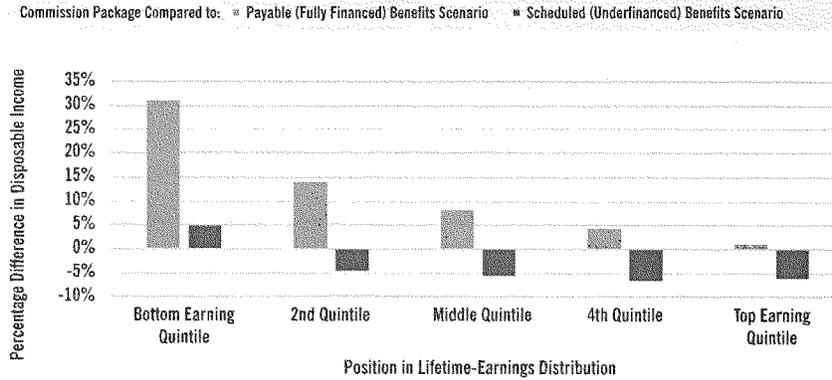


Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

Figure 24. Commission's Social Security Proposals Would Significantly Increase Incomes for Lower Earners

Projected change in disposable income for individuals aged 62 and older in 2065 under commission proposals relative to two reference Social Security scenarios: benefits payable under current law and scheduled (but underfinanced) benefits.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

incomes 6 percent below scheduled levels, beneficiaries with the lowest lifetime earnings would actually have incomes even higher than scheduled levels (by 5 percent). Importantly, older Americans in every lifetime-earnings quintile would have real incomes significantly higher than similarly situated individuals have today.

Despite the fact that some middle-earning beneficiaries may see reduced benefits relative to scheduled levels in a given year, lifetime Social Security benefits would be the same or greater for many of these beneficiaries due to the enhanced survivors benefit and other reforms. The tables in **Figure 25** display estimates of the effects

of our Social Security reform package on the lifetime benefits of hypothetical households, by family configuration and number of work years. Over a lifetime, households in the bottom two quintiles of earners would on average receive higher benefits than scheduled levels under our proposed reforms, middle earners would receive benefits roughly at scheduled levels, and the highest earners would be closer to payable levels. These outcomes could be achieved while avoiding the higher taxes that would otherwise be required to fund current benefit schedules.

Figure 25. Commission's Social Security Proposals Increase Progressivity and Improve Work Incentives

Projected lifetime combined Social Security and SSI benefits for hypothetical workers born in 1993 (age 67 in 2060), by family type and earnings (AIME) level, relative to two reference Social Security scenarios: benefits payable under current law and currently scheduled (but underfinanced) benefits.

Commission Proposals Relative to Payable Benefits										
Work Years	Single Individual					Two-Earner Couple (equal earnings)				
	Bottom Quintile	2nd Quintile	3rd Quintile	4th Quintile	Top Quintile	Bottom Quintile	2nd Quintile	3rd Quintile	4th Quintile	Top Quintile
25	153%	156%	145%	127%	85%	152%	137%	127%	115%	81%
30	159%	156%	139%	120%	88%	151%	137%	127%	116%	90%
35	166%	153%	135%	118%	94%	153%	138%	131%	120%	98%
40	175%	158%	140%	125%	103%	163%	149%	142%	130%	108%
45	168%	147%	140%	128%	105%	159%	152%	147%	135%	110%

Commission Proposals Relative to Scheduled Benefits										
Work Years	Single Individual					Two-Earner Couple (equal earnings)				
	Bottom Quintile	2nd Quintile	3rd Quintile	4th Quintile	Top Quintile	Bottom Quintile	2nd Quintile	3rd Quintile	4th Quintile	Top Quintile
25	140%	122%	110%	96%	64%	118%	104%	96%	86%	61%
30	136%	119%	105%	91%	66%	116%	104%	95%	87%	68%
35	134%	116%	102%	88%	71%	117%	104%	98%	90%	74%
40	140%	119%	105%	94%	77%	124%	112%	107%	98%	81%
45	127%	110%	104%	96%	78%	129%	114%	110%	101%	82%

Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Figure is presented on a per-capita basis, which means that estimates are for individual persons assuming that couples equally divide household benefits. Please see the box on page 87 for an explanation of AIME.

Source: The Urban Institute - DYNASIM3

What Do the Lifetime-Benefits Tables Show?

The tables in **Figure 25** compare the discounted value of lifetime benefits under our proposals with discounted lifetime benefits under both the scheduled- and payable-benefits scenarios.²⁹⁷ Comparisons are displayed for hypothetical households with different earnings levels, family configurations, and time spent in the workforce.

Unlike previous charts, which show the impact of our recommendations in a particular year, these tables show the effect on the lifetime value of benefits received by a household. The tables also focus specifically on changes in Social Security benefits rather than on broader measures of income. (Social Security is a smaller component of overall income for high-income households.) In the case of a married couple, the analysis combines lifetime benefits for both members of the household. Values over 100 percent mean that the household would receive greater lifetime benefits under our proposals relative to the comparison scenario, while values under 100 percent indicate that the household would receive lower benefits. For example, lifetime benefits to a single individual who worked for 40 years in the second-highest quintile of the lifetime-earnings distribution would be 25 percent higher under the commission's proposals than in the payable-benefits scenario but 6 percent below scheduled levels. (These tables do not show the effects of changes to Social Security taxes, which would vary across the scenarios considered.)

Our reforms would also improve work incentives, especially for Americans who are near retirement and confronting decisions about whether to remain in the workforce for another year or two. Many of those who would benefit most from these changes, both in dollar terms and as a percentage of currently scheduled benefits, would be individuals and couples who have

worked for at least 35 years in covered employment. In particular, **Figure 25** shows that benefit adjustments would be more generous for individuals who have spent 40 years in the workforce compared to those who have worked for only 35 years, regardless of their earnings level. This is a particularly important age range to focus on, as more than two-thirds of Americans over the age of 62 in 2065 will have worked for more than 35 years.²⁹⁸ At that point, many of those individuals will be making critical decisions about whether to retire or extend their working lives.

Our package of recommendations would achieve these results by modifying Social Security's benefits and dedicated revenues. On net, the Office of the Chief Actuary estimates that the reforms we have proposed would close 53 percent of the program's shortfall through changes to revenues and 47 percent through adjustments to scheduled benefits. The Urban Institute reached a similar conclusion, estimating that the commission's package would close 54 percent of the program's financial shortfall through changes to revenues and 46 percent through adjustments to scheduled benefits.

Addressing the unsustainable finances of the OASI program is integral to improving U.S. retirement security. Waiting to do so until 2035, when the crisis is unavoidable, would be the worst of all outcomes — both for individuals who are collecting benefits at that time and for individuals who are still in the workforce. As we developed this package of proposals, we sought to balance changes to revenues and benefits while minimizing intergenerational inequities. This is no easy task. If current and soon-to-be beneficiaries are shielded from significant changes to benefits, younger generations must carry most of the burden of program changes, both in terms of paying higher taxes during their working years and in terms of absorbing future benefit adjustments (relative to scheduled levels). However, younger people would be significantly better off if our proposed recommendations are implemented than if policymakers fail to address Social Security's financial challenges.

If adopted, the commission's recommendations would secure the program's trust funds for 75 years and beyond, enhance protections

How Are Social Security Benefits Calculated?

When a worker becomes eligible to receive OASI benefits, the Social Security Administration (SSA) uses a four-stage process to determine his or her monthly benefit amount:

Step 1: Calculate the worker's average indexed monthly earnings (AIME). SSA calculates the worker's **average indexed monthly earnings (AIME)** by adjusting each year's earnings (up to the maximum covered under Social Security) by the growth in average wages since the wages were earned and determining the 35 highest-earning years so indexed.²⁹⁹ Averaging these adjusted annual earnings and dividing by 12 yields the individual's AIME.

Step 2: Calculate the primary insurance amount (PIA) based on the worker's AIME. SSA applies a progressive benefit formula to the worker's AIME to calculate the worker's **primary insurance amount (PIA)**. The PIA is the monthly Social Security benefit that an individual who claims at full retirement age would receive. (The full retirement age is 66 for individuals born between 1943 and 1954; it phases up to 67 thereafter.) Under current law, the formula for 2016 is:

- 90 percent of the worker's AIME up to \$856;
- plus 32 percent of AIME between \$856 and \$5,157;
- plus 15 percent of AIME above that (and below the taxable cap of \$9,875).

The dollar amounts at which the PIA factors change (currently \$856 and \$5,157) are known as the program's "bend points." The bend points are increased each year by the percent increase in average wages.

Step 3: Adjust the benefit to account for whether the worker started receiving benefits before or after the full retirement age (FRA). In reality, only a small fraction of workers start receiving Social Security benefits at the age assumed in the calculation of the worker's PIA. If a worker claims benefits before the **full retirement age (FRA)**, SSA reduces the monthly benefit up to a maximum of 30 percent for individuals who have an FRA of 67 and claim at age 62. In contrast, if a worker claims after reaching the FRA, SSA increases the monthly benefit up to a maximum of 24 percent for workers with an FRA of 67 who claim at age 70.²⁶⁰ These adjustments to monthly benefits are made because beneficiaries who claim before or after the FRA are expected to receive benefits for longer or shorter periods of time, respectively. The intent is to keep expected lifetime benefits constant irrespective of claiming age, though the actual impact will vary by individual. Adjustments for early or delayed claiming apply to spousal benefits and any subsequent survivors benefit, as well as to the primary claimant. This is the final step in calculating an individual's initial Social Security benefit amount.

Step 4: Adjust the worker's benefit annually to account for inflation. Once the initial benefit amount is established, SSA adjusts benefits in each succeeding year for inflation, as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). This annual benefit adjustment is referred to as a **cost-of-living adjustment (COLA)**.²⁶¹

for those retirees who are most at risk of poverty, and modernize Social Security for the changing U.S. workforce. We hope that this package demonstrates, first, that it is possible to work across partisan and ideological lines to address an issue that is critical for all U.S. workers, and second, that a better future for Social Security is attainable if we act soon.

Policymakers recently took action to improve Social Security on a bipartisan basis by closing an unintentional loophole that allowed beneficiaries to use arcane “claim-and-suspend” strategies to increase their benefits.²⁶² These unintended benefits accrued largely to individuals in upper-income households, who were more likely to be aware of these strategies and could afford to claim only modest Social Security benefits in the near term.

Congress and the president closed this loophole in 2015 by adopting a requirement that individuals must claim and receive their individual benefit at the same time that a spousal benefit is claimed on their record. We commend policymakers for working to strengthen the integrity and equitability of Social Security and hope this represents the beginning of bipartisan efforts to improve the program. Our recommendations offer a framework for further progress toward that objective.

Recommendations for Improving Social Security

This section describes a package of reforms designed to protect workers across the earnings spectrum in retirement, including particularly improving retirement security for lower-income beneficiaries, while attaining long-term solvency for the Social Security program.

1. Recommendation: Increase the progressivity of the benefit formula.

The formula for calculating a Social Security beneficiary's primary

insurance amount (PIA) is progressive, with earnings at lower levels replaced at higher rates.²⁶³ This formula is applied to the average of a worker's highest (wage-growth-adjusted) 35 years of covered earnings, known as average indexed monthly earnings (AIME).²⁶⁴ The current benefit formula includes two "bend points" at which the marginal replacement rate for earnings, known as the PIA factor, changes.

We recommend revising these bend points and PIA factors, as indicated in **Figures 26 and 27**, to make the benefit structure more progressive. A 10-year phase-in of the new formula would begin for claimants who turn 62 in 2022. Due in part to this recommendation, our package actually increases benefits for the lower-earning workers who are at greatest risk of experiencing poverty in old age.

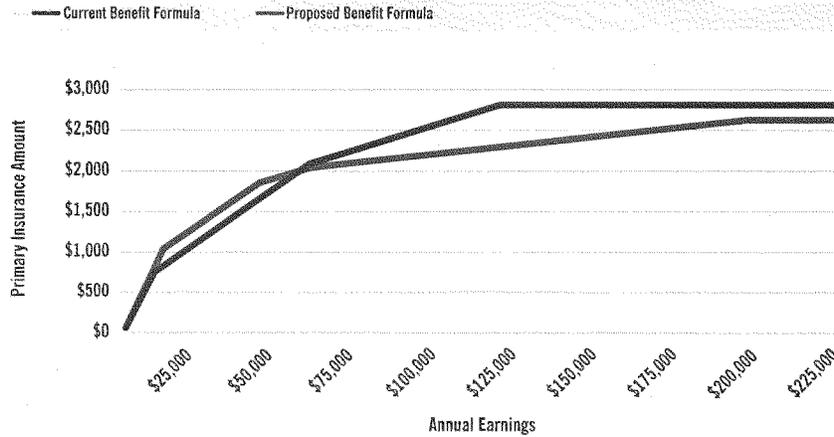
Figure 26. Current-Law and Proposed Bend Points and PIA Factors

Current Law (2016)		Proposal (2016)	
AIME	PIA Factor	AIME	PIA Factor
Up to \$856	90%	Up to \$1,095	95%
Between \$856 and \$5,157	32%	Between \$1,095 and \$3,655	32%
		Between \$3,655 and \$5,157	15%
Between \$5,157 and taxable maximum (\$9,875)	15%	Between \$5,157 and new taxable maximum (\$16,250)	5%

Note: None of the Social Security recommendations apply to 2016. Rather, bend points are displayed using 2016 values (adjusted for wage growth) to show a consistent comparison between the proposed PIA formula (once fully implemented) and the current PIA formula.

Figure 27. Commission's Proposal Makes the Social Security Benefit Formula More Progressive

Proposed benefit formula vs. current formula (in 2016 wage-indexed dollars), by average annual earnings.



Note: This chart assumes that a worker has consistent earnings (after accounting for wage growth) for 37 years in covered employment. Absent reforms to strengthen the program's finances, the "current benefit formula" values would be reduced by 23 percent starting in 2035.

Source: BPC staff calculations

2. Recommendation: Apply the benefit formula annually to earnings to more evenly reward continued work.

The Social Security benefit formula applies to a worker's average earnings. Thus, it does not distinguish between higher earners who work fewer years and lower earners who work many years. Both receive a relatively high replacement rate from Social Security, even though the progressive benefit formula is intended to advantage those who are most likely to need the retirement income. For example, an individual who earns \$100,000 for 15 years receives the same benefit as one who earns \$50,000 for 30 years.

Individuals with few Social Security-covered earnings years are

not necessarily from lower-income households. Rather, many older Americans with shorter earnings records either immigrated mid-career, are married to a higher-income spouse, or became wealthy through inheritance or their own efforts. The current benefit formula, however, redistributes income toward such beneficiaries on the often-mistaken presumption that they are low-income individuals.

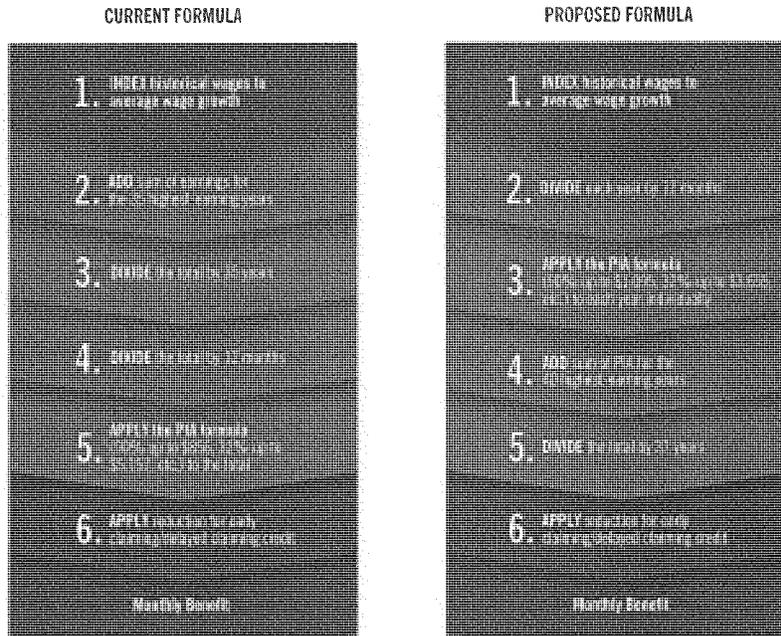
A related issue is that Social Security provides limited work incentives to nearly all workers as they reach older ages. These problematic work incentives are mainly caused by two aspects of the current benefit formula. First, the formula only counts a worker's 35 highest-earning years. Thus, once an individual has worked for 35 years, any additional years of earnings can at best replace lower-

earning years from earlier in the person's working life. In practice, because each year of earnings is adjusted for national average wage growth, the difference is typically small.²⁶⁹ Second, because earnings are averaged before PIA factors are applied, most workers have earned the maximum that can be replaced at the 90-percent rate early in their career. As a result, these workers receive a much lower replacement rate on all additional earnings. At the same time, despite diminishing returns to continued work in terms of expected Social

Security benefits, workers continue to face the same payroll-tax rate that they paid throughout their working life. The trade-off between Social Security taxes paid vs. future benefits received strongly favors earlier retirement.

For these reasons, we recommend applying the replacement-rate formula to each individual year of a worker's earnings to calculate an "annual PIA," as detailed in **Figure 28**. Under the annual-PIA

Figure 28. Calculation of Current Benefit Formula Compared to Annual-PIA Benefit Formula



approach, SSA would calculate a PIA for each year of work; these amounts would then be added up and averaged to calculate a worker's actual Social Security benefit. This change, which would be phased in over five years beginning in 2022, would better distinguish between workers with similar total lifetime earnings but different tenures in the workforce. For example, using an annual PIA, a worker who earned \$100,000 in a given year but who had a shorter career would have the progressive benefit formula applied to *that individual year*. Consequently, most of these earnings would receive a 15-percent replacement rate. By contrast, under current law, the same earnings might be replaced at 90 or 32 percent if the worker's high-earning years had been averaged in with other years when the worker did not pay into Social Security. By ending preferential treatment for workers with fewer years in the workforce, an annual PIA would increase the incentive to work.

Implementing an annual PIA can also provide additional benefits to individuals with longer working lives. By 2035, according to current projections, roughly 6 in 10 Americans over age 62 will have worked more than 40 years.²⁶⁶ Social Security's structure should reflect this reality by rewarding additional years in the workforce beyond the 35 years that the program now recognizes. Thus, we recommend counting up to 40 years of earnings in the annual-PIA formula, and dividing the result by 37.²⁶⁷ This change would provide an incentive to continue working, especially for individuals who are nearing typical retirement ages. In effect, the accrual of Social Security benefits would look more like the accrual of benefits under a private pension plan. Instead of the current formula, in which each added year of work after a certain point may only slightly affect an individual's Social Security benefit, our proposal would increase benefits proportionally with each year of work, up to 40 years.

Lastly, an annual PIA would improve Social Security's transparency, helping workers understand the marginal benefit of an additional year of work.²⁶⁸ This information should be clearly reported on Social Security statements, thereby reinforcing improved work incentives.

3. Recommendation: Establish a basic minimum benefit to enhance Social Security for beneficiaries with low incomes.

For various reasons, millions of older Americans live with very low incomes, in or near conditions of poverty. Some of these individuals worked intermittently and for low wages, due to a variety of circumstances, and therefore earn only meager Social Security benefits.

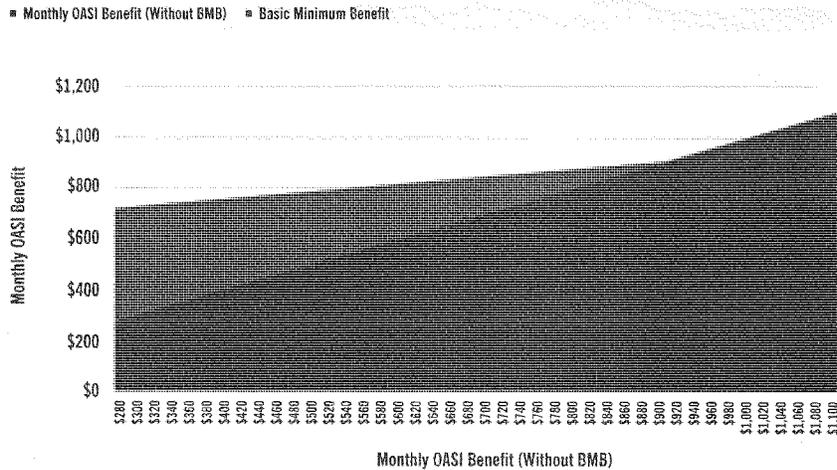
The average annual OASI benefit for current beneficiaries who are in the bottom quintile of the lifetime-earnings distribution is less than \$9,100 — significantly below the federal poverty level.²⁶⁹ For these individuals, most of whom are also among the least able to accumulate significant personal savings during their working years, a higher benefit is necessary to keep them out of poverty during retirement.

We recommend establishing a new basic minimum benefit (BMB) within Social Security to reduce poverty among OASI beneficiaries. Starting in 2020, a modest additional amount would supplement standard Social Security payments for low-income beneficiaries above the full retirement age. The specific BMB amount for each individual would be scaled so that those with the lowest OASI benefits would receive the largest BMB add-on payments. Total benefits (OASI including any BMB supplement), however, would always increase with additional covered earnings, preserving some incentive for lower earners to continue working.

Lower-income beneficiaries who struggle to maintain consistent employment during their pre-retirement years would benefit most from this new provision.²⁷⁰ The BMB, along with the other reforms that the commission is proposing, would increase overall retirement income for beneficiaries with lower lifetime earnings.

Figure 29. Basic Minimum Benefit Provides Boost to Individuals With Low Social Security Benefits

Composition of total Social Security benefits at the FRA for a single individual (in 2016 wage-indexed dollars).



Note: This example assumes a single individual claiming at the FRA once the BMB and other changes to the benefit formula have been fully implemented.

Source: BPC staff calculations

To demonstrate how this proposal would work in practice, suppose that the BMB were implemented in 2016. It would be scaled using a formula illustrated in Figure 29. For example, a single person with a monthly OASI benefit of \$500 would receive a \$284 BMB, bringing the total monthly Social Security payment to \$784. A single person with a somewhat higher monthly OASI benefit of \$750 would receive a BMB of \$109, for a total monthly Social Security payment of \$859.

The BMB would effectively replace Supplemental Security Income (SSI) for all eligible OASI beneficiaries above the full retirement age, because SSI benefits are replaced by OASI benefits dollar-for-dollar. This would yield federal budget savings outside of Social Security,

which could help to offset the cost of our other recommendations that are aimed at expanding participation in workplace retirement savings plans. Unlike SSI, which requires an application for enrollment and includes a resource test, the BMB would not apply a resource test and enrollment would be automatic. The Social Security Administration would add the BMB to the benefit of any eligible beneficiary. Notably, the Social Security Administration estimated in 2002 that almost 40 percent of eligible beneficiaries did not participate in SSI, meaning that a significant portion of this population did not collect benefits to which they were entitled.²⁷¹ An automated process would eliminate this problem and better protect these individuals from poverty.

The BMB would be calculated by reducing a base amount by 70 cents for every dollar of Social Security benefits received. If the policy were implemented in 2016, this base amount would be \$634 per month for singles and \$951 for couples. Single beneficiaries with monthly OASI benefits (before any BMB is added) under \$906 per month (\$1,359 for married couples) would receive a BMB; beneficiaries with OASI benefits above the thresholds would not. The phase-out described above would ensure that individuals who are likely to qualify for the BMB always have a marginal incentive to earn more during their working years. The base amount used to calculate the BMB would be indexed to average wage growth moving forward.

We developed the BMB's specifications through extensive modeling, with the goal of improving retirement outcomes in a targeted and efficient manner. If our approach is implemented, policymakers should periodically review the parameters of the BMB supplement, both in terms of program costs and in terms of its effectiveness in reducing poverty and ensuring that low-income workers receive adequate benefits.

Of course, the BMB is not intended to support households with small OASI benefits and large amounts of non-Social Security income. Thus, any single filers with an adjusted gross income (AGI) of more than \$30,000 or joint filers with an AGI over \$45,000 who do not have their BMB offset by Social Security income would have to repay their BMB through the income-tax system. Our modeling shows that in 2025, around 9.6 percent of individuals over the FRA would receive (and keep) a BMB.²⁷²

Commission members believe in the need to provide greater support for those workers who had the least opportunity or capacity to save for retirement throughout their careers. The BMB would raise incomes for these beneficiaries and substantially reduce poverty among older Americans.

What Is Supplemental Security Income?

Supplemental Security Income (SSI) is a federal program that provides cash benefits to individuals with low incomes and few assets who either are over age 65 or have a disability. More than 2 million older Americans receive SSI; their average monthly benefit is \$435.²⁷³ The maximum monthly SSI benefit is \$733 for an individual and \$1,100 for a couple, and benefits are reduced from these levels if beneficiaries have other income, including Social Security benefits.²⁷⁴

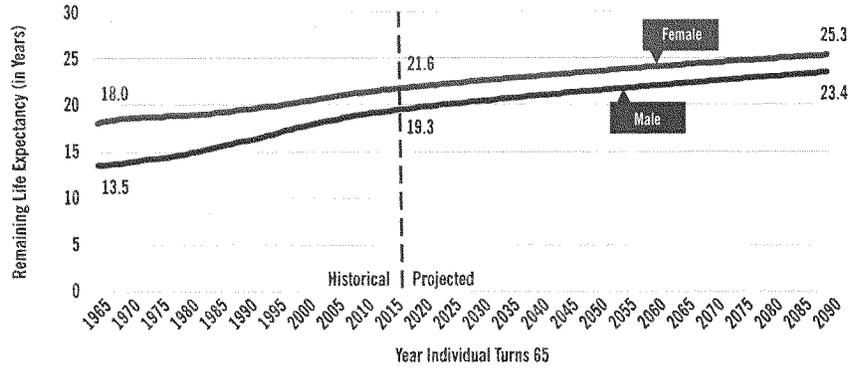
The Social Security Administration administers SSI, but the program is funded with general revenues, not by the payroll and self-employment taxes that finance Social Security. Participation among older Americans in SSI increases by age, as retirees experience drops in income, exhaust assets, and thus qualify for the program. The modelers estimate that 3.6 percent of Americans in their early seventies participate in SSI, while 7.9 percent of Americans aged 85 and older receive SSI.²⁷⁵ SSI benefits are indexed to general inflation, in contrast to initial Social Security benefits, which are indexed to wage growth. Because inflation is generally lower than wage growth, the proportion of older Americans who are eligible for SSI is expected to shrink.

4. Recommendation: Index the retirement age to longevity to reflect ongoing increases in average life expectancy.

The full retirement age (FRA) is the age at which an individual can claim a monthly Social Security benefit equal to his or her PIA. The FRA was increased from 65 to 66, the current level, over many years as a result of the Social Security reforms adopted in 1983. The FRA is scheduled to continue rising gradually to 67 for individuals who turn 62 years old in 2022 or later.

Figure 30. Americans Are Living Longer – and This Trend Is Projected to Continue

Historical and projected life expectancy at age 65, by gender.



Source: U.S. Social Security Administration²⁷⁶

Social Security benefits can be claimed as early as age 62, the earliest eligibility age, but the monthly benefit is permanently reduced for every month that a beneficiary claims before he or she reaches the FRA. Conversely, an individual who waits to claim past the FRA receives a permanently higher monthly benefit. The increases continue for each month that an individual waits up to age 70, the maximum benefit age.

To reflect changes in life expectancy, we recommend gradually raising both the FRA and the maximum benefit age. Starting in 2022, both of these thresholds would rise by one month every two years. The gradual increases would continue for 48 years until the full retirement age reaches 69 and the maximum benefit age reaches 72 (in 2070). The earliest age of eligibility would remain unchanged, meaning that the maximum benefit reduction for early claiming would increase by 5 percentage points for each year that the FRA is increased.

If projected longevity trends materialize, this gradual increase in the FRA would mean that, decades in the future, individuals who

retire when they reach the FRA would spend roughly the same proportion of their adult lives in retirement as they do today, on average — and a substantially higher proportion of their lives in retirement compared to previous generations of beneficiaries.²⁷⁷ Because projections become more uncertain the further ahead one estimates, policymakers should re-examine whether to continue indexing the full retirement age once it reaches 69.

Notably, longevity increases have not been evenly shared across the income distribution, and the life-expectancy gap between upper- and lower-income individuals has grown over time.²⁷⁸ Some of our other recommendations, including changes to the benefit formula and the BMB (the latter of which would become available at the FRA), would more than offset the impact of a higher FRA on individuals with lower lifetime earnings.

As Americans live longer, Social Security cannot afford to provide the current trajectory of benefits for an ever-increasing number of years without either reducing annual benefits (such that lifetime benefits

are unchanged) or increasing total program costs at a rate exceeding growth in worker earnings. Constraining growth in the number of years over which benefits must be paid reduces the need for such outcomes. Gradually adjusting the FRA over time would ensure that Social Security adapts to changing demographics and provides workers with sufficient notice to account for a higher FRA when making savings and retirement decisions.

5. Recommendation: Use a more-accurate measure of inflation for Social Security's cost-of-living adjustments and for indexing parameters within the tax code.

Social Security beneficiaries receive an annual cost-of-living adjustment (COLA) on their benefits to reflect inflation, as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Many economists believe that the CPI-W overstates actual inflation because the measure insufficiently accounts for consumers' ability to change purchasing patterns in response to relative price changes (among other computational issues).²⁷⁹

We recommend linking COLAs to the Chained Consumer Price Index for All Urban Consumers (C-CPI-U) beginning in 2017. The C-CPI-U is an alternative measure of inflation developed by the Bureau of Labor Statistics that better accounts for substitution effects and fixes the technical issues with the CPI-W. This reform would have a positive effect on Social Security's finances by ending the practice of paying COLAs that exceed general price inflation.

Adjusting the federal government's official measure of inflation would also raise general revenue if the change were applied to the income-tax code. Most rate thresholds, as well as many deductions and credits, are indexed to inflation. Using the C-CPI-U would mean that these thresholds grow more slowly over time. In 2014, the Congressional Budget Office estimated that applying the C-CPI-U to the tax code would raise approximately \$150 billion in additional revenue over 10 years.²⁸⁰ The revenue from this correction could be used to offset the costs associated with other reforms to incentivize savings and promote stronger retirement security.

6. Recommendation: Cap and re-index the spousal benefit.

Individuals who are either married or divorced (after a marriage that lasted at least 10 years) may be entitled, regardless of their work history, to a Social Security spousal benefit. The maximum spousal PIA is equal to half of the PIA of the individually entitled worker. The amount of the spousal benefit, like the OASI benefits claimed on a person's own work record, depends on the age of claiming. A beneficiary may only claim the higher of their individual benefit, technically known as a retired-worker benefit, or the spousal benefit.

The current spousal benefit fails to reflect changes in women's workforce participation since the time when Social Security was first enacted. Today, with a significant majority of working-age women working outside the home, wives of men with high incomes are less likely to work than women in less-affluent households.²⁸¹ As a result, the spousal benefit mostly benefits certain high-income families who can afford to have only one earner and, in this way, undermines the progressivity of Social Security.²⁸²

We recommend capping the maximum spousal benefit for new claimants at half of the 75th percentile PIA (which is equal to the spousal benefit received by someone married to a worker in the 75th percentile of the earnings distribution) and then indexing it to the C-CPI-U thereafter. Implementation of this change would begin with claimants who turn 62 years old in 2022, when the new maximum spousal PIA is projected to be \$843.²⁸³ By itself, this change would have no impact on benefits for widows and widowers. There would be a minor interaction with our next recommendation concerning survivors benefits, but survivors under our proposed approach would still receive higher benefits than they do with the current survivors benefit design.

Limiting spousal benefits for higher-earning couples would improve Social Security's financial outlook and do so in a way that primarily reduces benefits to households with other significant sources of income and assets. Additionally, this change would further reward work by increasing the difference between Social Security benefits for two-earner and single-earner couples.

7. Recommendation: Enhance survivors benefits to help widows and widowers maintain their standard of living.

On average, survivors experience roughly a one-third reduction in household OASI benefits when their spouse dies.²⁸⁴ For two-earner couples with similar earnings, household benefits can drop by as much as half. With more two-earner couples in the workforce than ever before, this reduction often means that remaining benefits are inadequate, as expenses for the surviving spouse generally do not fall by half.^{285, 286} Indeed, the poverty rate among widows and widowers over age 62 in 2015 is above 11 percent — more than double the poverty rate for married individuals over age 62.^{287, 288}

Under current law, widows and widowers who are aged 60 or older are entitled to the greater of their own benefit or the benefit of their deceased spouse.²⁸⁹ For example, suppose that both members of a married couple are OASI beneficiaries, with one spouse receiving a monthly benefit of \$750 and the other receiving a monthly benefit of \$1,500. If the spouse with the higher benefit dies first, the widow(er) would receive a survivors benefit equal to \$1,500. Should the spouse with the lower benefit die first, the widow(er) would continue to receive only her or his own retired-worker benefit of \$1,500. In both cases, monthly household OASI benefits would drop from \$2,250 to \$1,500.

We recommend enhancing the survivors benefit so that widows and widowers receive 75 percent of their deceased spouse's benefit in addition to the entirety of their own benefit. Initial benefits for married claimants would be adjusted so that expected lifetime benefits remain unaffected on average. Our modeling shows that this adjustment would reduce initial benefits for a 62-year-old married individual claiming in 2020 by roughly 9 percent.²⁹⁰ While some couples, particularly those in which one member significantly outlives the other, would come out ahead as a result of this change, those with average lifespans would experience no change in lifetime benefits. Those who live shorter-than-average lives would receive fewer lifetime benefits, all else equal. For lower-income beneficiaries with shorter lives, other

recommendations in our package would more than offset the impact of this change in married couples' initial benefits. Overall, benefits would still increase for couples with low lifetime earnings. As in our other recommendations, we propose implementing this change beginning with new claimants who turn age 62 in 2022.

The reform we propose would leave total lifetime benefits for the average married household unchanged. Importantly, however, it would shift the timing of those benefits in a way that improves retirement security for widows and widowers, especially for spouses who outlive the other by many years.

8. Recommendation: Reinstate benefits for college-aged children of deceased beneficiaries and certain other Social Security beneficiaries.

Before 1981, the children of workers who passed away or who received Disability Insurance (DI) benefits on the basis of a work-limiting disability were able to receive Social Security benefits up to age 22 as long as they were full-time students at an accredited college or university. These benefits for college-aged students were discontinued as part of a 1981 law. As a result, most children of these workers can now receive benefits only until age 18.²⁹¹

The 1981 legislation eliminated benefits for college-aged children, in part, because of the difficulty of verifying students' educational status. Recent advances that allow for digital filing of the Free Application of Federal Student Aid (FAFSA) now enable easy and low-cost verification.

We recommend reinstating Social Security benefits for college-aged children who are full-time students, subject to the same conditions that applied prior to 1981. The benefits would be available beginning in 2017. Based on projections, the cost of reinstating these benefits would be modest.^{292, 293}

Many college students receive at least some parental support for their education. Social Security benefits should reflect this reality and

promote educational attainment by providing benefits that can help young Americans who lose a parent to remain in school and reap the financial benefits of a higher education.

9. Recommendation: Raise the maximum taxable earnings level.

The Social Security reforms of 1977 raised the maximum level of taxable earnings (also known as the “taxable maximum”) for Social Security’s payroll and self-employment taxes to \$35,700 of an individual’s earnings, a level that covered 90 percent of total national earnings in 1983.²⁹⁴ The maximum is now indexed to average wage growth. Because earnings for workers at the top of the wage distribution have grown faster than average wages, however, the percentage of earnings above the taxable maximum has increased. In 2013, Social Security taxes covered only 83.1 percent of total national earnings.²⁹⁵

We recommend increasing the taxable maximum to generate additional program revenues and prevent further erosion of Social Security’s tax base. Specifically, we propose raising the cap from \$118,500 (in 2016) to \$195,000 by 2020 and indexing further increases thereafter to average wage growth plus 0.5 percentage points.²⁹⁶ The chief actuary estimates that the new taxable maximum would cover approximately 85.6 percent of total national earnings in 2020.²⁹⁷

A compromise plan to shore up the finances of the Social Security trust funds suggests the need for a balanced blend of new revenues and restraints on benefits. The commission believes that beneficiaries with the highest incomes should make proportionally larger contributions on both sides.

10. Recommendation: Gradually increase the payroll-tax rate by 1 percentage point.

Workers and their employers each owe Social Security payroll taxes

on 6.2 percent of all wages — 5.3 percent for OASI and 0.9 percent for DI — for a grand total (combining the employer and employee contributions) of 12.4 percent, up to the taxable maximum.^{298, 299} These revenues provide the vast majority of the OASI Trust Fund’s income.

We recommend increasing the payroll- and self-employment-tax rates by 1 percentage point (0.5 percentage points for both employees and employers). The increase should be implemented gradually, by raising the combined payroll tax paid by employees and employers 0.1 percentage points each year for the next 10 years (beginning in 2017). This recommendation would raise the payroll-tax rate for both employers and employees from 6.2 to 6.7 percent and the self-employment-tax rate from 12.4 to 13.4 percent by 2026.

Taken as a whole, our package of recommendations ensures that both revenue and benefit contributions to securing Social Security’s long-term finances come predominantly from those with higher incomes. Relying exclusively on high-income individuals for additional revenue, however, would require either paying additional benefits to those who do not need them or further weakening the relationship between program contributions and benefits. Raising revenue through a modest payroll-tax-rate increase would mitigate this concern, protect middle-class Americans from abrupt changes to benefits, and help finance the substantial benefit increases that low-income individuals would receive under our proposals. The added revenue also enables the package to achieve a roughly even mix of revenue increases and benefit adjustments.

11. Recommendation: Increase taxes on benefits for high-income beneficiaries.

Taxing Social Security benefits is complicated and controversial. Single beneficiaries with combined income (defined as all normally taxable income plus nontaxable interest and one-half of Social Security benefits) over \$25,000 for single filers or \$32,000 for

joint filers may owe income taxes on up to 85 percent of their Social Security benefits.³⁰⁰ This policy was established in 1983 as part of a broader package of reforms. Because these thresholds are not indexed, a growing number of beneficiaries will be required to pay taxes on Social Security benefits over time. Today, less than 40 percent of beneficiary households pay taxes on a portion of their Social Security benefits, but by 2030, more than half of recipient households are projected to be subject to taxes on their benefits.³⁰¹

We recommend including in taxable income all benefits received by Social Security beneficiaries with adjusted gross incomes (AGI) of over \$250,000 (or \$500,000 for couples) starting in 2022, with both thresholds being indexed to average wage growth in subsequent years. For these high-income beneficiaries, the change would result in a small increase from the 85 percent of Social Security benefits that is subject to tax under current law to 100 percent. Revenues from this proposal would be modest, but the commission believes that full taxation of benefits is appropriate for the highest-income beneficiaries.³⁰²

12. Recommendation: Replace the windfall elimination provision (WEP) and government pension offset (GPO) with a pro-rated benefit for workers with non-covered earnings.

Some types of employees, such as certain federal, state, and local government workers, are not covered by Social Security and do not contribute payroll taxes on their earnings from those positions. The WEP and GPO are designed to prevent these individuals from receiving overly generous, unintended Social Security benefits.³⁰³ But these policies are quite complicated and unfair in certain situations.

Our annual-PIA proposal would reduce the need for the WEP and GPO by individually crediting each year of covered earnings. Workers in uncovered full-time employment, however, could still potentially receive Social Security windfalls if they simultaneously engage in long-term, part-time employment in covered jobs.

We recommend eliminating the WEP and GPO and instead, pro-rating Social Security benefits based on the fraction of lifetime total earnings that were covered by Social Security. This change would begin with beneficiaries turning 62 years old in 2022. Our straightforward approach, which is substantially similar to a bipartisan proposal advanced by House Ways and Means Committee Chairman Kevin Brady (R-TX), Rep. Richard Neal (D-MA), and President Obama, would permanently fix this long-standing problem.

13. Recommendation: Improve the Disability Insurance (DI) program and address the impending depletion of the DI Trust Fund.

In 2015, BPC convened a *Disability Insurance Working Group* to address the impending depletion of the Disability Insurance Trust Fund, which was then projected to be exhausted by late 2016. The working group also recommended ways to improve the DI program to better meet the needs of those with disabilities. The package included proposals to improve work incentives, pilot new approaches to facilitate return-to-work, fund and conduct Continuing Disability Reviews on schedule, evaluate the medical-vocational guidelines, pilot a variety of approaches to improve the initial determination and appeals processes, and reallocate payroll and self-employment taxes between the DI and OASI trust funds to ensure that benefits continue to be paid as scheduled.³⁰⁴

We commend members of Congress for including several of these recommendations in legislation enacted in 2015 to extend the ability of the DI Trust Fund to pay full benefits through 2022. Nonetheless, we encourage policymakers to continue working to improve the program and to consider other recommendations proposed by the BPC Working Group.³⁰⁵

How Would the Commission's Proposals Impact Disability Insurance?

Early in our deliberations, we decided not to make specific recommendations concerning Social Security disability policy, in part because of the concurrent work of BPC's Disability Insurance Working Group. Accordingly, all of the proposed adjustments to benefits that we recommend have been modeled as applying only to OASI benefits and not to DI benefits. The analyses conducted by the program's chief actuary and the Urban Institute both found that our recommendations would be sufficient to attain long-term financial balance for the combined Social Security trust funds. In practice, however, policymakers would need to consider whether and how any such measures should also affect Social Security's DI program. Implementing our recommendations exactly as modeled risks creating inconsistent benefit structures and poor incentives as individuals near the age when they could no longer claim disability benefits and would only be allowed to claim old-age benefits.

If our recommendations were applied to Social Security DI benefits, total savings would be greater than shown in this report, leaving the entire Social Security program with a substantial positive actuarial balance. In that instance, lawmakers would have the option of using these additional savings to make improvements in the overall treatment of DI beneficiaries and/or other Social Security participants.

***Conclusion:
A Comprehensive Package of Proposals
to Improve Retirement Security***

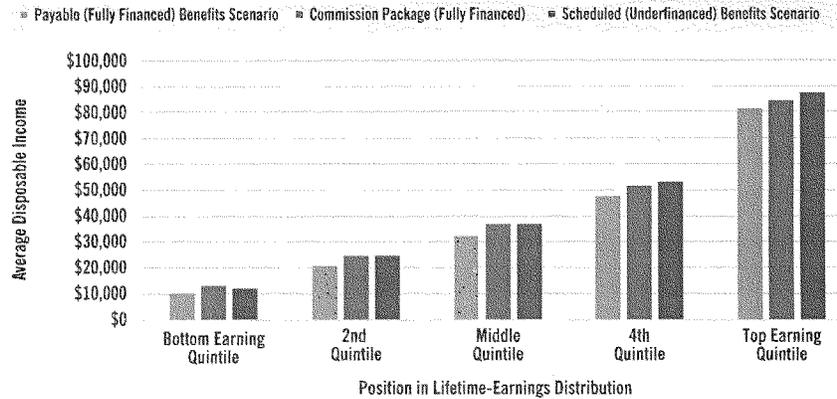


Our recommendations on Social Security, pensions, and other savings complement one another in a variety of ways. Greater access to workplace retirement savings plans, and less pre-retirement leakage from those plans, would especially benefit the middle class. Reforms to Social Security would secure this program as the base of retirement income for all Americans and also reduce

poverty. Better take-up of lifetime-income options would reduce financial calamities among the oldest Americans, especially widows and widowers. More-effective use of home equity would help older Americans to age in their preferred setting. Finally, greater financial acumen would elevate the effectiveness of all efforts to improve retirement security.

Figure 31. Commission’s Proposals for a Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Achieve Incomes for Older Americans At or Above Scheduled Levels for Both Lower- and Middle-Earners

Projected average disposable income (in 2015 dollars) for individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission’s Social Security proposals.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

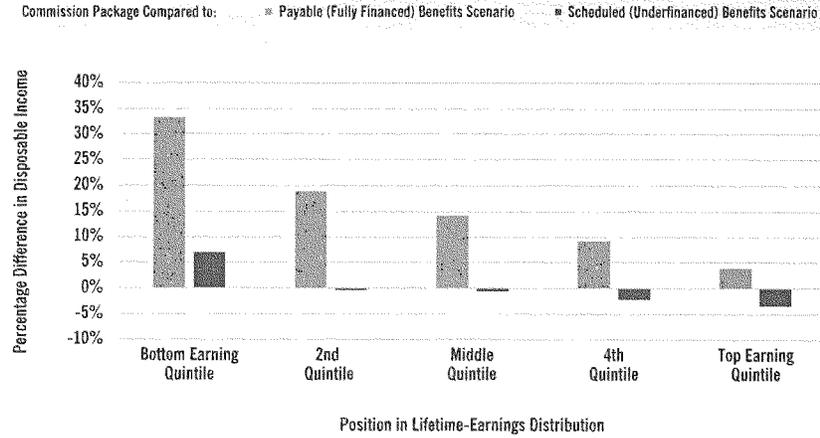
Source: The Urban Institute - DYNASIM3

As both **Figures 31 and 32** show, implementing the commission’s proposals in their entirety would not only provide almost all older Americans with incomes above payable levels, but would provide both lower- and middle-earners with incomes at or near what they are projected to be under the scheduled-benefits scenario. Moreover, this result could be achieved without imposing the additional tax burden that would be required to finance such levels absent any additional reforms.

Critically, our package of recommendations also protects all program participants from a significant disruption to Social Security benefits and does so in a way that improves retirement outcomes. Reforming Social Security to secure its finances and improve its targeting of benefits would especially benefit lower- and middle-income individuals who are likely to rely most on the program in old age. Pairing these necessary adjustments with near-universal access to workplace retirement savings plans would empower individuals with a greater ability to contribute to their own retirement security.

Figure 32. Commission's Proposals for Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Increase Progressivity and Protect Lower- and Middle-Earners from Abrupt Changes

Projected change in disposable income among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission's Social Security proposals.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

The approach that we recommend would improve projected retirement income across the economic spectrum relative to a scenario in which only benefits that can be financed by dedicated Social Security taxes are paid. To the extent that our recommendations result in modest reductions from projected incomes (under a scenario in which scheduled benefits are somehow fully honored despite the projected shortfall in Social Security funding), these reductions are targeted on beneficiaries with the highest incomes.

Together, Americans have a great opportunity to improve their financial future. But change will not happen without a determined effort. Leadership is required and difficult trade-offs have to be made. We hope that our work spurs action to ensure that all Americans can regain their confidence in a secure retirement.

Appendix A: Detailed Policy Specifications

Establish Retirement Security Plans to facilitate and increase small-employer adoption of retirement savings plans

Multiple Employer Plans (MEPs) already exist, but participating employers must have a nexus (i.e., be in a related business). This, along with other rules, makes MEPs inaccessible or unattractive as currently structured. With reforms, MEPs could enable smaller employers to more efficiently offer low-cost, high-quality retirement plans to their employees. Doing so would expand coverage and improve plan features for participants in small plans.

Proposal: Establish a rigorous certification process for Retirement Security Plans (which would legally be MEPs) that would be open to all employers, without a commonality requirement (also known as a nexus).

Retirement Security Plans would provide a way for unrelated employers of any size to band together and offer their employees highly efficient retirement plans with significantly less administrative and fiduciary responsibility for the adopting employers, while maintaining the consumer protections of ERISA for participants. Because Retirement Security Plans would be ERISA plans, many of the rules governing their operations (e.g., vesting rules) would follow those already set out in ERISA and existing regulations.

What Are the Consumer Protections of ERISA?

The Employee Retirement Income Security Act of 1974, more-commonly known as ERISA, provides many protections for retirement-plan participants. First and foremost, employers that sponsor retirement plans, and others who manage or control plan assets, are subject to a fiduciary standard, which requires them to act in the sole interests of plan beneficiaries. This means that plan sponsors and service providers must put the interests of plan participants ahead of their own interests, and they must manage the plan in ways that avoid conflicts of interest. In practice, these rules prohibit certain kinds of compensation to service providers. ERISA provides for many other participant protections, including disclosure requirements, a requirement that plans establish a grievance and appeals process, and the right of participants to sue in certain circumstances.

This proposal envisions that employers could adopt one of many Retirement Security Plans, which would be formed and operated by Retirement Security Plan Sponsors that have applied and been given permission to operate by a **new certification board**. Organizations likely to apply to become certified sponsors include large financial services companies and benefits consultants that have substantial experience in the retirement-plan sector, but any organization or joint venture that can meet the certification criteria could do so.

Intended to be large plans with highly efficient, professional administration, Retirement Security Plans would be open to any employer with fewer than 500 employees. In order to protect employers and participants, Retirement Security Plans would be subject to oversight by a new board organized by the Labor Department and Treasury Department. Employers that adopt a Retirement Security Plan would have no fiduciary liability, very limited administrative responsibilities, and would be shielded from nondiscrimination and top-heavy testing provided that they adopt a Retirement Security Plan and select safe-harbor enrollment and contribution schemes.

Eligibility:

- **Which Employers?** Employers with fewer than 500 employees (over a three-year rolling average) could adopt a Retirement Security Plan. No nexus with other adopting employers would be required.
- **Acceptable Participation Limits:** Employers could limit participation in the Retirement Security Plan to full-time employees who are over the age of 21 and to those employees with at least three months, six months, or one year of service. These minimum eligibility standards would pre-empt the need for 410(b) testing.
- **Retirement Security Plans Would Be Qualified Plans:** Therefore, they could be structured as 401(k)/403(b)/457 plans.

Contributions:

- **Contribution Limits and Testing:** Contribution limits would be governed by the type of qualified plan (e.g., a 401(k) plan) adopted by the Retirement Security Plan. Nondiscrimination and top-heavy testing would be conducted as under current law; testing would be conducted separately for each subset of participants of the Retirement Security Plan for a particular employer, unless that particular employer implemented one of the **contribution safe harbors** (i.e., any of those in current law or the enhanced auto-enrollment safe harbor described below). Retirement Security Plan Sponsors could choose to operate a safe-harbor plan, meaning that adopting employers would be limited to contribution formulas that satisfy one of the contribution safe harbors. Safe-harbor plans would therefore be exempt from nondiscrimination and top-heavy testing.

Plan Administration:

- **The Retirement Security Plan Sponsor:** Retirement Security Plans would be administered by a Retirement Security Plan Sponsor — an independent organization that would have to be certified (i.e., given permission to operate) by the Treasury and Labor Departments (see below for details on the certification process) and would be responsible for all plan administration. The Retirement Security Plan Sponsor would be the fiduciary of the plan and would hold fiduciary responsibility for all aspects of the plan not specifically reserved for the employer. Like any other ERISA plan sponsor, Retirement Security Plan Sponsors could contract out some of those responsibilities, including investment management, according to the existing frameworks established by ERISA.
- **Types of Acceptable Plans:** Retirement Security Plans could be structured as any type of qualified defined contribution retirement plan allowed under current law, such as 401(k) and 403(b) plans. They could be organized as participant-directed or professionally managed (with no opportunity for participant direction) plans, and they could have lump-sum and/or lifetime-income distribution options.
- **Responsibilities of the Retirement Security Plan Sponsor:** Retirement Security Plan Sponsors would be responsible for administrative and fiduciary duties, including:
 - Completing a certification process with the Treasury and Labor Departments;
 - Hiring or serving as a recordkeeper;
 - Hiring or serving as a trustee;
 - Selecting investment options or hiring an investment manager, in which case the Retirement Security Plan Sponsor would have fiduciary responsibility for selecting

and periodically monitoring the investment manager, and the manager would have fiduciary responsibility for making investment decisions. (Note: This is the same as for current employer-sponsored plans.) Either the Retirement Security Plan Sponsor or the investment manager would select investment options, including a QDIA to serve as a default fund for automatically enrolled participants;

Note: Retirement Security Plans would be required to have a QDIA.

- Filing a combined, special version of form 5500, an annual independent audit of the plan, and any other required disclosures to the Labor and Treasury Departments, which would include additional details on plan design, including investment options, lifetime-income options, and fees;
 - Collecting contributions from employers (or hiring and monitoring a service provider to do so);
 - Monitoring employers to ensure that contributions are forwarded by the employer to the service provider as scheduled;
- Note: Retirement Security Plan Sponsors would be required to notify the Labor Department if an employer is more than three months delinquent in forwarding contributions.*
- Ensuring that contributions are invested as directed by participants;
 - Establishing a portal for participants to make changes to investment of funds (in the case of participant-directed plans), select among lifetime-income options, and manage withdrawals;
 - Facilitating rollovers to other plans or IRAs and accepting rollovers from other plans or IRAs, at the discretion of participants, by joining the Retirement Security Clearinghouse; and

- Accepting the proposed Starter Saver's Match from the Treasury Department and directing the funds into the accounts of eligible participants.

Employers:

Employers would have very limited administrative responsibility and no fiduciary liability beyond forwarding contributions as scheduled to the Retirement Security Plan. Employers would not be responsible for actions of the Retirement Security Plan Sponsor or for the actions of other employers that adopt the Retirement Security Plan, and the plan itself could not be disqualified due to the actions of any members (i.e., the one-bad-apple rule would be eliminated) unless the certification board found that the plan had somehow tacitly or explicitly encouraged malfeasance. Employers would be responsible for:

- **Selecting a Retirement Security Plan:** Employers could adopt any Retirement Security Plan without fiduciary liability for that decision.
- **Establishing Enrollment Processes for Employees:** At a minimum, employers would establish once-annual open enrollment periods during which employees would have the ability to enroll, opt out, or change contribution levels.
- **Forwarding Contributions and Participant Data:** This would include forwarding funds (i.e., payroll deductions and employer contributions) and participant data (e.g., Social Security numbers, birthdates, and dates of hire) to the Retirement Security Plan. Employers could also contract with payroll processors to complete these functions.
- **Correcting Mistakes:** Employers would be required to fix mistakes (e.g., accidentally depositing too little into an employee's account) and would be allowed to do so without penalty within a certain brief time period (e.g., three months).

- **Nondiscrimination and Top-Heavy Testing:**

Nondiscrimination and top-heavy testing would continue to be conducted on participant groups separately by employer; testing could be avoided by employers that utilize the proposed **enhanced automatic-enrollment safe harbor** (detailed on page 109) or any existing contribution safe harbor.

- **410(b) Minimum-Coverage Testing:** Employers that adopt a Retirement Security Plan would be exempt from 410(b) minimum-coverage testing, because they would be required to, at minimum, allow all full-time employees over the age of 21 with at least one year of service to participate. (Employers could exceed these minimums as specified above and cover part-time employees, employees younger than age 21, or employees who have completed less than one year of service.)

Labor/Treasury Departments:

- **Regulation:** The Labor and Treasury Departments would be directed to publish regulations that allow, ease, and simplify the formation of Retirement Security Plans, as outlined here.
- **Certification Process:** The Labor and Treasury Departments would establish a Retirement Security Plan Certification Board.

Board Structure and Operations: The board would include three members appointed by the Secretary of Labor, three members appointed by the Secretary of the Treasury, two members appointed by the Executive Director of the Pension Benefit Guaranty Corporation, and one member appointed by the Director of the Consumer Financial Protection Bureau. The Labor and Treasury Departments would provide staff to support the work of the board, with operational and enforcement costs funded initially by appropriations and then by a per-participant fee charged to each Retirement Security Plan Sponsor.

Board Responsibilities: The board would establish certification

and decertification processes and criteria, and would have final authority on certifying and, if necessary, decertifying Retirement Security Plans. The board would actively perform oversight of Retirement Security Plans that are operating, including maintaining a streamlined annual reporting process and, on an as-needed basis, auditing of plans. Retirement Security Plans would undergo recertification every other year. The board would establish criteria upon which to evaluate potential Retirement Security Plan Sponsors. The subject of this evaluation must include both the proposed design of the Retirement Security Plan and the qualifications of the prospective Retirement Security Plan Sponsor. At minimum, these criteria must include:

- Quality of the product offered, including the level of fees relative to the services provided, adherence to generally accepted investment theories, and the likelihood of conflicts of interest;
- Expertise, including the professional qualifications, business model, experience, and training of the prospective Retirement Security Plan Sponsor and any service providers that the sponsor intends to use;
- Availability of the plan to a broad spectrum of employers (either nationwide or within a particular region);
- Registration, licensing, and financial soundness; and
 - In order to be certified, sponsors would need to demonstrate that participant funds would be handled by a regulated financial entity (defined in the box on the next page).
- Reputation and customer service, including record of comments or complaints from employers and participants, timely consideration and resolution of complaints filed, and independent rating or accreditations.

What Is a Regulated Financial Entity?

Any Retirement Security Plan functions that actually involve participant funds, including accepting contributions, investing assets, and disbursing withdrawals, would need to be performed by a regulated entity that is either: 1) covered by the Federal Deposit Insurance Corporation, the National Credit Union Administration, or the Securities Investor Protection Corporation; or 2) an insurance company that is licensed in at least 26 states and in every state in which it would serve participants of a Retirement Security Plan. Thus, a prospective Retirement Security Plan Sponsor that does not meet these criteria (such as a payroll processor) would need to establish a joint venture with a regulated entity. This requirement would provide additional assurance that the service providers offering and supporting Retirement Security Plans are legitimate and that participant funds would be protected.

The Retirement Security Plan Certification Board could add additional criteria to this list. Furthermore, the board would be directed to give preference to Retirement Security Plan proposals that include in-plan retirement-income features, which could follow one or more of the proposed lifetime-income safe harbors. The board would also be directed to establish a review process to evaluate the performance of Retirement Security Plan Sponsors on these criteria and to decertify sponsors with poor performance. That process would include review of regular filings, independent audit results, and any other information requested by the board. This decertification process must include an orderly transition for participant accounts from the decertified plan to another Retirement Security Plan that is in good standing. Each employer that had adopted the now-decertified plan would be able to select any remaining Retirement Security Plan for this transition; in the event that an employer does

not or cannot make a choice (e.g., an employer that no longer exists and has legacy participants), the certification board may solicit proposals and select a different Retirement Security Plan to assume the participant accounts for that particular employer. The certification board would also identify Retirement Security Plans eligible to serve as default providers for employers that utilize an option to contribute to a plan using the payroll-tax system, discussed below.

- **Retirement Security Plan Portal:** The Labor and Treasury Departments would publish basic information about all Retirement Security Plans (which would be reported on a special version of form 5500) — including basic plan-design information, investment options, and plan-wide fees — on a central website so that employers could easily compare the offerings.
- **Payroll-Tax Conduit for Contributions:** The Treasury Department would explore possibilities and, if feasible, establish an option for employers to use existing or modified versions of payroll tax forms and payment processes to enroll employees and forward contributions to a default Retirement Security Plan.

Improve access to workplace retirement savings plans and promote auto-enrollment by establishing a new, more-flexible, automatic-enrollment contribution safe harbor

Proposal: Establish an optional, enhanced automatic-enrollment safe-harbor provision to encourage higher employee contribution rates, incentivize the use of automatic features, and allow for more flexibility in employer matches. Plan sponsors could continue to use the existing automatic-enrollment safe harbor if they prefer.

Exempt Safe-Harbor Adherents from Most Testing:

All ERISA plans that comply with the standards that follow would be exempt (i.e., have a safe harbor) from nondiscrimination and top-heavy testing. Plans would be allowed to continue conducting split testing for their full-time and part-time employees in order to, for example, adopt the enhanced automatic-enrollment safe harbor for full-time employees only and continue to use voluntary enrollment for part-time employees.

- **Auto-Enroll New Employees:** Implement automatic enrollment (with ability to opt out or select a different contribution rate) into a QDIA at an employee deferral rate of at least 3 percent and no more than 10 percent of pay. Participants could select a different investment option. Employers could change this default contribution rate. For example, an employer that initially adopted a 3-percent default contribution rate could increase the default to 6 percent at a later time. Employers would have two options for the timing of automatic enrollment:

- Employers could automatically enroll each eligible employee at the time of hire or upon completion of a specific period after hire (such as three months), not to exceed one year.

- Alternatively, employers could establish an open-enrollment period that would occur at least once annually, at which time they would automatically enroll all eligible employees. Employers could limit the open-enrollment period to employees with at least six months of service or a shorter time period, such as three months, but not a longer period than six months. Some employers might find this option to be administratively simpler, as it would enable them to enroll all eligible employees at once.

For automatic enrollment and automatic escalation, there should be a minimum of two notifications to the employees in advance, providing them with sufficient opportunity to select a different contribution rate or to opt out entirely.

- **Auto-Enroll Non-Participating Employees:** Once every three years, automatically enroll (with ability to opt out) non-participating employees under the same rules (i.e., default contribution rates, auto-escalation, etc.) as new employees.
- **Automatic Escalation:** Implement automatic escalation (with ability to opt out and select a different contribution rate) of employee deferral rates for all participants. The automatic-escalation rate must be at least 1 percent of pay per year and no more than 2 percent of pay per year until the combined employee plus employer contribution rate reaches at least 8 percent of pay and is no greater than 15 percent of pay. Employers could adjust this parameter from year to year. For example, they could switch from escalation at 1 percent of pay per year to escalation at 2 percent of pay per year.

- **Contributions:** Unlike the current automatic-enrollment safe harbor, eligible smaller employers would not be required to make an employer contribution to benefit from the enhanced safe-harbor exemption from nondiscrimination and top-heavy testing. *However, contribution limits for plans sponsored by these employers would differ based on whether or not the employer makes a contribution and the size of any contribution.*
 - For smaller employers that do not offer a contribution and otherwise adopt the enhanced automatic-enrollment safe harbor, the employee contribution limit would be 40 percent of the 402(g) limits, plus 40 percent of any applicable catch-up contribution. For 2016, this would be \$7,200 plus a \$2,400 catch-up contribution for participants over age 50. These employers could continue to offer an automatic-enrollment plan with no employer contribution but would have to undergo nondiscrimination and top-heavy testing in order to allow their employees to contribute up to the full contribution limits (\$18,000 in 2016).
 - Full employee contribution limits (\$18,000 plus a \$6,000 catch-up contribution for participants over age 50 in 2016) would be available for plans that adopt the safe harbor and either offer an existing DB plan that is not closed to new employees or include an employer contribution of either: 1) a non-elective contribution of at least 2 percent of pay; or 2) a match of at least 3 percent of pay, structured so that matching begins at the first dollar of the employee contribution and ends at no more than the 15th percentage point of pay contributed.
 - A sliding scale of contribution limits would apply to small-employer plans that adopt the safe harbor, as shown in **Table 4**.
 - Larger employers must offer a contribution to qualify for the safe harbor. Specifically, they would need either a matching contribution of at least 3 percent of pay, an automatic contribution of at least 2 percent of pay, or sponsorship of a DB plan.

Table 4. Contribution Limits Under Enhanced Automatic-Enrollment Safe Harbor

Employer Contribution	Contribution Limits (including any applicable catch-up limit)
No contribution	40 percent of the full limits
1 percent of pay matching contribution	60 percent of the full limits
1 percent of pay automatic contribution	70 percent of the full limits
2 percent of pay matching contribution	80 percent of the full limits
3 percent of pay matching contribution or 2 percent of pay automatic contribution	100 percent of the full limits

Enhance myRA to provide a base of coverage for workers who are least likely to be offered a plan

Proposal: Modify myRA to provide a simple (for both participants and employers) and effective supplemental DC retirement savings option that is particularly well suited for workers with irregular, part-time, or low-earning work patterns — individuals who are unlikely to be served by existing or future private-sector DC arrangements.

Table 5. Comparison of Existing myRA Program and Proposed Enhanced myRA

	Existing myRA	Proposed Enhanced myRA
Employer Contributions	Not allowed	Allowed, count toward contribution limit
Automatic Enrollment	Not allowed	Allowed at a default contribution rate of 2-6 percent of pay
Contribution Limit	IRA limit (\$5,500)	IRA limit (\$5,500)
Account Size Limit	\$15,000	\$15,000
Investment Option	Treasury debt	Treasury debt
Administration & Oversight	Treasury Department	Treasury Department
Rollover Process (once account balance limit reached)	Not yet determined	Propose criteria by which trustees would select service providers for auto-rollover; service providers must be willing to serve as fiduciaries
Tax Treatment	Roth	Roth

Eligibility:

- **Which Individuals?** As under current policy, anyone who is eligible to contribute to a Roth IRA would be allowed to access myRA. Households with income above certain levels (in 2016, \$132,000 for single filers and \$194,000 for joint filers) are not eligible to make contributions to Roth IRAs.³⁰⁶
- **Which Employers?** Employers of any size could offer myRA to employees who are not covered by a qualified plan, such as a 401(k) plan.

Contributions:

- **Tax Treatment:** myRA accounts would continue to be treated as Roth accounts for tax purposes, which means that contributions could only be made on an after-tax basis.
- **Contribution Limits:** Employers would be allowed to contribute, but total employer plus employee contributions would be capped at the IRA limit (\$5,500 in 2016, plus an extra \$1,000 for those over age 50).³⁰⁷

- **Employer Contributions:** Employer contributions would be limited to simple designs, such as a flat percentage match of up to 3 percent of pay that ends no later than an employee contribution of 6 percent of pay contributed or a non-elective contribution of 3 percent of pay or less.
- **Contribution Processing:** Employers could either forward contributions to myRA directly using the Treasury Department's existing system or could use a new option to contribute to myRA through the payroll-tax forms and collection process.
- **Account Cap:** Individuals with myRA accounts would no longer be allowed to contribute once their account balance exceeds \$15,000. At that time, individuals could select a commercial Roth IRA provider to manage their savings. Individuals who do not make a selection would have their accounts automatically rolled into a default commercial Roth IRA according to the procedure detailed below.

Administration:

- **Administrative Responsibility:** myRA would continue to be administered by the Treasury Department, which would be responsible for:
 - Investing funds in Treasury securities with no risk to principal;
 - Facilitating rollovers to other plans. Participants could roll savings out of the accounts to a private-sector Roth IRA once balances reach \$10,000 and would be automatically rolled out of myRA accounts when savings exceed the \$15,000 account cap. Treasury would make the final determination on default rollover options for myRA owners who exceed the account cap;
 - Facilitating rollovers from other plans to myRA. myRA owners could initiate a trustee-to-trustee transfer to move balances from qualified plans to myRA, as long as the transaction would not exceed the myRA account limits. Additionally, plan sponsors could automatically transfer myRA balances of participants who leave employment with less than \$5,000 in plan savings, unless the participant elects a different rollover option. Treasury would partner with the Retirement Security Clearinghouse to facilitate such transfers; and
- Establishing withdrawal options.
- **Rollovers:** The Treasury Department would administer a rollover process that myRA owners could initiate at any time once balances reach \$10,000 or that would be automatically implemented at the end of any year in which a myRA owner's account balance exceeds the account cap of \$15,000. myRA owners could select a particular IRA provider and investment funds offered by that provider. In the absence of an affirmative election on the part of the myRA owner, Treasury would designate a default roll-out procedure based on a competitive process.
 - The Treasury Department would receive annual bids from IRA providers for the accounts scheduled to be rolled out. Eligible IRA providers would, at minimum: 1) agree to serve as a fiduciary for the individuals whose accounts are rolled over from myRA; and 2) offer an appropriate default investment selection that invests savings into increasingly more-conservative asset allocations as the IRA owner approaches typical retirement age and would offer bids based on all-in fees of an account with savings invested in the default fund.
 - The Treasury Department would be responsible for selecting a default option for automatic rollovers for myRA owners who reach the account cap and do not make an affirmative choice. The Treasury Department could choose to limit automatic rollovers to a single IRA provider or to several (with random assignment) based on overall evaluation of the value offered by service

providers that participate in the competitive process. The Treasury Department should consider the quality and design of the investment vehicles, fees and simulated performance net of fees, and service quality, among other criteria to be defined by the department.

- **Notifications:** Other than the notifications specified below that would come from employers, the Treasury Department would be responsible for providing myRA owners with all other notifications, including annual account statements.

Employers:

- **Limited Fiduciary Liability:** Employers could automatically enroll their employees into myRA and would have no fiduciary liability or administrative responsibilities beyond: properly notifying their employees of the enrollment process and the opportunity to select a different contribution rate or opt out of making contributions entirely; forwarding the contributions deducted from employee paychecks to myRA; and collecting and forwarding relevant participant data, including Social Security numbers, birthdates, and dates of hire. This might require a modification of the ERISA statute.
- **Automatic Enrollment:** Employers could implement automatic enrollment and escalation, within limits. Initial enrollment must be set at a default contribution rate no lower than 2 percent of pay and no higher than 6 percent of pay with auto-escalation to no higher than 8 percent of pay.

Note: These parameters are different from those proposed for the enhanced automatic-enrollment safe harbor (described above) to reflect the likelihood that myRA will mostly serve lower-earning workers who might be more likely to opt out at higher contribution rates.

- **Open Enrollment:** Employers could either implement enrollment at the time of hire or at an annual open-enrollment period. For those employers opting for an annual open-enrollment period, initial enrollment and increases to contribution rates, whether initiated by the participant or

through automatic enrollment and escalation, would be limited to that period. Employers that adopt annual open enrollment must allow employees to stop contributing at other times during the year. During open-enrollment periods, employers could choose to limit eligibility for automatic enrollment to employees with service of three months or longer.

- **Contributions:** Employers could make contributions as long as a simple design is used, such as a flat percentage match of up to 3 percent of pay that ends no later than an employee contribution of 6 percent of pay or a non-elective contribution of 3 percent of pay or less.

- Employers could limit their contributions to employees who have service of at least one year. All contributions would be vested immediately.

- **No Testing:** Employers would not be subject to nondiscrimination and top-heavy testing for myRA.
- **Correcting Mistakes:** Employers would be required to fix mistakes (e.g., accidentally depositing too little into an employee's account) and would be allowed to do so without penalty within a certain brief time period (e.g., three months).
- **Converting to a Qualified Plan:** Employers that adopt myRA could subsequently convert to an ERISA-covered plan, such as a Retirement Security Plan (as described above).

Employees/myRA Owners:

- **Enrollment:** At the time of initial eligibility and at least once per year thereafter (when the employer holds open-enrollment periods), employees would have the opportunity to enroll in myRA or change contribution rates. Employees could stop contributing at any time.
- **Distributions:** myRA owners could take distributions from myRA beginning at age 59 ½. Because all myRA accounts would be Roth accounts, most withdrawals after age 59 ½ would be tax free. Additionally, the principal could be removed tax- and penalty-free at any time.³⁰⁸

Appendix B: Detailed Specifications for Modeling Commission's Social Security Proposals

Our deliberations on Social Security benefited greatly from an analysis, conducted by the Urban Institute, that modeled the results of our proposals using the DYNASIM3 model. The model projects U.S. population demographics, income, and assets for older individuals (aged 62 and over) for the next 75 years.³⁰⁹

The modelers estimated the impact of our Social Security package compared to two baselines: 1) a payable scenario, in which benefits are assumed to be limited to those that can be financed by dedicated revenue sources; and 2) a scheduled scenario, in which benefits are assumed to be paid according to the current benefit formula and rules (either through additional taxes or increased debt) even after the OASI Trust Fund is exhausted. These estimates are included throughout the report, and additional output tables are available on BPC's website.³¹⁰

The following specifications were used to model the package of reforms. Please note that we only considered proposals that would impact the OASI program; no specific changes were recommended for the DI benefit formula. Specifications below that refer to DI were crafted for modeling purposes only and do not represent recommendations of the commission.

- **Annual PIA:** Beginning with OASI claimants who attain age 62 in 2022 (and all future cohorts), the current PIA calculation would be replaced with a new algorithm. The new algorithm would:
 - *Apply the bend-point/PIA-factor formula to individual years of wage-indexed earnings; then, sum the 40 largest of these amounts and divide by 37.*

Note: This package proposes new bend points and PIA factors below, which would impact beneficiaries who reach age 62 beginning in 2022.

- *Phase in over five years*, meaning that in 2022, 80 percent of the benefit would be based on the old 35-year average PIA formula and 20 percent on the new annual-PIA formula, shifting by 20 percentage points each year until 100 percent is based on the new annual-PIA formula for those attaining age 62 in 2026.

- **Replace the WEP and GPO With a Proportional Reduction in OASI Benefits Based on Covered Earnings:** Beginning with beneficiaries turning 62 years old in 2022, PIAs would be calculated as if all earnings (up to the taxable maximum) were covered and then pro-rated (multiplied by the proportion of covered earnings over total earnings ((covered earnings plus uncovered earnings) up to the taxable maximum). For beneficiaries with earnings at or above the taxable maximum, covered earnings would count first. For example, a beneficiary with a PIA of \$1,000 for whom 75 percent of earnings were covered would have his or her PIA reduced to \$750. For beneficiaries who continue to work, adjustments to OASI benefits would reflect both the contribution of additional earnings to their PIAs and the changing proportion of covered earnings over total earnings.
- **Limit Spousal Benefits:** Claimants who turn age 62 in 2022 (and all future cohorts) would be subject to a new limit on spousal benefits. In 2022, the maximum spousal benefit would be limited to that received by the spouse of the 75th percentile worker (i.e., half of the 75th percentile worker's PIA, a formula which would include "annual PIA" for some). In 2023 and subsequent years, the spousal limit would be equal to the 2022 limit plus an update for inflation (i.e., the 2022 limit would be indexed for inflation annually using the C-CPI-U).

- **Enhance Survivors Benefits:** Beginning for claimants who turn age 62 in 2022 (and all future cohorts), all claimants who are married would receive a 75-percent joint-and-survivor annuity benefit (i.e., surviving spouses would receive 75 percent of the decedents' benefits, in addition to their own). Initial benefits would be actuarially adjusted to keep the expected value of benefits equivalent to what would otherwise be current law (i.e., with the other provisions of this package incorporated).
- **Improve Progressivity of Benefit Formula:** For OASI claimants turning 62 beginning in 2022 (and all future cohorts), new PIA factors and one additional bend point would phase in over the course of 10 years. This proposal would adjust the current bend points and add a new one, resulting in PIA factors of 95/32/15/5 percent. The new PIA bend point (i.e., at the change from 32 to 15 percent) would begin at the 50th percentile of the AIME distribution minus \$100 (in 2015 dollars). The bottom bend point (\$826 in 2015) would move up to the equivalent of \$1,050 per month in 2015. The dollar amount for the top bend point would remain at its current law level. Changes would phase in such that beneficiaries who turned 62 in 2022 would have 10 percent of their benefit computed using the new bend points, those who turned 62 in 2023 would have 20 percent, etc.
- **Increase Social Security Tax Base:** The taxable maximum for Social Security taxes would increase to \$195,000 over four years beginning in 2017 (reaching that figure in 2020) and would then be indexed to the average wage index (AWI) plus 0.5 percentage points in subsequent years.
- **Increase Social Security Tax Rate:** The Social Security total payroll- and self-employment tax rates would increase by 1 percentage point from 12.4 percent to 13.4 percent over the course of 10 years (by 0.1 percentage points per year) beginning in 2017; the rate would reach 13.4 percent in 2026. In the case of the payroll tax, the increase would be split evenly between the employer and employee shares.
- **Increase Retirement Ages:** Once the full retirement age (FRA) reaches 67 for those attaining age 62 in 2022, the FRA would continue to increase by one month for every two years (e.g., rising to 67 years and 1 month in 2024). Starting in the same year, the maximum age for the delayed retirement credit (currently 70) would begin to increase by one month for every two years. These increases would stop once the FRA reaches age 69 for new claimants. The early eligibility age (currently 62) would not change.
- **Modify Cost-of-Living Adjustment (COLA) in OASI:** Beginning in 2017, for OASI beneficiaries only (DI beneficiaries would only be affected when their benefit switches to OASI at the FRA), the annual COLA would switch to the C-CPI-U.
- **End "Claim-and-Suspend" Games:** Beginning in 2016, OASI beneficiaries could no longer receive a spousal benefit if the primary earner has suspended his or her benefits. Additionally, people would be required to claim their individual benefit if their individual PIA is larger than the spousal benefit to which they are entitled. This is similar to what is now current law.³¹¹
- **Extend the Survivors Benefit to Adult Children Up to Age 22:** Beginning in 2017, survivors benefits would continue for children of deceased workers and DI beneficiaries until age 22 if the child is in high school, college, or a vocational school.
- **Create a Basic Minimum Benefit for All Individuals Above the FRA Eligible for Social Security:** Beginning in 2020, create a basic minimum benefit (BMB) within Social Security (i.e., the cost of the BMB would be charged as a cost to the OASI Trust Fund). This recommendation would yield general federal budget savings from reduced Supplemental Security Income (SSI) expenditures.
 - Eligibility for the BMB would be limited to OASI beneficiaries who have attained the FRA or above. OASI beneficiaries under the FRA would not be eligible

for the BMB, but those between the age of 65 and the FRA could still receive SSI benefits under current SSI eligibility standards.

- There would be no resource test for the BMB.
- No application for the BMB would be required. It would be calculated and added to Social Security benefit payments automatically.
- The BMB would be calculated on a household basis and split equally between Social Security recipients in the household. In the case of a married couple, both spouses would need to claim any Social Security benefits for which they are eligible before they could receive the BMB. If both spouses have claimed and one has attained the FRA or above and the other has not, only the half of the BMB for the spouse over the FRA would be paid.
- The BMB amount for single beneficiaries would be equal to either: 1) the BMB base (\$604 in 2015) minus 0.7 times current monthly OASI benefits (not including any BMB), if positive; or 2) zero. (The BMB could never be negative.)
- The BMB amount for married beneficiaries would be equal to either: 1) the BMB base (\$906 in 2015) minus 0.7 times total household current monthly OASI benefits (not including any BMB), if positive; or 2) zero.
- For beneficiaries with a mix of covered and non-covered employment, any BMB would be proportionally reduced in the same manner as described in the WEP/GPO-replacement proposal.
- The BMB bases for singles and couples would be updated annually for changes in the average wage index (AWI).
- The BMB amount would be recalculated at least annually, whenever there is a change in Social Security benefits

(e.g., annually for COLAs, upon conversion to survivors benefit).

- Single filers with adjusted gross income (AGI) over \$30,000 and joint filers with AGI over \$45,000 would have any BMB clawed back through the income-tax system. (These thresholds, in 2015 dollars, would be indexed to C-CPI-U.) Clawbacks would be credited back to the OASI Trust Fund.

- **Tax 100 percent of Social Security benefits for beneficiaries with annual income above \$250,000.**

Beginning in 2022, single/head-of-household/married-filing-separately taxpayers with AGI of more than \$250,000 and joint filers with AGI of more than \$500,000 would have 100 percent of Social Security benefits included in taxable income (up from 85 percent). In subsequent years, these thresholds would be updated for growth in wages (AWI). Revenue from this provision would be credited to the Social Security trust funds. *Only the Chief Actuary's scoring of the package modeled this provision, as it was expected to yield negligible savings.*

Note: For modeling purposes, all benefit adjustments were applied only to OASI benefits. The commission did not make recommendations regarding whether or how these proposals should apply to DI benefits.

Appendix C: Measuring and Projecting Retirement Outcomes

Retirement outcomes depend upon a wide variety of resources and risks. Because of this, describing the circumstances of the “average” retiree is complicated. Many sources of income and savings can support consumption at older ages, including earnings from continuing to work, workplace pensions, savings in tax-advantaged retirement accounts, Social Security benefits, private savings outside of retirement accounts, home equity, small businesses, help from family members, and more. On the flip side, Americans face a *diversity of risks*: even those who seem relatively well-prepared risk the possibility of poor investment returns, unexpected medical bills, needing prolonged LTSS, or living longer than anticipated and exhausting resources.

Of course, not everyone is vulnerable — some will effectively navigate the current system and find themselves financially secure in retirement through a combination of preparation and luck. But others will struggle to make ends meet, and for far too many, our retirement system is not helping them plan effectively. Although substantial disagreement exists over the exact share of Americans who are at risk of experiencing hardship in retirement, many are clearly not preparing appropriately.

Overall Measures of Retirement Preparedness

A number of models attempt to project financial wellbeing in retirement. The Employee Benefit Research Institute (EBRI) has developed the Retirement Security Projection Model, which estimates future retirement income from Social Security and pensions as well as the accumulation and spend-down of retirement savings according to projected consumption levels. Using the model, EBRI estimates that over 40 percent of Americans entering and approaching retirement (specifically, Boomer and Gen-X households) will run short of money in retirement.³¹² The Center for Retirement Research (CRR)

at Boston College uses a very different methodology and finds that over 50 percent of working-age Americans are at risk of being unable to maintain their standard of living in retirement.³¹³ Other researchers have estimated that a smaller share of the population is at risk of financial inadequacy in retirement. For example, Michael D. Hurd and Susan Rohwedder concluded that 29 percent of 66-69 year-olds are not adequately prepared to maintain their pre-retirement level of consumption throughout older age.³¹⁴ These models use various techniques and metrics, so it is not surprising that they arrive at different estimates about the extent of retirement preparedness in the U.S.

Another approach altogether is to examine the extent to which older Americans live in poverty. While entitlement programs like Social Security and Medicare have resulted in lower poverty rates for older Americans, significant poverty remains. The U.S. Census Bureau’s official poverty measure estimates the percentage of American households with income below certain thresholds.³¹⁵ In 2014, the official measure found that 10.0 percent of Americans aged 65 and older lived in poverty, which was lower than the rates for working-age Americans (13.5 percent) and children (21.5 percent).³¹⁶ These differences narrow substantially, however, when additional factors, such as out-of-pocket medical expenses and refundable tax credits, are incorporated, as under the Supplemental Poverty Measure (SPM). Supplemental poverty rates among older Americans (14.4 percent) are much closer to those for working-age adults (15.0 percent) and children (16.7 percent), compared to the official measure.³¹⁷

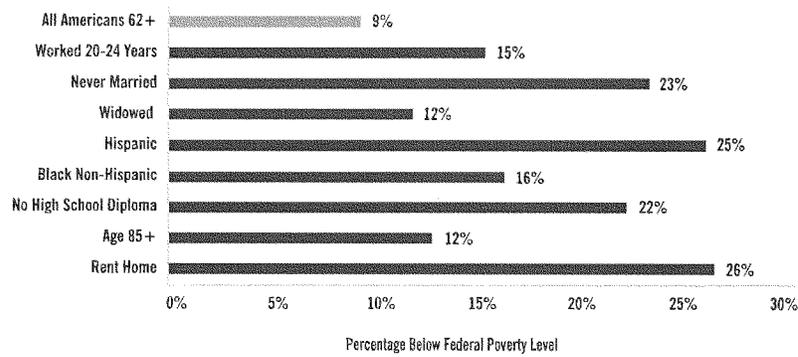
What Exactly Are the Poverty Thresholds? And How Are They Used?

In 2015, the poverty thresholds for Americans aged 65 and older were \$11,367 for one person living alone and \$14,326 for two people living together. The thresholds are higher for Americans under 65 years of age. These thresholds, which are used by the Census Bureau to calculate the official poverty measure, are different from the federal poverty guidelines, which are published by the Department of Health and Human Services and used to determine eligibility for federal programs, such as Medicaid and Supplemental Security Income.³¹⁸

Despite a similar — or even lower — poverty rate than the general population, policymakers often focus on reducing poverty among older Americans, because this demographic is more likely to face physical or mental constraints that preclude earning income. Projections show that old-age poverty is especially high among widows and widowers, racial and ethnic minorities, divorced individuals, and Americans older than age 85 (Figure 33).³¹⁹ The persistence of poverty across the age spectrum, however, underscores the need to consider the broader impact of proposals to improve retirement security on low-income, younger Americans.

Figure 33. Some Retirees Are More Likely to Be in Poverty

Poverty rates for individuals aged 62 and older in 2015, by various demographics.



Source: The Urban Institute - DYNASIM3

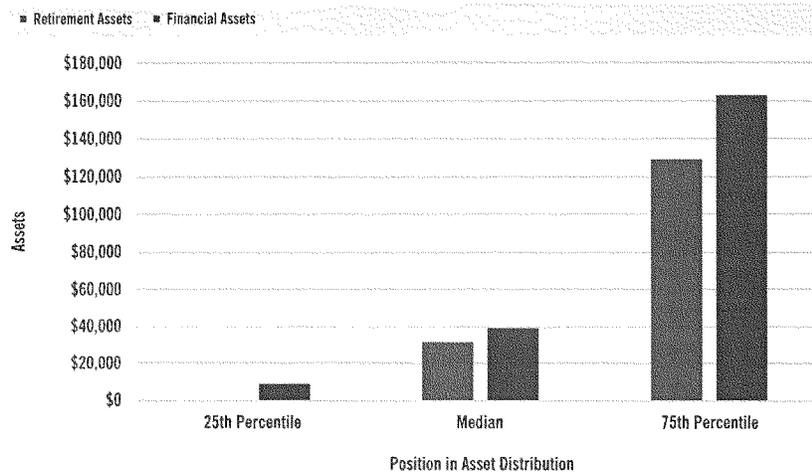
Retirement and Financial Assets³²⁰

The broad lack of significant personal savings for retirement is remarkable. Fully 29 percent of households aged 55 and older have neither assets in a retirement account nor a defined benefit (DB) pension.³²¹ Even among households aged 55-64 with retirement savings, the median total account balance is only about \$104,000, which in most cases is insufficient, by itself, to support a retirement that could last 20 or 30 years (or longer).³²²

Indeed, our modeling paints a troubling picture of retirement security, especially for those in the bottom half of the distribution of retirement assets. Median, per-capita retirement assets, which include savings in DC plans and IRAs, among younger retirement-age individuals (ages 62-69) was around \$32,000 in 2015. Meanwhile, those in the 25th percentile lack any retirement assets whatsoever. Even individuals in the 75th percentile of retirement assets have only around \$129,000, which is likely still insufficient on its own to finance a decades-long retirement.

Figure 34. Half of Americans Aged 62-69 Have Little or No Savings

Retirement and financial assets for Americans aged 62-69 in 2015.

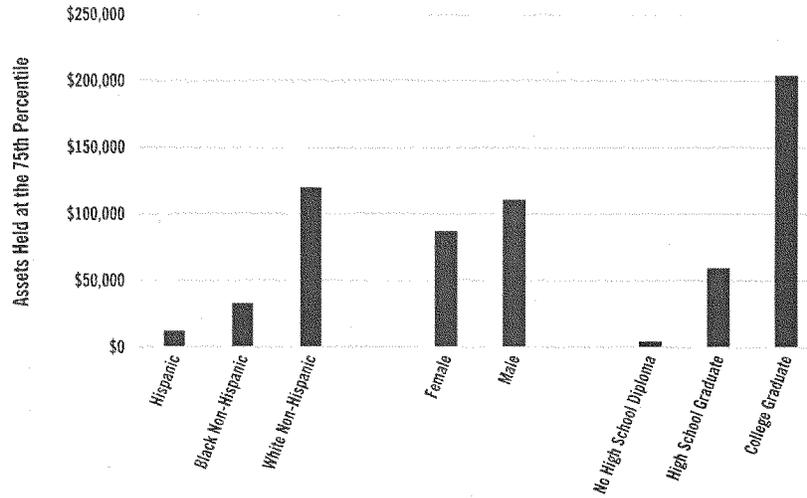


Note: Retirement assets include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Financial assets include savings, checking, money market, certificate of deposits, stock, bond, farm and business equity, and vehicle equity, less unsecured debt. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets.

Source: The Urban Institute - DYNASIM3

Figure 35. Educational Attainment and Race/Ethnicity Associated With Largest Disparities in Retirement Savings

Retirement savings at the 75th percentile for individuals aged 62 and older in 2015, by race/ethnicity, gender, and education.



Note: Retirement assets include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets.

Source: The Urban Institute - DYNASIM3

But looking at retirement assets alone paints an incomplete picture of financial security, as many individuals have savings outside of retirement accounts. Although estimates of financial assets — which include bank account balances, stocks and bonds — paint a somewhat brighter picture of older Americans’ finances, overall savings levels remain largely insufficient to finance a long retirement. Median, per-capita financial assets for 62-69 year-olds was around \$39,000 in 2015, compared to \$163,000 at the 75th percentile and just \$9,000 at the 25th percentile (Figure 34).³²³

Our modeling estimates also reveal that retirement assets are far from equally shared among the population. Disparities by race, ethnicity, and education are especially stark. In 2015, estimated median per-capita retirement assets for white, non-Hispanic Americans aged 62 and older was \$31,000; for black, non-Hispanic Americans and for Hispanic Americans it was zero. Similarly, in 2015, Americans over age 62 with college degrees had a median of \$86,000 in retirement assets, while the median among those without a high school diploma was zero. The breakdowns at the 75th percentile, depicted in Figure 35, are striking as well. (As

a caveat, these demographic projections present an incomplete snapshot of accumulated retirement savings, as they include all individuals aged 62 and older, including older retirees who may have already spent down a majority of their savings.)

The data also show that women tend to have fewer retirement assets than men, although the gap is projected to narrow in the coming decades.³²⁴ Unmarried individuals of any gender have less in retirement assets than those who are married. Along these lines, the EBRI Retirement Confidence Survey found that only 50 percent of unmarried women have saved for retirement, as compared to 59 percent of unmarried men and 79 percent of married workers.³²⁵

Asset levels also vary greatly depending on the age of the retiree. The “very old” (age 85+) tend to have less wealth, as they have spent down the majority of their savings. Among 62-69 year-olds,

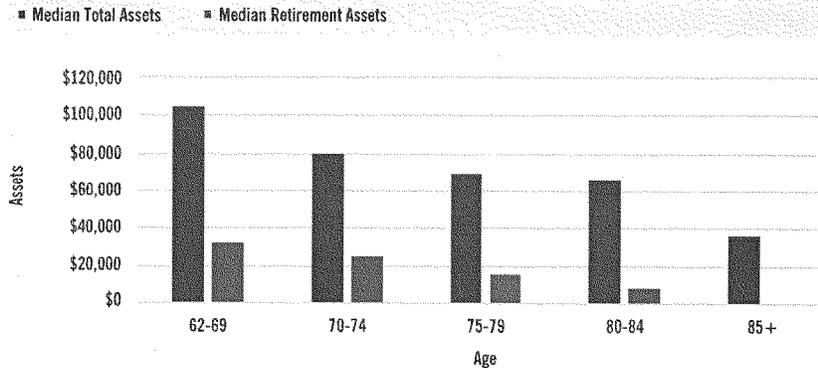
median, per-capita total assets stood at around \$105,000 in 2015, while the 85+ demographic had just around \$36,000 in total assets (Figure 36).

Finally, as one would expect, accruing meaningful retirement savings can be extremely difficult for those with low incomes during their working years. These households are likely to find themselves depending on Social Security and, possibly, Supplemental Security Income (SSI) for virtually all of their retirement income. One estimate found that retirees in the bottom half of the income distribution get almost 85 percent of their income from Social Security.^{326, 327}

Those with low career incomes are also most likely to experience financial hardship in retirement. According to the EBRI retirement security metric, individuals in the quarter of the population with the

Figure 36. Retirees Draw Down Assets as They Age

Median assets for Americans aged 62 and older in 2015, by age.

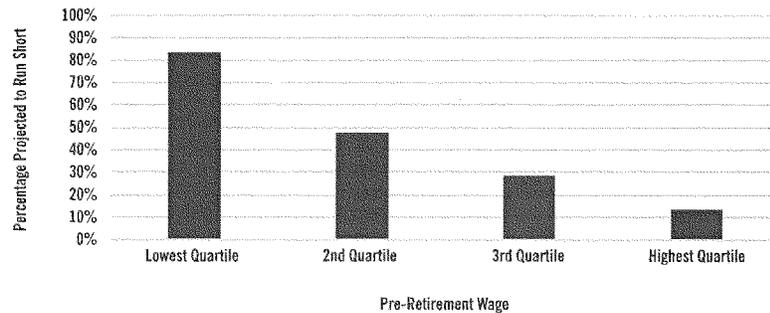


Note: Total assets include retirement assets, financial assets, and home equity. Retirement assets include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Financial assets include savings, checking, money market, certificate of deposits, stock, bond, farm and business equity, and vehicle equity, less unsecured debt. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets.

Source: The Urban Institute - DYNASIM3

Figure 37. Lower Earners Are Most Likely to Run Short of Money in Retirement

Individuals projected to run short of money in retirement, by pre-retirement wage quartile.



Note: Population is segmented based on pre-retirement wages; for example, the bottom quartile represents those individuals whose total pre-retirement wages were in the lowest 25 percent of all Americans.

Source: Employee Benefit Research Institute³²⁹

lowest pre-retirement income are projected to run short of money in retirement nearly 85 percent of the time, while those in the top quarter are projected to run short less than 15 percent of the time (Figure 37).³²⁸

Insurance Risks and Retirement Outcomes: Longevity, Health Care, and Long-Term Care

The retirement security challenge is partly a savings problem and partly a problem of underemployment and low wages during working years, but a significant contributor, often overlooked, is an insurance problem. Many aspects of retirement are unpredictable. Certain risks, if not managed properly, are capable of depleting even substantial retirement savings. Chief among these risks are longevity, health care, and long-term care.

Longevity:

Living an especially long life has obvious rewards, but it also puts increased strain on limited financial resources, which must fund

regular living expenses over a longer timeframe. The difference in financial outcomes for those with shorter versus longer lives is significant: According to EBRI's projections, just 18 percent of Gen-Xers (those born between 1965 and 1974) with the shortest life expectancies of their cohort will run short of money, while 67 percent of the longest-living Gen-Xers will run short (Figure 38).^{330, 331}

Health Care:

Utilization of health-care services, such as office visits to health-care providers, hospitalizations, surgical procedures, and management of chronic conditions, can be unpredictable and expensive throughout life and especially so in old age. Almost all Americans aged 65 and older receive health insurance from the Medicare program.³³² While Medicare provides substantial financial protection for older Americans who use health-care services, beneficiaries are responsible for many costs. These expenses include premiums and cost sharing, as well as the cost of services that Medicare does not cover, such as dental care.

As Americans prepare for retirement, Medicare reduces, but does not eliminate, uncertainty regarding out-of-pocket health-care costs in old age. Simulations conducted by EBRI of health-care spending (not including long-term care expenses) demonstrate this point: In order to have even a 50-percent chance of being able to cover all out-of-pocket health-care expenses in retirement, a 65-year-old man would need to accumulate \$68,000 in savings, and a 65-year-old woman would need to amass \$89,000.^{333, 334}

Medicare's trustees have identified significant long-range financial challenges for the program that will need to be addressed with legislation.³³⁵ While these challenges are beyond the scope of this report, other BPC initiatives have recommended reforms to payment and delivery systems, as well as beneficiary cost sharing, in Medicare.³³⁶

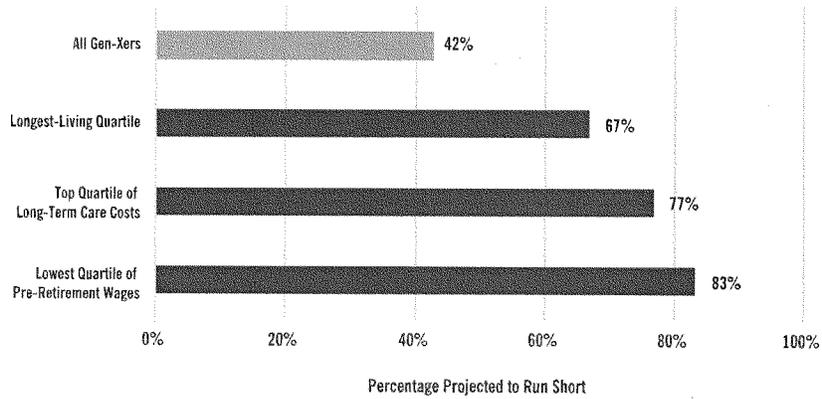
Long-Term Care:

The financial challenges of a very long life or poor health can be compounded by the higher likelihood of needing long-term services and supports (LTSS) among the oldest Americans, especially those over the age of 85.³³⁷ Many individuals begin to have problems with regular activities, such as bathing, dressing, cooking, and managing medication, as they age. Although Americans who need such assistance often rely upon the help of family members or friends, many will eventually turn to paid assistance. (Additionally, unpaid caregivers often sacrifice their own earnings and retirement savings in order to care for family members who need LTSS.)

While LTSS expenses can be extreme in some cases, the expected out-of-pocket lifetime LTSS spending for a 65-year-old varies

Figure 38. Some Individuals Are Especially at Risk of Outliving Savings

Individuals projected to run short of money in retirement.



Note: All percentages are of individuals considered part of Generation X.

Source: Employee Benefit Research Institute³⁴²

greatly. The majority (63 percent) will spend nothing out of pocket on LTSS for the rest of their lives, either because they will not need this level of care or because they will receive services from other sources, such as unpaid assistance from family and friends. A small group (17 percent) will ultimately spend more than \$100,000 of their own or family funds on services, with the rest spending more than zero but less than \$100,000.^{338, 339}

EBRI's estimates show that out-of-pocket spending on LTSS is a factor with great potential to drain the savings of those who are otherwise prepared for retirement. For example, among Gen-Xers who are not projected to have any LTSS spending, only 16 percent will run short of money in retirement, while 50 percent of Gen-Xers who have LTSS expenses will run short.³⁴⁰

Because the likelihood of needing LTSS rises with age, and the costs are not covered by Medicare, this is clearly a risk that should be considered in the context of planning for retirement. BPC has a separate [Long-Term Care Initiative](#), which released a set of policy recommendations to improve LTSS financing in 2016.³⁴¹ Because of this, our commission did not make policy recommendations regarding the financing of long-term care.

It is easy to get lost in all of these statistics and data sources, but the bottom line is clear: Americans face a diversity of risks that threaten retirement security. Solutions are within reach for many of these scenarios, but Americans and policymakers must pay attention and act.

Endnotes

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- ⁸ See, e.g., VanDerhei, Jack. 2014. "What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model." Employee Benefit Research Institute Issue Brief, no. 396, P. 6. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.
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- ¹⁰ Employers that freeze benefit accruals for traditional DB plans typically replace them with DC plans or hybrid plans, such as cash balance plans. The latter is still technically a DB plan under pension regulations but functions as a DC plan from the perspective of covered workers.
- ¹¹ See, e.g., Joint Committee on Taxation. 2016. "Present Law and Background Relating to Tax-Favored Retirement Saving and Certain Related Legislative Proposals." United States Congress. 114th Congress. Report No. JCX-3-16. Pp. 22-28. <https://www.jct.gov/publications.html?func=startdown&id=4865>. For more information on plan types and structures.
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- ²⁹ *Id.* at 31.
- ³⁰ *Id.* at 23.
- ³¹ Lucas, *et al.* DCIA Plan Sponsor Survey 2014 at 5.
- ³² This problem is exacerbated in today's dynamic economy with more frequent job changes, because when a worker starts his or her new job, any progress from auto-escalation may be erased.

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- ¹⁸⁸ *Id.*
- ¹⁸⁹ Internal Revenue Service. 2015. Retirement Topics – Hardship Distributions. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Hardship-Distributions>.
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- ¹⁹¹ United States Department of Labor. 2013. What You Should Know About Your Retirement. P. 21. <http://www.dol.gov/ebsa/pdf/wyskgreenbook.pdf>.
- ¹⁹² A variety of details, such as where the funds would be deposited, how they would be administered, associated costs and worker protections would need to be addressed by policymakers.
- ¹⁹³ Bipartisan Policy Center staff communications with plan sponsors.
- ¹⁹⁴ Internal Revenue Service. 2014. Longevity Annuity Contracts. Internal Revenue Bulletin 2014-30. https://www.irs.gov/irb/2014-30_IRB/ar07.html.
- ¹⁹⁵ Previously, such long-deferred annuity contracts would have been counted as assets subject to minimum required distributions, which apply to participants beginning at age 70½. Under the new rule, the value of the QLAC is exempt from required distributions.
- ¹⁹⁶ Abraham, Katharine G. and Benjamin H. Harris. 2014. "Better financial security in retirement? Realizing the promise of longevity annuities." The Brookings Institution. <http://www.brookings.edu/research/papers/2014/11/06-retirement-longevity-annuities-abraham-harris>.
- ¹⁹⁷ ERISA generally requires that investment options be made available to all plan participants, regardless of age. Therefore, an individual reaching a typical retirement age in 2040 could choose to invest in a fund with a different target date. However, this would pose challenges for the inclusion of deferred annuities within such funds, since annuity pricing varies by age. The guidance clarifies that plan sponsors that integrate deferred annuities, such as QLACs, within a series of target-date funds can limit the investment option to participants who are of the intended age for each fund.

- ¹⁹⁸ Internal Revenue Service. 2014. Lifetime Income Provided Through Target Date Funds in Section 401(k) Plans and Other Qualified Defined Contribution Plans. Notice 2014-66. <https://www.irs.gov/pub/irs-drop/n-14-66.pdf>.
 See, Cook, Lynn and Bill Kalten. 2014. Lifetime Annuity Income Provided Through Target Date Funds. WillisTowersWatson. <https://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2014/lifetime-annuity-income-provided-through-target-date-funds>.
 See also, Aon Hewitt. 2014. Deferred Annuities in Target Date Funds. http://www.aon.com/attachments/human-capital-consulting/Deferred-Annuities-in-Target-Date-Funds_Finalv2.pdf.
- ¹⁹⁹ Some of the features described in these lifetime-income recommendations may be issues of plan design (in ERISA terminology, settlor functions rather than fiduciary functions) and could be encouraged through issuance of non-regulatory guidance. Many plan sponsors, however, seek the clarity and certainty of a regulatory or statutory safe harbor from fiduciary responsibility; therefore, new safe harbors are likely to be more effective at encouraging plan sponsor adoption of lifetime-income features, but either safe harbors or guidance would be an improvement upon current policy.
- ²⁰⁰ Plan sponsors that utilize this safe harbor should not preclude the ability of a participant to make a one-time purchase of a guaranteed lifetime-income product using retirement plan assets.
- ²⁰¹ The proposed laddering safe harbor could be used with QLACs that, under current regulation, provide an exemption from minimum distribution requirements to insured participants.
- ²⁰² Such products in the current market are sometimes called “guaranteed minimum withdrawal benefits” or “guaranteed lifetime withdrawal benefits.”
- ²⁰³ See, e.g., Spital, A. 1995. “Mandated choice: A plan to increase public commitment to organ donation.” *Journal of the American Medical Association*. <http://www.ncbi.nlm.nih.gov/pubmed/7837372>.
 See also, Anand Keller, Punam Bari Harlam, George Loewenstein and Kevin Volpp. 2011. “Enhanced Active Choice: A New Method to Motivate Behavior Change.” *Journal of Consumer Psychology*. 2011. <http://www.cmu.edu/dietrich/sds/docs/loewenstein/EnhancedActiveChoice.pdf>.
- ²⁰⁴ Carroll, Gabriel D., James J. Choi, David Laibson, Brigitte Madrian and Andrew Metrick. 2005. Optimal Defaults and Active Decisions. National Bureau of Economic Research. Working Paper. No. 11074. <http://www.nber.org/papers/w11074>.
- ²⁰⁵ Employee Benefits Security Administration. 2013. Pension benefit statements. United States Department of Labor. RIN 1210-AB20. <http://www.dol.gov/find/20130507/2013-106336.pdf>.
 See also, United States Department of Labor. 2013. Fact Sheet: Lifetime Income Illustration. <http://www.dol.gov/ebsa/newsroom/fsanprm.html>.
- ²⁰⁶ See, e.g., SAFE Retirement Act of 2013. S. 1270. 113th Congress. <https://www.congress.gov/bill/113th-congress/senate-bill/1270/text>.
 See also, USA Retirement Funds Act of 2014. S. 1979. 113th Congress. <https://www.congress.gov/bill/113th-congress/senate-bill/1979/text>.
- ²⁰⁷ We recommend revisions to ERISA and the issuance of appropriate regulations to allow DC-plan participants of any age to initiate an in-service plan-to-plan transfer or rollover to an IRA of a lifetime-income product in the following special circumstances: 1) the participant has purchased an in-plan lifetime-income product; and 2) that particular product is no longer available within the plan. In other words, the transfer or rollover could not include other plan assets, such as mutual funds.
- ²⁰⁸ United States Department of the Treasury. 2012. Treasury Fact Sheet: Helping American Families Achieve Retirement Security by Expanding Lifetime Income Choices. Pp. 3-4. <https://www.treasury.gov/press-center/press-releases/Documents/020212%20Retirement%20Security%20FactSheet.pdf>.
- ²⁰⁹ Board of Governors of the Federal Reserve System. 2014. 2013 Survey of Consumer Finances. <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>.

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- ²¹⁸ United States Department of Housing and Urban Development. 2014. Mortgagee Letter 2014-10. <https://portal.hud.gov/hudportal/documents/huddoc?id=14-10ml.pdf>.
- ²¹⁹ United States Department of Housing and Urban Development. 2004. Mortgagee Letter 2004-25. http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmml.
- ²²⁰ United States Department of Housing and Urban Development. FHA Reverse Mortgages (HECMs) for Seniors. http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmabou.
- ²²¹ United States Department of Housing and Urban Development. 2015. Single Family Upfront Premium, Late, and Interest Charges. http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/premiums/ufpli.
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See, Kearns, Deborah. 2016. "Pros and Cons of a Cash-Out Refinance." *Nerdwallet*. <https://www.nerdwallet.com/blog/mortgages/refinance-cash-out/>.
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See, United States Department of Housing and Urban Development. 2015. HECM for Purchase FAQ. http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/faqs_hecm.
- ²²⁴ Consumer Financial Protection Bureau. 2014. What are the Costs I will Have to Pay for a Reverse Mortgage? <http://www.consumerfinance.gov/askcfpb/237/what-are-the-costs-i-will-have-to-pay-for-a-reverse-mortgage.html>.

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- ²³⁶ Council for Economic Education. 2016. Survey of the States: Economic and Personal Finance Education in our Nation's Schools. P. 2. <http://councilforeconed.org/wp/wp-content/uploads/2016/02/sos-16-final.pdf>.
- ²³⁷ Higher One and EveryFi. 2015. Money Matters on Campus. White Paper. *Money Matters*. P. 25. http://moneymattersoncampus.org/wp-content/uploads/2013/02/MoneyMatters_WhitePaper_2015_FINAL.pdf.
- ²³⁸ *Id.* at 14.
- ²³⁹ United States Department of the Treasury. 2014. President's Advisory Council on Financial Capability. <https://www.treasury.gov/resource-center/financial-education/Pages/Advisory.aspx>.

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- ²⁴¹ Social Security Administration. 2015. Annual Statistical Supplement, 2015. Table 6.B5.1. <https://www.ssa.gov/policy/docs/statcomps/supplement/2015/6b.html>.
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- ²⁴⁹ Social Security Administration. Exempt Amounts Under the Earnings Test. <https://www.ssa.gov/oact/cola/rtea.html>.
- ²⁵⁰ A higher threshold and a slower offset applies in the year that an individual reaches the FRA. For example, if an individual worked in 2016 and also attained the FRA in 2016, \$1 is withheld for every \$3 that the individual earns over \$41,880; this is compared to a withholding of \$1 for every \$2 that the individual earns over \$15,720 if he or she worked in 2016 but would attain full retirement age after 2016.
- ²⁵¹ Social Security Administration. 2015. Annual Statistical Supplement, P. 5.31. <https://www.ssa.gov/policy/docs/statcomps/supplement/2015/5b.pdf>.
- ²⁵² *Id.*
- ²⁵³ The Urban Institute projects that the shortfall between dedicated program revenue and benefits in the 75th year would fall from 28 percent of program costs to just 7 percent. Nonetheless, the package meets the Chief Actuary's criteria for sustainable solvency because SSA projects that the ratio of trust-fund reserves to annual program costs would still be rising at the end of the projection period.
- ²⁵⁴ Committee on Ways and Means. 2015. "The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." United States House of Representatives, 114th Congress, 1st session. H. Rep. 114-51, P. 66. <https://www.ssa.gov/oact/TR/2015/tr2015.pdf>.
- ²⁵⁵ *Id.* at 64.
- ²⁵⁶ *Id.*
- ²⁵⁷ See, Khan Academy. 2016. Introduction to Present Value. <https://www.khanacademy.org/economics-finance-domain/core-finance/interest-tutorial/present-value/v/introduction-to-present-value>. For an explanation of the time value of money and why discounted, present value calculations are utilized for analyses such as these.

- ²⁵⁸ The Urban Institute. 2016. DYNASIM3.
- ²⁵⁹ If an individual claims OASI benefits after fewer than 35 years in the workforce, additional years up to 35 are averaged in as zeros in their AIME calculation.
- ²⁶⁰ See, Social Security Administration. Effect of Early or Delayed Retirement on Retirement Benefits. https://www.ssa.gov/oact/ProgData/ar_drc.html. For reductions by birth year and claiming age.
- ²⁶¹ See, Social Security Administration. How Work Affects Your Benefits. <https://www.ssa.gov/pubs/EN-05-10069.pdf>. If an individual works for an additional year after claiming benefits and those earnings end up being one of an individual's 35 highest (after previous years are indexed), he or she automatically receives a higher benefit.
- ²⁶² Previously, the law allowed individuals who were above the FRA and who had already claimed Social Security benefits to suspend their benefits and thereby accumulate delayed retirement credits (with each year of suspension permanently increasing the monthly benefit that could be collected after reinstatement by 8 percent). This loophole enabled one member of a couple to collect spousal benefits while the other spouse suspended his or her individual benefit and took advantage of delayed retirement credits. Because each spouse could potentially add to his or her individually earned benefit while also receiving spousal benefits, some called this approach "double dipping."
- ²⁶³ See, Meyerson, Noah P. 2015. "How Social Security Benefits Are Computed: In Brief." Congressional Research Service. <https://www.fas.org/sgp/crs/misc/R43542.pdf>. For a full explanation of the Social Security benefit formula.
- ²⁶⁴ Only earnings upon which Social Security taxes were paid are counted. Earnings in years before an individual reaches age 60 are adjusted to account for the historical growth of average wages.
- ²⁶⁵ Earnings before an individual reaches age 60 are adjusted for average economy-wide wage growth, so earnings from earlier years may be more comparable to later years even though most workers earn less in nominal dollars at the beginning of their working life than towards the end.
- ²⁶⁶ The Urban Institute. 2016. DYNASIM3.
- ²⁶⁷ The division by 37 in the new PIA formula is necessary to convert the aggregate amount into an annual figure.
- ²⁶⁸ This new approach to the benefit formula would reduce the need for the windfall elimination provision, which limits Social Security benefits for people who worked for many years in non-covered employment and also worked in covered jobs.
- ²⁶⁹ BPC Staff Calculation. The Urban Institute. 2016. DYNASIM3.
- ²⁷⁰ Individuals who claim early would not receive the BMB until reaching the FRA and would thus be subject to the early claiming reduction without offset until they reach the FRA (at which point the BMB would go into effect).
- ²⁷¹ Davies, Paul S., Minh Huynh, Chad Newcomb, Pail O'Leary, Kalman Rupp, and Jim Sears. "Modeling SSI Financial Eligibility and Simulating the Effect of Policy Options." *Social Security Bulletin*. Vol. 64, No. 2. 2001/2002. P. 16. <http://www.ssa.gov/policy/docs/ssb/v64n2/v64n2p16.pdf>.
- ²⁷² The Urban Institute. 2016. DYNASIM3.
- ²⁷³ Social Security Administration. 2016. Monthly Statistical Snapshot, January 2016. Table 3. https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/.
- ²⁷⁴ Social Security Administration. 2016. SSI Federal Payment Amounts for 2016. <https://www.ssa.gov/oact/cola/SSI.html>.

- ²⁷⁵ The Urban Institute. 2016. DYNASIM3.
- ²⁷⁶ Committee on Ways and Means. 2015. "The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." Table V.A4. Cohort Life Expectancy. 114th Cong., 1st sess. H. Rep. 114-51. <https://www.ssa.gov/oact/TR/2015/lr5a4.html>.
- ²⁷⁷ Office of the Chief Actuary. "Provisions Affecting Retirement Age." Social Security Administration. Number C1.3. <https://www.ssa.gov/oact/solvency/provisions/retireage.html>.
- ²⁷⁸ National Academies of Sciences. 2015. "The Growing Gap in Life Expectancy by Income: Implications for Federal Programs and Policy Responses." P. 37. <http://www.nap.edu/read/19015/chapter/5>.
- ²⁷⁹ When the price of a good increases substantially, consumers are likely to seek out similar substitutes with lower prices. For example, if the price of beef rises, consumers may switch to chicken. C-CPI-U would reflect the true change in consumer costs, while CPI-W would merely reflect the change in the price of beef.
- ²⁸⁰ Congressional Budget Office. 2014. *Options for Reducing the Deficit: 2015 to 2024*. <https://www.cbo.gov/sites/default/files/cbofiles/attachments/49638-BudgetOptions.pdf>.
- ²⁸¹ Federal Reserve Bank of St. Louis. Civilian Labor Force Participation Rate: Women. <https://research.stlouisfed.org/fred2/series/LNS11300002>.
- ²⁸² Schieber, Sylvester. 2012. *The Predictable Surprise*. Oxford University Press. P. 121.
- ²⁸³ Upon implementation for claimants turning 62 in 2022, the maximum spousal PIA is projected to be \$843. The Urban Institute. 2016. DYNASIM3.
- ²⁸⁴ Weaver, David A. 2010. "Widows and Social Security." *Social Security Bulletin*, Vol. 70, No. 3. <https://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p89.html>.
- ²⁸⁵ On average, women need 83 percent of joint income in order to be as well off living alone as they were living with their spouse.
- ²⁸⁶ Browning, M., P.A. Chiappori, and A. Lewbel. 2013. "Estimating Consumption Economies of Scale, Adult Equivalence Scales, and Household Bargaining Power." P. 33. <https://www2.bc.edu/arthur-lewbel/lcb24.pdf>.
- ²⁸⁷ The Urban Institute. 2016. DYNASIM3.
- ²⁸⁸ The difference in poverty rates may be explained by various demographic differences between widow(er)s and married individuals. For example, married individuals are more likely to be younger than widow(er)s, and younger individuals typically have greater income from earnings and savings; increased poverty among widow(er)s is at least partially due to a higher probability of having outlived savings.
- ²⁸⁹ Additionally, while not the focus of this recommendation, survivors benefits are available for widows and widowers younger than age 60 who are caring for a child of the deceased person, and in certain other circumstances.
- ²⁹⁰ The Urban Institute. 2016. DYNASIM3.
- ²⁹¹ Full-time students in secondary school can receive benefits up to age 19. Children who experience a disability before age 22 (disabled adult children) are eligible to receive these benefits even after age 19.
See also, DeWitt, Larry. Social "Research Note #11: The History of Social Security Student Benefits." Social Security Administration Historian's Office. 2001. <https://www.ssa.gov/history/studentbenefit.html>.

- ²⁹² This provision was estimated to increase program costs by 0.07 percent of taxable payroll (i.e., it would increase the program's long-term shortfall by approximately 2 percent).
- ²⁹³ Office of the Chief Actuary. 2016. "Provisions Affecting Family Member Benefits." Social Security Administration, Number D1. https://www.ssa.gov/oact/solvency/provisions/tables/table_run240.html.
- ²⁹⁴ Tax Policy Center. 2015. Historical Social Security Tax Rates. http://www.taxpolicycenter.org/taxfacts/content/pdf/ssrate_historical.pdf.
- ²⁹⁵ Committee on Ways and Means. 2015. "The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." United States House of Representatives. 114th Congress, 1st session. H. Rep. 114-51. P. 142. <https://www.ssa.gov/oact/tr/2015/tr2015.pdf>.
- ²⁹⁶ Earnings that are newly taxed by the increase of the cap would receive a 5-percent replacement rate under the new PIA formula.
- ²⁹⁷ Calculations by the Office of the Chief Actuary.
- ²⁹⁸ Between 2016 and 2018, the payroll-tax allocation is 5.015 percent for OASI and 1.185 percent for DI. This change was part of the 2015 legislation to extend the life of the DI Trust Fund until 2022.
- ²⁹⁹ Social Security Administration. Social Security Tax Rates. <https://www.ssa.gov/oact/progdata/oasdiRates.html>.
- ³⁰⁰ Social Security Administration. Benefits Planner: Income Taxes and Your Social Security Benefits. <https://www.ssa.gov/planners/taxes.html>.
- ³⁰¹ Munnell, Alicia H. 2015. "Falling Short: The Coming Retirement Crisis and What To Do About It." Center for Retirement Research at Boston College. No. 15-7. http://crr.bc.edu/wp-content/uploads/2015/04/IB_15-7.pdf.
- ³⁰² Given the very minor impact that this proposal would have on OASI's finances, it was not included in the overall scoring of the package by the Urban Institute.
- ³⁰³ See, Social Security Administration. 2016. Information for Government Employees. <https://www.ssa.gov/planners/retire/gpo-wep.html>. For more information about the WEP and GPO.
- ³⁰⁴ See, Bipartisan Policy Center. 2015. Improve the SSDI Program and Address the Impending Trust Fund Depletion. <http://bipartisanpolicy.org/library/ssdi-program/>. Complete recommendations of the working group.
See, Ritz, Ben and Brian Collins. 2015. "Replacing Cash Cliff with Gradual Offset Would Improve DI Work Incentives." Bipartisan Policy Center. <http://bipartisanpolicy.org/blog/replace-cash-cliff-disability-insurance-beneficiaries/>. Explanation of one of the proposals to improve work incentives (by addressing the so-called "cash cliff") for certain beneficiaries.
- ³⁰⁵ Ritz, Ben. 2015. "Budget Agreement Includes Several BPC Recommendations on Disability Insurance." Bipartisan Policy Center. <http://bipartisanpolicy.org/blog/budget-agreement-includes-several-bpc-recommendations-on-disability-insurance/>.
- ³⁰⁶ Internal Revenue Service. 2015. Amount of Roth IRA Contributions That You Can Make for 2016. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Amount-of-Roth-IRA-Contributions-That-You-Can-Make-for-2016>.
- ³⁰⁷ Internal Revenue Service. 2015. Retirement Topics – IRA Contribution Limits. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-IRA-Contribution-Limits>.

- ³⁰⁸ Internal Revenue Service. 2016. Distributions from Individual Retirement Arrangements (IRAs). Publication 590-B, P. 30. <https://www.irs.gov/pub/irs-pdf/p590b.pdf>.
- ³⁰⁹ See Favreault, Melissa M., Karen E. Smith, and Richard W. Johnson. 2015. "The Dynamic Simulation of Income Model (DYNASIM): An Overview." The Urban Institute. <http://www.urban.org/research/publication/dynamic-simulation-income-model-dynasim-overview>. For background on the DYNASIM3 model.
- ³¹⁰ Bipartisan Policy Center. Summary Tables of DYNASIM3 Estimates Produced for the Commission on Retirement Security and Personal Savings. 2016. <http://bipartisanpolicy.org/crsps>.
- ³¹¹ Social Security Administration. 2015. Bipartisan Budget Act of 2015 Closes Social Security Loophole. <https://www.ssa.gov/legislation/Bipartisan%20Budget%20Act%20Closes%20Social%20Security%20Loophole.pdf>.
- ³¹² VanDerheij, Jack. What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model. Employee Benefit Research Institute Issue Brief, no. 396, P. 6. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14_RRRs2.pdf.
- ³¹³ Munnell, Alicia H., Wenliang Hou, and Anthony Webb. 2014. "NRRRI Update Shows Half Still Falling Short." Center for Retirement Research at Boston College. P. 3. http://crr.bc.edu/wp-content/uploads/2014/12/IB_14-20-508.pdf.
- ³¹⁴ Hurd, Michael D. and Susan Rohwedder. 2011. "Economic Preparation for Retirement." NBER Working Paper, no. 17203. <http://www.nber.org/papers/w17203.pdf>.
- ³¹⁵ United States Census Bureau. 2015. Poverty Thresholds for 2015 by Size of Family and Number of Related Children Under 18 Years. <http://www.census.gov/hhes/www/poverty/data/threshld/index.html>.
- ³¹⁶ Short, Kathleen. 2014. The Supplemental Poverty Measure: 2014. United States Census Bureau. P. 5. <https://www.census.gov/content/dam/Census/library/publications/2015/demo/p60-254.pdf>.
- ³¹⁷ Id.
- ³¹⁸ United States Census Bureau. 2015. "Poverty Thresholds for 2015 by Size of Family and Number of Related Children Under 18 Years." <http://www.census.gov/hhes/www/poverty/data/threshld/index.html>.
- ³¹⁹ The Urban Institute. 2016. DYNASIM3.
- ³²⁰ Retirement account assets include IRAs, Keoghs, and employer DC plans; financial assets include savings, checking, money market, certificate of deposits, stock, bond, farm and business equity, and vehicle equity, less unsecured debt.
- ³²¹ Government Accountability Office. 2015. Most Households Approaching Retirement Have Low Savings. P. 8. <http://www.gao.gov/assets/680/670153.pdf>.
- ³²² Id. at 11.
- ³²³ The Urban Institute. 2016. DYNASIM3.
- ³²⁴ Id.
- ³²⁵ Employee Benefit Research Institute. 2016. Gender and Marital Status Comparisons Among Workers. Retirement Confidence Survey Fact Sheet, no. 5. https://www.ebri.org/files/RCS_16.FS-5_Gender.pdf.

- ³²⁶ This estimate was developed based on data from the Current Population Survey, which is known to under-count income from DC-account and IRA withdrawals, but those in the lower half of the income distribution are not likely to receive significant income from these sources.
- ³²⁷ Poterba, James M. 2014. Retirement Security in an Aging Society. National Bureau of Economic Research Working Paper No. 19930. P. 16. <http://www.nber.org/papers/w19930.pdf>.
- ³²⁸ VanDerhei, Jack. 2014. "What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model." Employee Benefit Research Institute Issue Brief, no. 396. P. 7. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.
- ³²⁹ *Id.*
- ³³⁰ *Id.* at 13.
- ³³¹ The EBRI projection divides Gen-Xers into quartiles by longevity. The results in the main text refer to the first and fourth quartiles. Those in the second and third longevity quartiles are projected to run short of money in retirement 33 percent and 58 percent of the time, respectively.
- ³³² See, Cubanski, Juliette, et. al. 2015. "A Primer on Medicare: Key Facts About the Medicare Program and the People it Covers." Kaiser Family Foundation. <http://kff.org/medicare/report/a-primer-on-medicare-key-facts-about-the-medicare-program-and-the-people-it-covers/>. For background on the Medicare program.
- ³³³ Please note that this simulation of health-care costs in old age was not made using the EBRI Retirement Security Projection Model that is referenced elsewhere in this report.
- ³³⁴ Frostin, Paul, Dallas Salisbury, and Jack VanDerhei. 2015. "Amount of Savings Needed for Health Expenses for People Eligible for Medicare: Unlike the Last Few Years, the News is Not Good." Employee Benefit Research Institute Notes, vol. 36, no. 10. P. 1. https://www.ebri.org/pdf/notespdf/EBRI_Notes_10_Oct15_HlthSvgs_DB-DC.pdf.
- ³³⁵ Center for Medicare and Medicaid Services. 2015. "2015 Annual Report of The Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds." P. 4. <https://www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/reports/trustfunds/downloads/tr2015.pdf>.
- ³³⁶ See, Bipartisan Policy Center. 2015. "Transitioning from Volume to Value: Accelerating the Shift to Alternative Payment Models." <http://bipartisanpolicy.org/library/transitioning-from-volume-to-value-accelerating-the-shift-to-alternative-payment-models/>. For BPC recommendations regarding Medicare. See also, Bipartisan Policy Center. 2013. "A Bipartisan Rx for Patient-Centered Care and System-Wide Cost Containment." <http://bipartisanpolicy.org/library/health-care-cost-containment/>.
- ³³⁷ Office of the Assistant Secretary for Planning and Evaluation, Department of Health and Human Services. Measuring the Need for Long-Term Services and Supports. P. 4. <https://aspe.hhs.gov/sites/default/files/pdf/110376/MeasLTSSrb.pdf>.
- ³³⁸ Figures in 2015 dollars.
- ³³⁹ Favreault, Melissa and Judith Dey. 2015. "Long-Term Services and Supports for Older Americans: Risks and Financing." Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services. P. 7. <https://aspe.hhs.gov/sites/default/files/pdf/106211/ElderLTCrb-rev.pdf>.
- ³⁴⁰ VanDerhei, Jack. 2014. "What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model." Employee Benefit Research Institute Issue Brief, no. 396. P. 16. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.

³⁴¹ Bipartisan Policy Center. 2016. "Initial Recommendations to Improve the Financing of Long-Term Care." <http://bipartisanpolicy.org/library/long-term-care-financing-recommendations/>.

³⁴² VanDerhei, Jack. 2014. "What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model." Employee Benefit Research Institute Issue Brief, no. 396. Pp. 6-19. http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.



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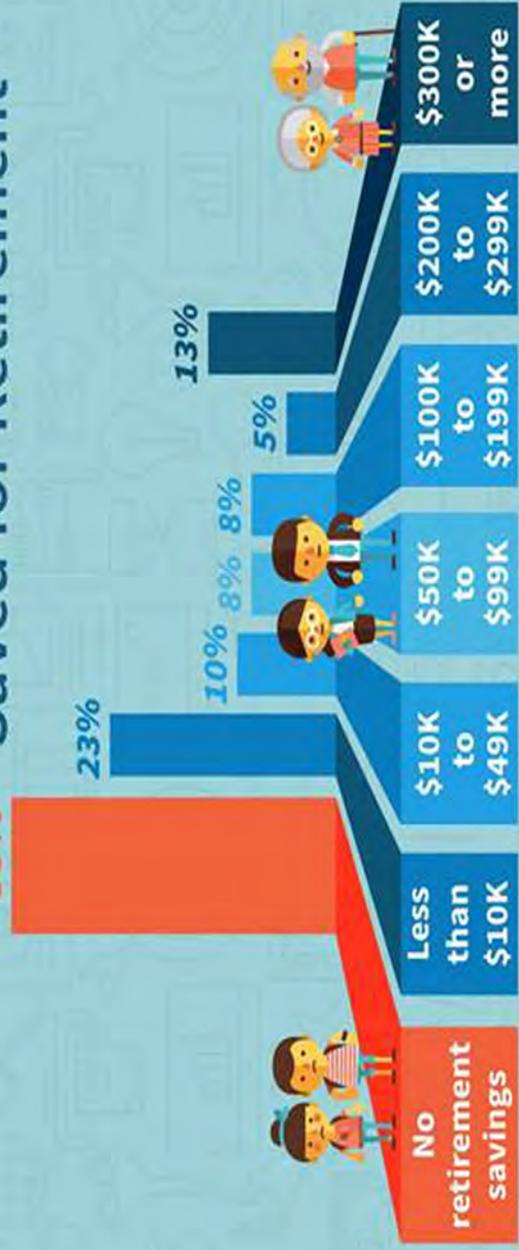
58% of working Americans have access to a workplace retirement account or 401K,¹ but up to 2/3 don't put away enough to cover costs of retirement.²

In ND, about 41% of private sector employees - or about 112,000 workers - work for an employer that does not offer a retirement plan.³



1. Pew Charitable Trusts, 2016
2. Bloomberg News, 2017
3. AARP, 2015

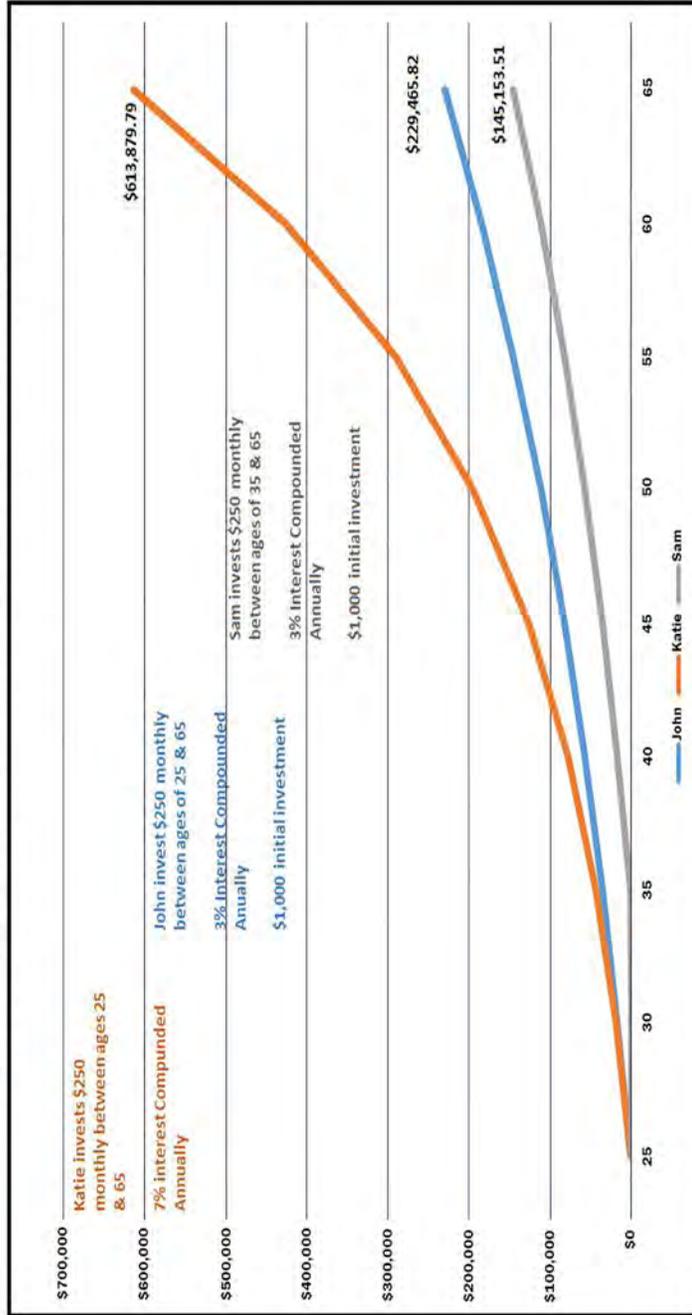
1 in 3 Americans Has \$0 33% Saved for Retirement



Courtesy of GoBankingRates.com

According to a survey by GoBankingRates

Growth of Retirement Savings





The Honorable Tom Cotton, Chairman
 Subcommittee on Economic Policy
 Committee on Banking, Housing, and Urban Affairs and Urban Affairs United States Senate
 534 Dirksen Senate Office
 Washington, D.C. 20510

The Honorable Heidi Heitkamp, Ranking Member
 Subcommittee on Economic Policy
 Committee on Banking, Housing, and Urban Affairs and Urban Affairs United States Senate
 534 Dirksen Senate Office
 Washington, D.C. 20510

Dear Senators Cotton and Heitkamp,

We are submitting this letter, and the accompanying documents for the committee's consideration as it seeks input on – and solutions to – the topic of "The Current State of Retirement Security in the United States".

It's no secret that we are witnessing a slow-motion retirement train wreck as millions of low and middle income Americans approach retirement with inadequate savings. What is less well understood is that we have the means at hand to change that downward trajectory, simply by preserving savings that have already been set aside in a 401(k)-type plan, but are currently being prematurely and needlessly cashed out when workers change jobs.

America's workforce is highly mobile; based on research provided by the non-partisan Employee Benefit Research Institute (EBRI), we have estimated that more than 14 million workers with 401(k) plans change jobs each year, and a discouragingly high percentage of them, particularly younger and low and middle income workers, cash out their retirement savings either immediately or within a few years of their job change.

What is also less well understood is why cash outs happen with such alarming frequency. A large-scale survey performed by Boston Research Technologies points to the answer – for most workers, cashing out is often easier than the alternative of taking the time and making the effort to move their savings forward to their current employer's plan. Said another way, the process of moving their account is encumbered with a string of small frictions that add up to a large hurdle standing in the path of "doing the right thing" – preserving their hard-earned savings for their retirement.

The solution lies in creating a 'better way' that produces a change in current behavior, one that includes using technology to automate and routinize the process of moving savings forward to a worker's new employer plan. This solution is called 'auto portability'. Based on new research by EBRI, auto portability has the potential to add \$1.5 trillion, measured in today's dollars, to the accumulated savings of the workforce, taking a big bite out of the current, aggregate estimate of America's retirement savings shortfall.

We have attached an auto portability Frequently Asked Questions and a copy of EBRI's research for the committee's review and we would be pleased to further explain auto portability at the committee's request.

Regards,

J. Spencer Williams
 President & CEO
 Retirement Clearinghouse, LLC

AUTO PORTABILITY FACT

1. What is Auto Portability?

Auto Portability is the routine, standardized and automated movement of an inactive participant's retirement account¹ from a former employer's retirement plan to their active account in a new employer's plan. Auto Portability is a voluntary benefit, i.e. participation is not mandated.



Auto Portability utilizes technology to reduce the time, paperwork and expense associated with moving a participant's account into their new-employer plan after they change jobs.

Auto Portability was conceived to serve the needs of participants that are subject to the Mandatory Distribution provision of their employer-sponsored plan, i.e. accounts with less than the current limit of \$5,000, and is designed to work within the existing infrastructure and data flows of the qualified employer plan system. Presupposing a future change from the current \$5,000 limit to perhaps \$15,000, Auto Portability can be readily adapted to larger account balances.

Auto Portability fits neatly into the framework of the many "auto" innovations – such as Auto Enrollment and Auto Investment Allocation (target date funds) – that have proven successful in enhancing the retirement-saving prospects of millions of Americans. Today's steady increase in the adoption of Auto Enrollment has triggered the creation of increasing numbers of small accounts in plans and further underscores the need for Auto Portability.

Like participation and investment selection, portability is a plan feature whose use is sub-optimized due to participant inertia and/or frictions with the plan-to-plan transfer process. These frictions produce negative consequences for participants' retirement security. Auto Portability is the first industry-wide solution to address this problem.

Auto Portability can be readily implemented through the introduction of a common utility / clearinghouse that maintains the technology interfaces and directs the flow of data between record-keepers and their plan clients.

2. What is the value of savings preserved by Auto Portability?

Auto Portability reduces leakage by retaining participants' savings and moving them forward to their new-employer plan at the time of their job change.

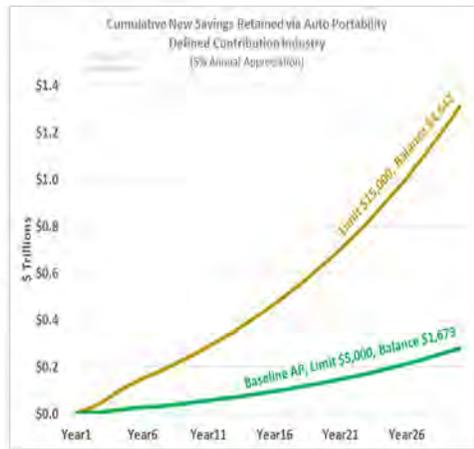
Using a sophisticated discrete simulation model, in collaboration with EBRI, Boston Research Technologies and Dr. Ricki Ingalls of Texas State University, Retirement Clearinghouse calculated the cumulative dollar

¹ In the initial adoption period, Auto Portability will work with accounts less than \$5,000, the current limit for accounts subject to an involuntary distribution, as established by EGTRRA in 2001. It is possible that the limit will increase in the future based on recommendations already in discussion by major trade organizations such as the American Benefits Council, the American Council of Life Insurers and the US Chamber of Commerce.

AUTO PORTABILITY FAQ

value of roll-ins to new-employer plans for account balances of \$5,000, and \$15,000 and compared those results to the current state of the industry.

The cumulative new private sector savings gain illustrated below is driven by the large number of annual job-changers with small accounts; 47% of all participants have less than \$15,000 in retirement savings at the time of their job-change (the gold line).

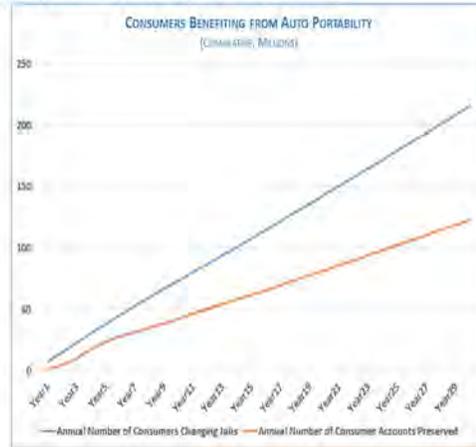


The Auto Portability Simulation (APS) demonstrates that the aggregate effect of Auto Portability is a powerful new source of retirement savings growth over the 30-year period that is modeled. With the Mandatory Distribution limit at \$15,000, Auto Portability would add more than \$1.3 trillion to America's retirement savings pool.

A related finding of the APS indicates that routine and systematic consolidation of participants' accounts when they change jobs would reduce the number of small accounts in the retirement system by more than 20%.

AUTO PORTABILITY FAQ

3. How many consumers will benefit from Auto Portability?²



The aggregate effect of Auto Portability is a powerful new source of private sector retirement savings growth over the 30-year period for the current and coming generation of retirement plan participants. Examining the discrete segment of the population that has less than \$15,000 in savings at the time of their job change, the benefits of Auto Portability will reach more than 125 million consumers.

These benefits largely accrue to middle class Americans. Almost by definition, small account balances are a function of income: the lower a consumer's income, the more ordinary household expenses eat up their paycheck, leaving only small amounts available for retirement savings. This same logic extends to younger consumers as it is well documented that incomes rise with age.³

By routinely consolidating these account balances into an employer-sponsored plan, younger and lower income participants receive the protections of plan sponsors' fiduciary obligations to the plan and the benefit of investment options that are most often institutionally priced.

4. How badly does a small balance cash out damage a consumer's retirement?

The chart below illustrates the long-term consequences of a 30-year-old consumer prematurely cashing out \$5,000 from her retirement plan at the time of a job change.

² Auto Portability Simulation (APS), Retirement Clearinghouse in collaboration with EBRI, Boston Research Technologies and Dr. Ricki Ingalls of Texas State University.

³ Fidelity Investments, "Cashing Out Can Derail Retirement", June 2014.

AUTO PORTABILITY FAQ



5. Why is Auto Portability needed?

America's workforce is more mobile than ever before, but its members' need to keep their savings intact, and move them forward as they change jobs, is not being met. The Employee Benefit Research Institute (EBRI) estimates that the average American will have 7.4 jobs over their working career, which translates into an estimated 13.6 million workers with retirement accounts changing jobs each year.⁴

- More than 5 million of these participants (28% of annual job changers) have less than \$5,000 in their account at the time of their job-change and, by statute, are subject to a mandatory distribution from their former retirement plan into a Safe Harbor IRA.⁵
- An additional 2 million participants (18% of annual job changers) have less than \$15,000 in their account at the time of their job change.
- The median account balance for all participants with less than \$15,000 (47% of all job-changers) at the time of their job-change is \$4,642.⁶

These participants are making decisions that create adverse consequences for their retirement savings. These include:

- 1) **Taking No Action:** Participants with less than \$5,000 that don't respond to a notice are forced out of their retirement plan and into a Safe Harbor IRA, where by statute they are invested in money market funds that yield little or no interest. Low money market returns combine with annual administrative fees to deplete these accounts over time.

Participants with account balances between \$5,000 and \$15,000 are permitted to keep their inactive accounts in their former employer's plan, yet industry reports indicate that these accounts remain at high risk of premature cash out.⁷

⁴ Employee Benefit Research Institute ("EBRI")

⁵ Ibid EBRI

⁶ Ibid EBRI

⁷ Composite result of Fidelity, Vanguard, & Aon Hewitt leakage reports.

AUTO PORTABILITY FAQ

2) Leakage/Cash-Outs:

- a. Participants with account balances of less than \$5,000 are prematurely cashing out their savings at rates approaching 55% at the time of their job-change ("fast leakage"), but that's not the whole story because accounts that are rolled over to Safe Harbor IRAs remain at risk. Of those whose savings are retained in a Safe Harbor IRA, research shows that an additional 33% cash out by the seventh anniversary of their job-change ("slow leakage").

Taken together, **Fast and Slow Leakage indicate that an estimated 87% of these job changers ultimately cash out their accounts**, incurring taxes and penalties and badly damaging their prospects for a secure retirement.⁸

- b. Participants with account balances between \$5,000 and \$15,000 are also prematurely cashing out their savings at rates approaching 40% at the time of their job-change.
- c. Combined leakage for all accounts less than \$15,000 is estimated to be 47%.⁹

- 3) Lost/Missing Accounts: Over time, participants change residences but neglect to update their address of record or lose track of their old accounts, creating the potential that these savings will ultimately be depleted by fees or lost to them via escheatment to their state of residence. Research indicates that 3% to 5% of all retirement accounts are classified as lost/missing.¹⁰

6. What problems does Auto Portability remedy?

Auto Portability remedies several systemic issues that currently plague tens of millions of middle-class Americans' efforts to save for retirement:

- 1) Reduce Leakage & Increase Savings: According to a 2009 U.S. Government Accountability Office report, 89% of all leakage occurs at the time a participant changes jobs.¹¹ Auto Portability creates a **new option** that inhibits leakage by **systematically consolidating savings** in a new employer's plan, thereby incubating savings when accounts are small and most at risk of being cashing out, and **methodically increasing overall retirement savings**. Leakage is particularly acute among younger and lower-income participants.¹²

Auto Portability has the potential to **help more than 20,000 small-balance participants per day retain their retirement savings**, which will accumulate to more than **\$1.3 trillion over the next generation of savers**.¹³

- 2) Reduce Duplicate Accounts & Reduce Cost: Auto Portability utilizes technology to systematically consolidate savings in a new employer's plan, reducing unnecessary costs incurred from maintaining multiple accounts.
- 3) Reduce Lost & Missing Retirement Accounts: Consolidating participants' retirement savings in their current-employer plans leads to fewer accounts classified as "lost/missing" simply because fewer accounts are stranded across the qualified plan universe.

⁸ GAO, "Policy Changes Could Reduce the Long-term Effects of Leakage on Workers' Retirement Savings," August 2009; composite result of Fidelity, Vanguard & Aon Hewitt leakage reports and Retirement Clearinghouse (RCH) research.

⁹ Composite result of Fidelity, Vanguard, & Aon Hewitt leakage reports.

¹⁰ Boston Research Technologies (BRT)

¹¹ Ibid, GAO, "Policy Changes..."

¹² Fidelity Investments: "Cashing Out Can Derail Retirement," February 2014

¹³ Auto Portability Simulation (APS), Retirement Clearinghouse in collaboration with EBRI, Boston Research Technologies and Dr. Rick Ingalls of Texas State University.

AUTO PORTABILITY FAQ

- 4) **More Appropriate Long-Term Investment Allocation:** Savings rolled into a participant's active plan will be invested in the plan's default investment option¹⁴, an appropriate investment alternative that has the potential to produce compounded earnings of 5% to 7% per year over a long investment horizon, a significant multiple versus the 0.10% to 0.5% annual interest earned in the money markets funds utilized in Safe Harbor IRAs.
 - 5) **Reducing Friction & Increasing Portability:** Each of the above issues traces their roots to a common cause: systemic frictions that frustrate saver's best intentions to retain and grow their retirement nest egg. These frictions are most evident at the time of a job change and can be remedied using technology and standardizations.
7. How does Auto Portability help address the African American workers' savings crisis?

SUMMARY

Auto Portability, consistently used, will increase the average African American's savings at retirement by 50%.¹⁵

THE ISSUE:

America's African-American community faces significant economic headwinds, and saving for retirement through America's defined contribution system is no exception.

The African-American retirement crisis is defined by a series of compounding factors:

1. African-Americans have less access to an employer-sponsored retirement savings plans
 - In 2013, only 41% of African-American families had retirement savings accounts, vs. 65% of white, non-Hispanic families.¹⁶
2. African-Americans have lower levels of plan enrollment and savings contribution rates¹⁷:
 - African-Americans have 68% average plan enrollment, vs. 79% for white participants
 - African-American contribution rates were 22.2% lower than for white participants
3. On average, African-American plan participants are younger, with lower incomes, less job tenure and higher job turnover:
 - African-American participants are 14% younger, with 10% less tenure and 30% lower average salaries¹⁸ vs. white participants
 - African-Americans have 28.4% higher job turnover, vs. whites.¹⁹

These factors, in turn, drive adverse retirement outcomes, including:

1. Significantly lower average retirement savings balances²⁰:
 - African-American retirement average retirement savings balances are significant lower than their white counterparts:
 - 48.6% lower average balance, for incomes less than \$30,000
 - 34.1% lower average balance, for income less than \$60,000

¹⁴ According to the PSCA 58th Annual Survey, 72% of plan sponsors have a target date fund, target risk fund, a balanced fund, or a professionally managed account as the default investment option for an automatic contribution.

¹⁵ Average impact based on multiple simulations encompassing a wide range of facts and circumstances

¹⁶ EPI Analysis of Survey of Consumer Finance data, 2013

¹⁷ 401(k) Plans in Living Color – The Ariel/Aon Hewitt Study 2012

¹⁸ The Vanguard Group: Diversity and defined contribution plans: The role of automatic features

¹⁹ Attrition & Retention Consortium (via Peter Horn, W.P. Carey School of Business

²⁰ 401(k) Plans in Living Color – The Ariel/Aon Hewitt Study 2012

AUTO PORTABILITY FAQ

2. Dramatically higher cash-out rates²¹:
 - African American participants are 61.5% more-likely to cash-out their retirement savings, vs. their white counterparts.
 - African-American cash-out rates following separation are even higher. African American participants with an income less than \$20,000 are 134% more-likely to cash out their retirement savings balances than white participants.

SOLUTIONS:

The African-American retirement crisis deserves immediate, focused attention from public policymakers and the private sector. Fortunately, there are actionable solutions that can collectively improve the situation for African-American retirement savers.

1. Increase access to employer-sponsored plans. This was the key focus of the Bipartisan Policy Center's Commission on Retirement Security and Personal Savings, when the BPC offered 16 proposals²² that addressed 6 key retirement security challenges.
2. Reduce cash-out leakage and consolidate retirement savings within the plan system. Supported by numerous studies, including the Bipartisan Policy Center, EBRI, the GAO, large recordkeeper cash-out studies and the Auto Portability Simulation (APS) model, reducing cash-out leakage is the best way to preserve and incubate retirement savings.
3. Increase minority enrollment through further adoption of auto enrollment features. Greater levels of automatic enrollment disproportionately encourage African-American 401(k) participation rates²³.

HOW AUTO PORTABILITY WILL HELP

1. By automatically moving small-balance retirement savings forward when participants change jobs, widespread adoption of Auto-Portability will act directly to preserve, incubate and grow the retirement savings of all small-balance 401(k) participants, who are disproportionately represented by African-Americans.
2. Solving the "small account problem" for high-turnover industries and small businesses, Auto Portability will indirectly support further adoption of auto enrollment.

The Impact of Auto Portability:

Reducing Cash Out Leakage²⁴:

	Participants (MM)	New Retirement Savings (BB)
African-Americans	15	\$151
All Minorities	47	\$454

Increasing Automatic Enrollment²⁵:

²¹ Ibid

²² Bipartisan Policy Center, *Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings*, June 2016

²³ The Vanguard Group, *Diversity and defined contribution plans: The role of automatic features*

²⁴ Ibid APS (supported by EBRI, US Census data)

²⁵ The Vanguard Group, *Diversity and defined contribution plans: The role of automatic features*

AUTO PORTABILITY FAQ

	Participation Rates	
	No AE	With AE
African-Americans	57.0%	94.0%
Hispanics	67.0%	95.0%

Incubating and Preserving Individuals' Retirement Savings:

Scenario: 25 year-old African-American female, 40-year projections²⁰

Scenario	Cash Outs	Cash Out Assets	Savings at Retirement	Retirement Income
No Auto Portability	4	\$17,622	\$112,911	\$144,436
Auto Portability	0	\$0	\$264,265	\$338,048

In the hypothetical scenario, above, by preventing just \$17,622 in cash-outs, Auto Portability could generate an additional \$151,354 in retirement savings, and another \$193,612 in retirement income.

8. What are the benefits to employers?

The benefits of Auto Portability accrue to all employers, primarily in the form of increased financial wellness for their employees. A secondary benefit of Auto Portability is the reduction of administrative costs and burdens for plan sponsors - by reducing the number of small, inactive accounts in their plans and reducing the incidence of lost and missing accounts that occur when a former employee changes address but fails to provide their former employer with their new address. Administrative cost and burdens are a particularly acute issue for companies that exhibit high rates of employee turnover, such as those in the retail, hospital services, transportation, hospitality, and food & beverage industries, which collectively employ tens of millions of workers.

9. What are the benefits to service providers?

The benefits to financial institutions and service providers accrue slowly over time and include increases in the assets that they invest and service as well as a significant reduction in the number of small accounts over time.

Auto Portability has been introduced to most of the major plan service providers and has seen measured progress along the path to adoption and implementation. Six of the top ten record-keepers - a group that includes Fidelity Investments, Empower Retirement, Aon Hewitt, TIAA-Cref, Voya Retirement, Transamerica, Principal Financial, Vanguard, Bank of America Merrill Lynch and Wells Fargo - are engaged in Auto Portability discussions at a variety of stages.

10. Can Auto Portability's benefits be extended to larger accounts?

Yes. In general, the benefits of 'frictionless portability' can be applied to accounts of all sizes. Extending the benefits to larger accounts would yield estimates of new private sector savings in the trillions of dollars. EBRI, the retirement industry's premier research institute has recently undertaken a project to quantify these broader benefits and expects to publish preliminary results in March 2017.

²⁰ Retirement Clearinghouse: Analysis of Individual Retirement Savings under Auto Portability, 2016

AUTO PORTABILITY FAQ

11. What makes Auto Portability work?

The "heart and soul" of Auto Portability is an electronic records matching technology that is used to **Locate & Match™** participant accounts across record-keeping platforms.

The Locate & Match technology is flexible and secure, and can be employed across a wide range of account types and platforms to locate and match participant accounts. For example, the technology can be utilized to confirm that an account in a Safe Harbor IRA belongs to the same participant with an active account in their current employer's plan. Similarly, the technology can be utilized to confirm that an inactive account in an employer's plan belongs to the same participant with an active account in a different employer's plan.

In addition to the Locate & Match service, Auto Portability encompasses **record-keeping and customary account services**. Record-keepers can continue to maintain small accounts on their platforms (defined contribution plan or Safe Harbor IRA) while utilizing the Locate & Match service to help participants keep their retirement savings intact. Alternatively, record-keepers may choose to outsource account administrative services to a third-party service that provides the Locate & Match service on their behalf.

Auto Portability also includes an **automated account roll-in service** that facilitates a roll-in to a new employer's plan, which occurs after a successful Locate & Match. An automated roll-in reduces the friction, time and expense typically spent moving a participant's savings into their new employer's plan.

12. How does Auto Portability work?

Auto Portability incorporates four basic operating elements:

- 1) **Notices:** Upon becoming subject to a Mandatory Distribution, legally-required information notices are provided to participants in the Auto Portability program.
- 2) **Electronic Records Locate & Match:**
 - a. Account information is extracted, formatted and passed to the clearinghouse.
 - b. The clearinghouse collects, standardizes and re-distributes account information to all record-keepers that participate in the Auto Portability program.
 - c. Participating record-keepers utilize the Locate technology to query their plan/participant records to identify potential matches of accounts.
 - d. Upon attaining a successful Match, account information is further validated and a notice is sent requesting that the participant consent to the transaction.
- 3) **Consent:** Participant consent to the roll-in transaction can be obtained utilizing a variety of methods including:
 - a. Affirmative written consent obtained at the time of enrollment in their new-employer plan.
 - b. Affirmative consent given by accessing a secure website or voice response system.
 - c. Affirmative consent given by contacting a call center.
 - d. Negative consent.²⁷
- 4) **Automated Roll-In:**
 - a. The inactive account is closed and the balance is rolled into the participant's new-employer plan.
 - b. The balance is automatically invested according to the participant's current investment elections, or if the participant has not made an election, into the retirement plan's default investment option.

²⁷ Negative consent is an optional feature that can be selected by a record-keeper or plan sponsor.

AUTO PORTABILITY FAQ

- c. The participant is notified when the account is moved and consolidated into the new-employer plan.

13. What does Auto Portability cost & who pays for it?

Auto Portability is a “user-pay,” fee-for-service program. Participants pay for services only as they are used. Fees are charged on a per-transaction basis, as illustrated in the table below:

Locate, Match & Automated Roll-In Services				
	Per Transaction (Micro-Balance Accounts)		Per Transaction (All Other Accounts)	
	Fees Based on Account Balance		Fees Based on Number of Transactions	
	\$0.01 - \$49.99	\$50 - \$590	1 - 1,000,000	>1,000,000
Participant Expense	No Charge	10%	\$58	\$47

Auto Portability offers a progressive pricing structure; account balances below \$50 will be moved to their new-employer plan at no charge, while accounts with between \$50 and \$590 will be charged proportionately lower fees as the account balance declines. Record-keepers that participate in the Auto Portability program receive a portion of the per transaction fees to compensate for their cost of processing roll-in transactions.

Auto Portability also incorporates a 20% reduction in the fee charged to a participant when the annual volume of roll-in transactions exceeds 1 million transactions per year, i.e. the benefits of scale/critical mass are passed on to participants in the form of reduced fees.

Due to the high ratio of accounts with less than \$590 to the total of all Mandatory Distributions, the average fee for a participant rolling savings into their new-employer plan is estimated to be \$40 to \$45 during the period when transaction volume is less than 1 million per year, and further reduced to \$30 to \$35 when system-wide critical mass is achieved, i.e. more than 1 million annual transactions.

Fees for record-keeping and account administrative services are separate from the Locate, Match & Automated Roll-In fees illustrated above, and are assessed by the account services provider.

14. Can Participants get assistance with Auto Portability?

Yes. At any point in time, participants can contact the clearinghouse call center to decline the service or get a status on their account. In addition, the call center is available to answer questions about the program.

15. What measures are taken to insure the privacy & security of participants' data?

Auto Portability utilizes state-of-the-art encryption technology in its database, and when data is transmitted to and from participating record-keepers. Participant data is never shared outside the network of participating record-keepers or used for any purpose beyond Auto Portability. The program meets the standards set for SOC Type II compliance and is examined annually by an accredited, independent service auditor.

16. Who will participate in the execution and delivery of Auto Portability?

Auto Portability will be delivered through an industry-wide network of cooperating record-keepers and plans and one or more Safe Harbor IRA repositories, all utilizing a common electronic records matching service operated by the utility/clearinghouse. Participation by any entity is optional.

17. What is the role of the clearinghouse in Auto Portability?

The clearinghouse is a utility whose primary function is to operate as a “middleman” to facilitate the movement of data and money between participating record-keepers and plans. The clearinghouse systematically receives, standardizes and re-distributes electronic records, in essence acting as the traffic control system for the network of financial institutions participating in Auto Portability. The

AUTO PORTABILITY FAQ

clearinghouse is also responsible for maintaining a permanent record of, and audit trail for, all transactions.

18. Why is Auto Portability initially targeted at accounts with less than \$5,000?

Accounts with less than \$5,000 have the highest cash-out rates of any segment of the mobile workforce, and can be forced out of plans without participant consent when the participant separates from service. In addition, many plans automatically cash out balances under \$1,000. Auto Portability will replace the practice of prematurely cashing out even these small accounts and address the cash out issue with all small accounts, where there is the greatest need for a remedy. A change to the \$5,000 limit would require new legislation, but would extend the benefits of Auto Portability to a larger population of job changers.

While Auto Portability is designed for accounts subject to the Mandatory Distribution provisions of their plans, a limit currently set at \$5,000, the technology and processes could be applied to any size account.

19. Who Loses from Auto Portability?

Auto Portability proposes to change the existing practices in the Mandatory Distribution segment of the rollover market; current service providers to that market – a.k.a. “landfill operators” – may experience changes to their business models over time.

In addition, the U.S. Treasury Department could see a temporal decrease in revenue from taxes and penalties that are imposed at the time of a premature cash-outs; as leakage is reduced, more taxes will be deferred until participants begin withdrawing from their accounts at retirement.

The Impact of Auto Portability on Increased Accumulations and Decreased Retirement Deficits: Evidence from EBRI's Retirement Security Projection Model

**Jack VanDerhei, Research Director
Employee Benefit Research Institute**

**Portability & Public Policy:
*Unlocking the Potential In Portability***

March 30th, 2017

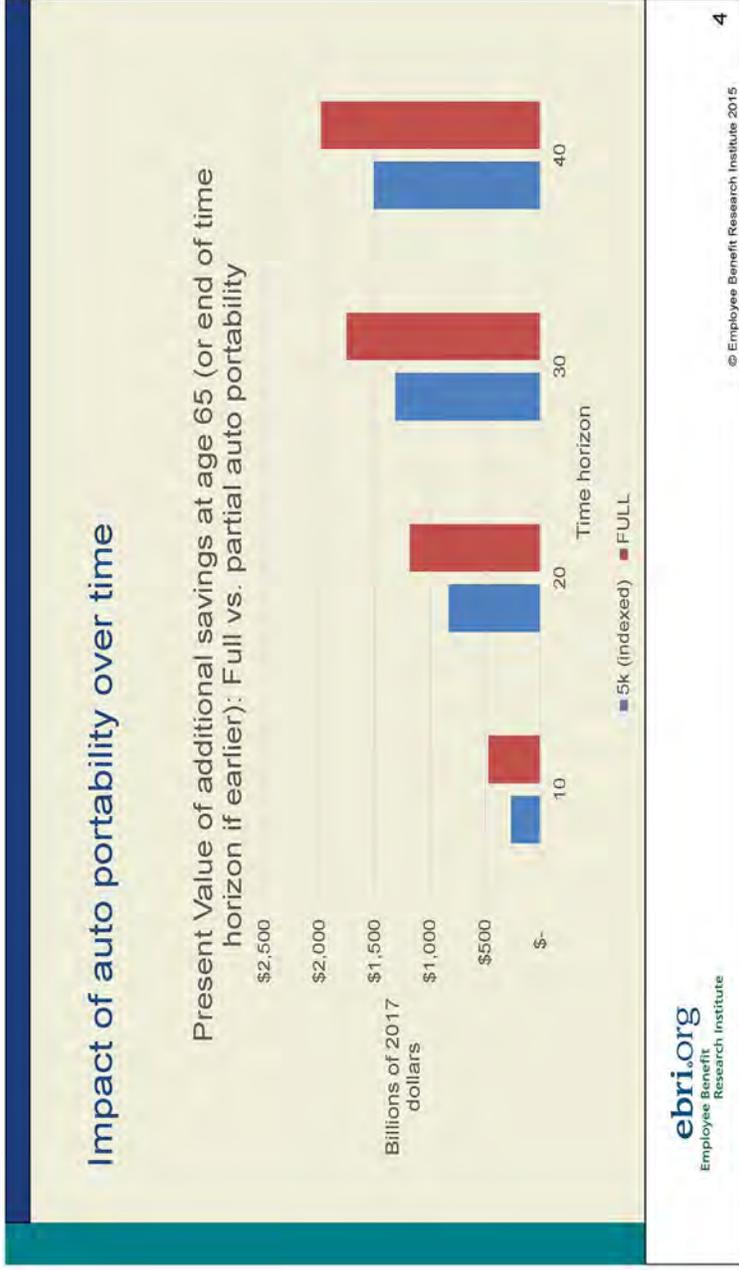
Overview

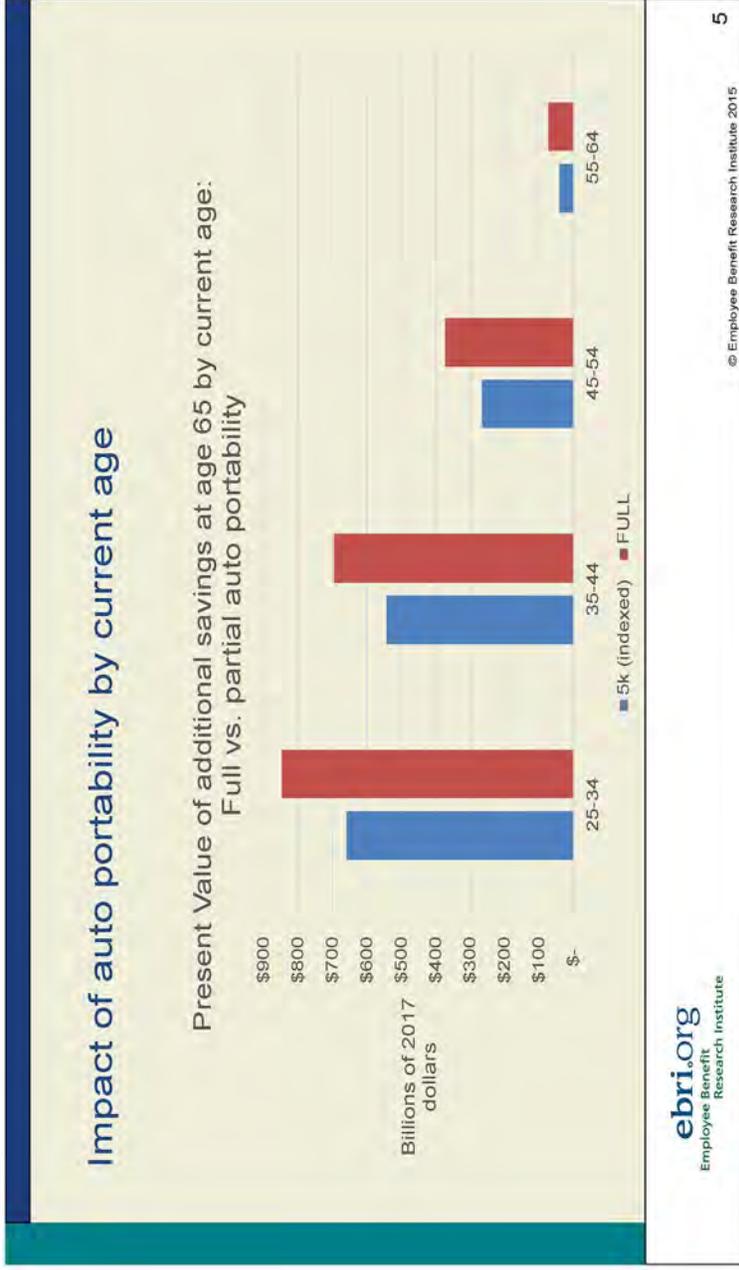
- **Three scenarios simulated:**
 - **1. FULL auto portability:** Every participant consolidates their savings in their new employer plan every time they change jobs, i.e. all participants arrive at age 65 with one account.
 - Leakage limited to hardship withdrawals
 - **2. Partial auto portability:** Every participant with less than \$5,000 (indexed for inflation) consolidates their savings in their new employer plan every time they change jobs
 - Leakage limited to hardship withdrawals
 - **3. Baseline: status quo**
 - In addition to hardship withdrawals, there is a participant-specific probability of cashing out and loan default leakage at job change
- **Compare present value of accumulations at age 65 (or end of time horizon if earlier) under FULL and PARTIAL auto portability with STATUS QUO**
 - Segmentation by
 - Age cohorts
 - Age-specific income quartiles
 - Time horizons (10, 20, 30, 40 years)
- **Compare retirement deficit reduction for FULL auto portability with alternative reform scenarios**

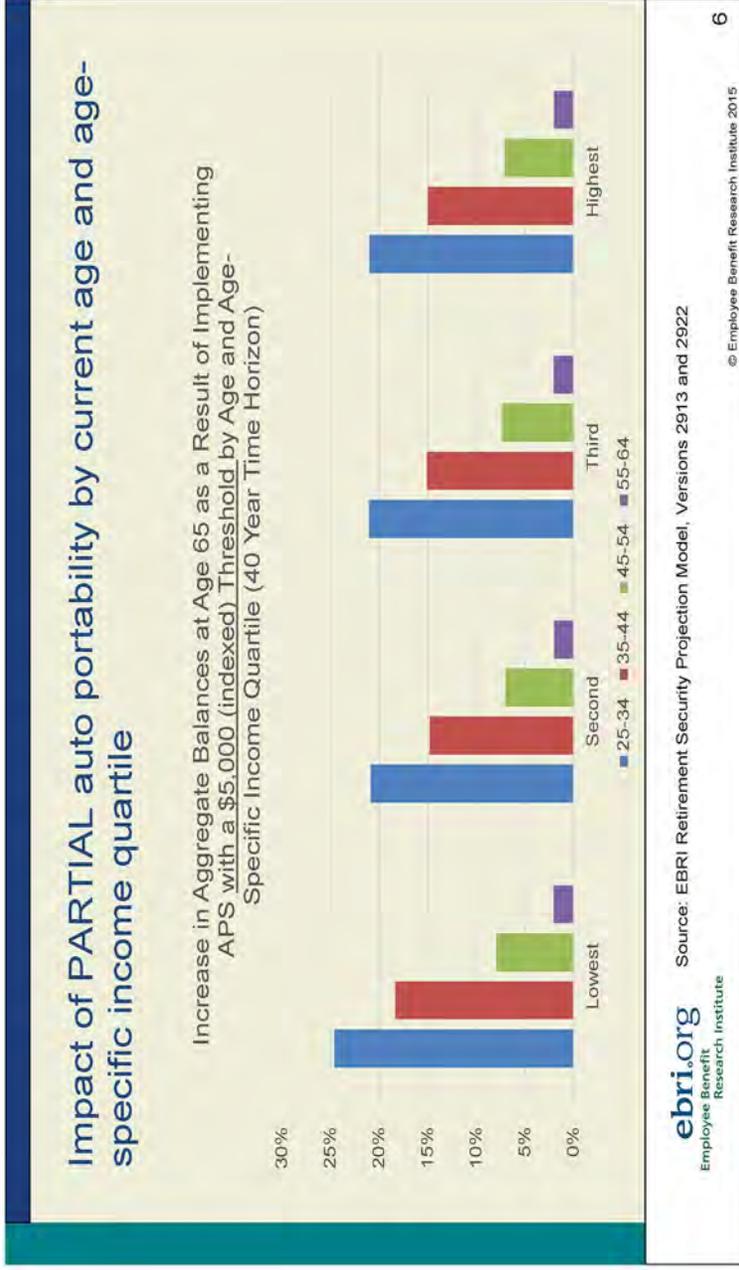
RESULTS: ACCUMULATION INCREASES

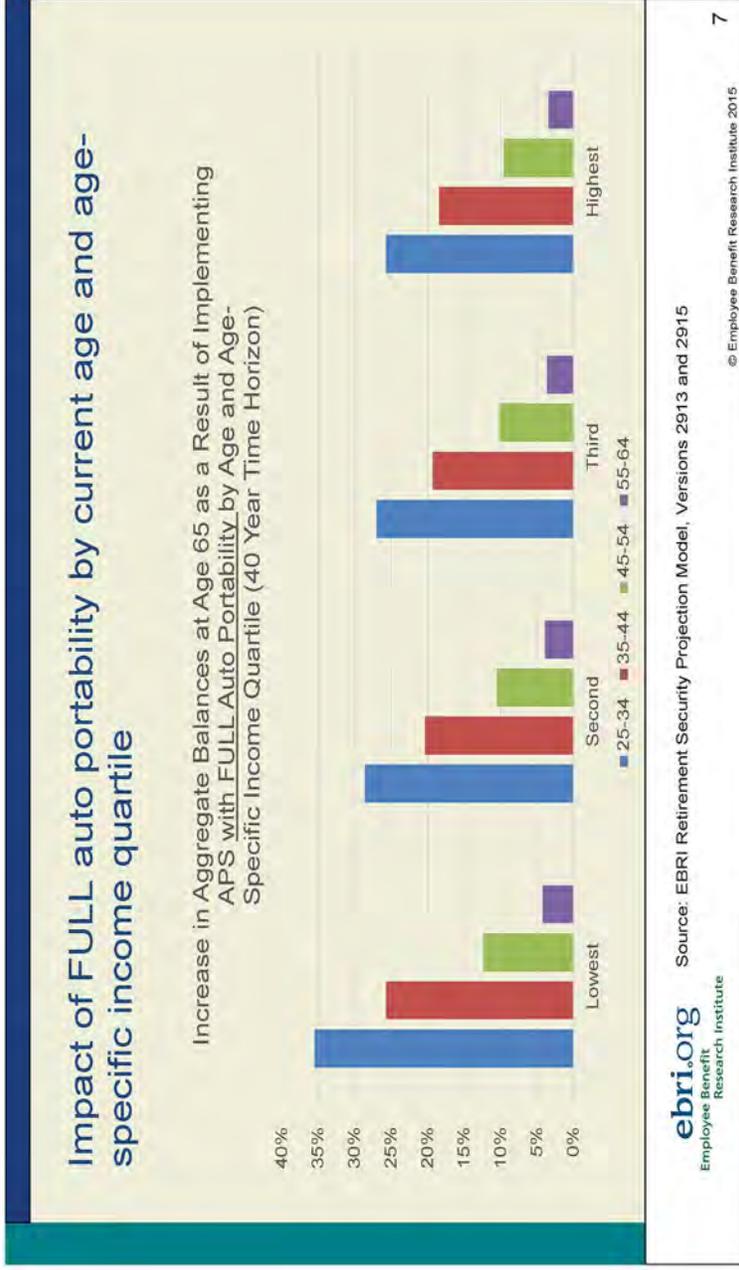
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**RESULTS: RETIREMENT
DEFICIT REDUCTIONS**

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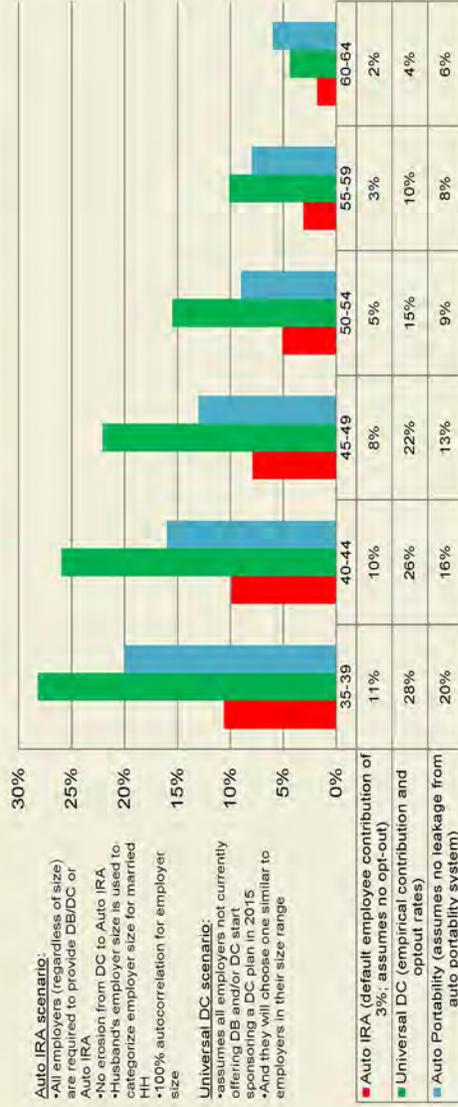
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8

EBRI Retirement Security Projection Model® (RSPM)

- Produces a Retirement Readiness Rating (RRR) and Retirement Savings Shortfall (RSS)
 - RRR: Percentage of simulated HH life-paths that do NOT run short of money in retirement
 - If all the retirement savings are exhausted and if the Social Security and defined benefit payments are not sufficient to pay expenses, the HH is designated as having run short of money at that point.
 - RSS: Present value of simulated retirement deficits at retirement age
 - NB: this only includes HHs simulated to have a deficit
 - E.g., If a HH is currently simulated to have no deficits, increasing their account balances at retirement will not change either RRR or RSS

Percentage Reductions in 2014 RSS With LTC Costs for HHs Ages 35-64 in Various Age and Reform Scenarios



Source: EBRI Retirement Security Projection Model,® versions 2258, 2270, 2749.



NEXT STEPS

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11

Future simulation work

- **Alternative assumptions**
 - Stochastic rates of return
 - Updated cash out assumptions
 - IRA withdrawal parameters
- **Structural design**
 - Alternative auto portability thresholds
 - Introduce auto portability leakage
- **Behavioral assumptions**
 - How would the existence of auto portability impact:
 - Participation activity
 - Contribution activity
 - Asset allocation activity
 - Plan design parameters



The image shows a page with a light beige background. At the top, there is a dark blue horizontal bar. In the center, the word "APPENDIX" is written in large, bold, blue capital letters. At the bottom, there is a teal horizontal bar. In the bottom right corner, the logo "ebri.org" is displayed in blue, with "Employee Benefit Research Institute" written in smaller black text below it. To the right of the logo, the text "© Employee Benefit Research Institute 2015" is written in a small font. In the bottom left corner, the number "13" is printed in a small font.

EBRI Retirement Security Projection Model® (RSPM)

- Accumulation phase
 - Simulates retirement income/wealth to retirement age for HHs from defined contribution, defined benefit, IRA, Social Security and net housing equity
 - Pension plan parameters coded from a time series of several hundred plans.
 - 401(k) participant behavior based on individual administrative records
 - Annual linked records dating back to 1996
 - Social security based on current statutory benefits for baseline
 - But sensitivity analysis is provided for scenarios in which Trust Fund is exhausted
- Retirement phase
 - Simulates 1,000 alternative life-paths for each household, starting at 65
 - Deterministic modeling of costs for food, apparel and services, transportation, entertainment, reading and education, housing, and basic health expenditures.
 - Stochastic modeling of longevity risk, investment risk, long-term care (LTC) costs

Leakages

- **401(k) cash outs, loan defaults, hardship withdrawals**
 - Based on confidential industry data
 - Function of:
 - Age
 - Income
 - Account balance
 - Type of plan
- **401(k) loan behavior**
 - Jack VanDerhei, Sarah Holden, Luis Alonso, and Steven Bass. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2014." EBRI Issue Brief, no. 423, and ICI Research Perspective , Vol. 22, no. 2 (April 2016).
- **IRA withdrawal behavior**
 - Derived from "Accumulation and Distribution of Individual Retirement Arrangements, 2010" by Victoria L. Bryant and Jon Guber Internal Revenue Service Statistics of Income Bulletin, Fall 2013 Washington, D.C.

Additional assumptions

- **Rate of return assumptions:**
 - Accumulation model:
 - Deterministic nominal returns of 6.45% for equity and 3.15% for non-equity
 - Retirement deficit model:
 - Stochastic returns with a higher geometric average (based on historical returns)
- **Age/wage profiles:**
 - Computed from EBR/ICI longitudinal data

When is a household considered to run short of money in EBRI's simulation model?

- If aggregate resources in retirement are not sufficient to meet average retirement expenditures
 - This version of the model is constructed to simulate retirement income adequacy
 - Alternative versions of the model allow similar analysis for replacement rates, standard-of-living calculations, and other ad hoc thresholds.
- The baseline version of the model used for this analysis assumes all workers:
 - retire at age 65
 - that they immediately begin drawing benefits from Social Security and defined benefit plans (if any)
 - to the extent that the sum of their expenses and uninsured medical expenses exceed the projected after-tax annual income from those sources
 - They immediately begin to withdraw money from their individual accounts (defined contribution and cash balance plans, as well as IRAs).

When is a household considered to run short of money (continued)?

- If there is sufficient money to pay expenses without tapping into the tax-qualified individual accounts
 - those balances are assumed to be invested in a non-tax-advantaged account where the investment income is taxed as ordinary income.
- Individual accounts are tracked until the point at which they are depleted.
 - At that point, any net housing equity is assumed to be added to retirement savings in the form of a lump-sum distribution (not a reverse annuity mortgage (RAM)).
- If all the retirement savings are exhausted and if the Social Security and defined benefit payments are not sufficient to pay expenses, the household is designated as having run short of money at that point.



Hearing Statement
 The American Council of Life Insurers
 Before the
 U.S. Senate Committee on Banking, Housing, & Urban Development
 Subcommittee on Economic Policy

"The Current State of Retirement Security in the United States"

April 5, 2017

On behalf of the American Council of Life Insurers (ACLI), I am pleased to submit this statement for the record regarding the current state of retirement security in the United States. We thank Chairman Tom Cotton (R-AR) and Ranking Member Heidi Heitkamp (D-ND) for holding this important hearing. In this statement, we will highlight the current state of our retirement savings system and recommend legislative enhancements that will build upon its success. I hope the Subcommittee considers these changes to improve upon the current state of retirement security in the U.S.

The American Council of Life Insurers is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States.

ACLI member companies offer insurance contracts and investment products and services to employment-based retirement plans (including defined benefit pension plans, 401(k), SIMPLE, SEP, 403(b), and 457(b) plans) and to individuals (through individual retirement accounts (IRAs) and annuities). Our members also are employer sponsors of retirement plans for their employees. As service and product providers, as well as employer sponsors, life insurers believe that savings for retirement, managing assets throughout retirement, and utilizing financial protection products are all critical to Americans' retirement income and financial security.

To provide context on the extent to which the life insurance industry helps Americans prepare for retirement, in 2015 alone, American families received \$328 billion in annuity payments, \$119 billion in life insurance death benefits, \$18 billion in disability income insurance benefits, and \$9.6 billion in long-term care insurance benefits. Through products like these that are offered by life insurance companies, Americans are able to plan, save and guarantee those savings for a secure retirement.

Current State of Our Retirement Savings System

Our retirement system is based on: employment-based retirement plans; personal savings (including IRAs, individual annuities, and regular savings and investment accounts); and Social Security. All three are important and play a vital role in retirement security.

American Council of Life Insurers
 101 Constitution Avenue, NW, Washington, DC 20001-2133
www.acli.com

Current tax incentives for retirement successfully help millions of American families accumulate savings and improve their retirement security. Last year, the Bureau of Labor Statistics reported that nearly 80 percent of full-time civilian workers have access to a retirement plan, and more than 80 percent of full-time civilian workers participate in a plan. All workers have access to individual annuities and IRAs.

As workers move from job to job, it is not uncommon for them to have more than one retirement account. A recent survey of one million employees who have both a workplace savings plan, such as a 401(k) or 403(b), and an IRA found that the average combined balance was \$225,600 at the end of 2015 for all workers, of all ages, in the sample.¹ Combined balances rose by age group from \$29,834 for those aged 25 to 29 and to \$529,669 for those aged 70 to 75.²

The 401(k) was introduced in the early 1980s, thus not enough time has elapsed for workers to retire after working a full 40- to 45-year career in the 401(k) system. However, a study found that accumulations through 401(k) plans, including rollover IRA balances, can generate significant income for retirees across all income groups over a full working life.³ The model includes Social Security income in its calculation. Employees can build up significant accumulations when they have continuous 401(k) coverage, even when equity returns are assumed to be lower.⁴ The model⁵ found that those with continuous coverage would reach replacement rates (how much a retiree will earn in retirement compared to the income he earned at the end of his employment) at retirement between 51 percent for the lowest-earning one-fourth (or quartile) of the population,⁶ and 69 percent for the highest income quartile.⁷ When combined with estimated Social Security payments, these accumulations could provide a replacement of 103 percent for the lowest-earning quartile and between 83 and 86 percent for the other quartiles.⁸

Given the ability of the current retirement savings system to enable workers to achieve retirement security, we recommend the following legislative enhancements that will build upon its success. ACLI supports a uniform federal approach to reforms and these recommendations will focus on proposals that will enhance pension coverage and worker participation, and facilitate lifetime income for these workers in retirement.

Increasing Access to and Expanding Coverage for Workplace Savings

Although a sizeable majority of full-time workers with access to a workplace plan are covered by workplace plans, more could be done to expand access and coverage. Many small businesses do not offer a retirement savings plan for a number of reasons, but not for a lack of marketplace product offerings. Slightly less than 50% of all workers employed by businesses with fewer than 50 workers have access to a workplace retirement plan. Access is much higher for workers at larger employers. The uncertainty of revenues is the leading reason given by small businesses for not offering a plan.

¹ Fidelity First Quarter Retirement Savings Analysis, Press Release, April 29, 2016.

² Id.

³ Sarah Holden and Jack VanDerhei, "Can 401(k) Accumulations Generate Significant Income for Future Retirees?" Investment Company Institute Perspective, Vol. 8, No. 8, November 2002.

⁴ Id.

⁵ The model includes 401(k) balances at employers and rollover IRA balances. The EBRI/ICI study focused on participants who were in their late 20's in 2000 and who would reach age 65 sometime between 2035 and 2039.

⁶ Id.

⁷ Id.

⁸ Id.

while cost, regulatory and administrative burdens, and lack of employee demand are other impediments cited by small business:

One policy ACLI supports is the expansion of private multiple employer plans or "open MEPs." Open MEPs can encourage and facilitate adoption by employers that are not prepared to sponsor their own stand-alone retirement plan.⁹ MEPs can be an important tool in reducing the costs and administrative burdens to small employers. Under a MEP, many businesses can join together to achieve economies of scale and advantages with respect to plan administration and advisory services, making plans much more affordable and effectively managed, and thereby encouraging more businesses to offer their employees retirement plans.

In addition to reforming and expanding MEPs, ACLI supports:

- Starter 401(k)s: Small employers should be encouraged to offer workplace savings opportunities with simple administrative rules and no required employer contributions.¹⁰
- Voluntary Auto-IRA: Employers without a retirement savings plan should be encouraged to automatically enroll employees into a payroll deduct IRA. "Auto-IRA" sponsors should receive the same level of protection and state wage law preemption offered to employers sponsoring "Auto-401(k)s."¹¹
- SIMPLE IRA: SIMPLE IRAs should be made more appealing to small businesses. Permitting a higher level of employer contribution and improving rollover rules could make the plans more valuable to employees.¹²

Small employers that provide payroll deduction IRAs should be eligible for a start-up cost credit to offset the employer's initial plan formation and administration expenses.

Lastly, in 2015, the "my Retirement Account" became available nationally. Small businesses without retirement plans may offer employees an opportunity to participate in the new "myRA," a Roth IRA backed by Treasury bonds. Offered by the U.S. Treasury, myRA provides the option to save for retirement with contributions as little as \$5 a month.¹³ The myRA program provides another useful tool to encourage people to start saving for retirement. ACLI has encouraged the Department of the Treasury to include the availability of lifetime income features in any program Treasury may adopt regarding the transfer of myRA accounts to private sector providers upon reaching the program's transfer thresholds.

Increasing Participation in Workplace Savings

Regardless of their financial circumstance, over 50 percent of Americans don't believe they know how much to save for retirement.¹⁴ However, the more money an individual contributes to their retirement plan, whether workplace-offered or individual IRA, the more likely they are to be financially secure.¹⁵ Fortunately, innovation in plan design is a key reason 401(k) plans have been able to reach more

⁹ See S. 3471, the Retirement Enhancement and Savings Act of 2016, sponsored by Sen. Hatch (R-UT) and H.R. 854, the Retirement Security for American Workers Act of 2017, cosponsored by Reps. Buchanan (R-FL) and Neal (D-MA).

¹⁰ See S. 3471.

¹¹ See H.R. 4067, the SAVE Act of 2015, co-sponsored by Reps. Kind (D-WI) and Reichert (R-WA).

¹² Id.

¹³ <https://myra.gov>

¹⁴ ACLI tabulations of Strategic Business Insights, Consumer Financial Decisions, MacroMonitor Data, 2016-17.

¹⁵ Id.

workers and improve the level of retirement benefits over time. One such innovation is automatic enrollment to get more workers into plans. Another change, auto-escalation, gradually increases the share of pay contributed each pay period. A joint study quantifies just how helpful auto-enrollment and auto-escalation can be in improving overall participation and total retirement savings.¹⁶ The study uses a projection model to show the increases in replacement rates (how much a retiree will earn in retirement compared to the income he earned at the end of his employment) that can result from these plan design innovations. Legislation had been introduced that would improve the current rules on auto-enrollment and auto-escalation.¹⁷

Importance of Guaranteed Lifetime Income to Ensure Retirement Income Security

Just as important as saving for retirement is making the savings last throughout retirement. Regardless of their financial stability, nearly three-quarters of Americans are concerned about having adequate income during retirement.¹⁸ Guaranteed lifetime income can help ensure that individuals have adequate income at advanced ages, even if they live to age 100 and beyond. By providing insurance to support one's standard of living, guaranteed lifetime income is an important tool for retirement planning. Guaranteed lifetime income has the potential to provide a higher sustainable level of income than can be achieved with other financial assets. Eighty-two percent of annuity owners think that annuities are an important source of retirement security and make them feel more comfortable in times of financial uncertainty.¹⁹

As the first wave of the baby boomer generation reaches retirement age, it is important to educate American workers about the need to consider augmenting Social Security with additional amounts of guaranteed lifetime income. Annuities and other guaranteed lifetime income solutions provide insurance protection against longevity risk by pooling that risk and distributing it among the retiree population, shifting the risk of outliving one's savings to a life insurer. Only state-regulated and licensed life insurance companies can provide guaranteed lifetime income.

ACLI urges policymakers to adopt the following policies to promote the awareness and availability of lifetime income:

Illustrate Individual Account Balances as Guaranteed Lifetime Income - Legislation has been introduced that would help individuals think of their retirement plan savings as not only a lump sum balance, but also as a source of guaranteed lifetime income.²⁰ With this additional income information on a benefit statement, coupled with the Social Security income statement, workers can see how much monthly income they could potentially receive in retirement. Workers can better decide whether to increase their savings, adjust their 401(k) investments, or reconsider their retirement date, if necessary, to assure the quality of life they expect in retirement.

Improve the Annuity Selection Rule for Individual Account Plans - The current Department of Labor safe harbor rule regarding the duties of a fiduciary in selecting an annuity provider for an individual account plan require the fiduciary, typically the employer, to make a determination as to whether "an annuity provider is financially able to make all future payments under an annuity contract." The regulation should be revised, as this standard is difficult to meet in part because it is hard to know

¹⁶ Sarah Holden and Jack VanDerhei, The Influence of Automatic-Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement. *Investment Company Institute Perspective*, Vol. 11 No. 2, July 2005.

¹⁷ See S. 3471.

¹⁸ The 2016-17 MacroMonitor Data.

¹⁹ The Committee of Annuity Insurers, *Survey of Owners of Individual Annuity Contracts* (The Gallup Organization and Mathew Greenwald & Associates, 2013). (survey of 1,008 owners of non-qualified annuity contracts, conducted on behalf of the Committee of Annuity Insurers)

²⁰ See S. 3471.

how to draw this conclusion. While it is part of a "safe harbor," the requirement makes it hard to use and it is not a requirement of selection of other financial protection products. Changes must be made to these rules to make it easier for employers to meet their duties while at the same time ensuring a prudent selection.

The safe harbor should be improved to provide greater certainty for plan sponsors and fiduciaries when selecting guaranteed lifetime income products.²¹ The rule should be clear that it applies to all guaranteed income products, including payout annuities with a fixed term. In considering an insurer's financial capability, a fiduciary may rely on specific representations from the insurer regarding its status in relation to state insurance regulation and enforcement. It is important to recognize the unique role of state insurance departments in oversight of life insurance companies including the imposition of NAIC uniform rules for the establishment of reserves, the valuation of assets and liabilities, risk-based capital requirements, and required capital. The insurance department conducts routine reviews of the financial strength of each insurer and its ability to meet its commitments and the insurance department has a number of powers to intervene and protect policyholders. This system is a factor in the consideration of the quality of an annuity provider.

Promote Lifetime Income Portability – The portability rules should be expanded to maintain participants' access to lifetime income benefits. When the termination of a plan's annuity contract would lead to the loss of access on the part of plan participants to the contract's guaranteed lifetime benefits, participants need a means to maintain access to these benefits. Legislation has been introduced that would enhance the portability of guaranteed lifetime income products.²² ACLI supports legislation and regulation that would permit the distribution of a participant's insured plan benefit when a guaranteed lifetime income product is no longer offered by the plan. The rules should permit the distribution to be made via a qualified plan distributed annuity contract or a direct rollover to an IRA or other eligible retirement plan.

Over the long run, the nation will benefit when individuals address their long-term financial security needs today, because they will be less likely to rely on public assistance tomorrow. Government policies that encourage prudent behavior, such as long-term savings for retirement, should not only be maintained, they should be enhanced. Therefore, ACLI continues to urge policy-makers to support and build on the current retirement savings system.

²¹ Id.

²² Id.

U.S. Senate Committee on Banking, Housing & Urban Development

Subcommittee on Economic Policy

Hearing on "The Current State of Retirement Security in the United States"

Testimony of Catherine Weatherford

President and CEO, Insured Retirement Institute

April 5, 2017

Chairman Cotton, Ranking Member Heitkamp, and Members of the Subcommittee, my name is Cathy Weatherford and I am President and CEO of the Insured Retirement Institute. I am pleased to provide our perspective on the current state of the retirement security and to recommend common sense, bipartisan solutions that would lead to a dignified retirement for all Americans. I commend you for holding this hearing, and I welcome the opportunity to address the Subcommittee.

Summary of Testimony

Consistent with our consumer-focused mission, my testimony today will address two (2) key points:

1. Consumers in America are facing a retirement income crisis, but insured retirement products can play a vital and unique role in helping them protect against the risk of outliving their assets. Federal and state regulators should provide consumers more education regarding the risk of outliving their assets and the financial strategies that can provide guaranteed lifetime income. Legislation should seek to improve access to education and information by allowing American savers to make effective and informed decisions regarding their finances.
2. Expansion of workplace retirement plans, along with streamlining options and responsibilities of employers, will assist Americans in saving more and better preparing for retirement. These efforts, combined with preserving the current tax treatment for retirement savings, will ensure savers are equipped with the tools to best prepare for a secure retirement.

About IRI

As you may know, I have over 30 years of regulatory experience, including over half of that time as an elected Insurance Commissioner and Insurance Department staff in the State of Oklahoma. Prior to joining IRI, I served as CEO of the National Association of Insurance Commissioners for 12 years, where I

Testimony of Catherine Weatherford

April 5, 2017

worked with over 50 state insurance commissioners to craft important consumer protections, including critical measures aimed at safeguarding our senior citizens. I joined IRI because my life's work is perfectly aligned with IRI's mission.

IRI exists to vigorously promote consumer confidence in the value and viability of insured retirement strategies, bringing together the interests of the industry, financial advisors and consumers under one umbrella. Our mission is to: encourage industry adherence to highest ethical principles; promote better understanding of the insured retirement value proposition; develop and promote best practice standards to improve value delivery; and to advocate before public policymakers on critical issues affecting insured retirement strategies and the consumers that rely on their guarantees.

IRI is the only national trade association that represents the entire supply chain for the insured retirement strategies industry. We have over 700 member companies, including major insurance companies like TIAA, Prudential and AXA, banks like Wells Fargo and JPMorgan Chase, broker-dealers like Morgan Stanley, Raymond James and Edward Jones, and asset management companies like Goldman Sachs and BlackRock. Our member companies represent more than 97 percent of annuity assets, and include the top 15 distributors ranked by assets under management. We offer education, research and advocacy resources to more than 180,000 financial advisors and more than 6,000 home office professionals affiliated with our member companies.

Our members are represented by hundreds of thousands of registered financial advisors across the country, and therefore, we bring a perspective from Main Street America to the Congress today. After my many conversations with these financial advisors, I have developed a deep level of appreciation for the long-standing relationships they have with their clients and friends—ten, twenty or even forty years. Our financial advisors consider that relationship to be a sacred trust and as such, they are

Testimony of Catherine Weatherford

April 5, 2017

intensely committed to helping their clients reach their retirement income objectives, which involves a series of the most significant financial decisions a person ever makes over a very long lifetime.

America's Retirement Income Crisis and the Roles of Insured Retirement Products & Professional Financial Advice

Americans today are at risk of outliving their assets. The longevity risk has never been greater. The shift from defined benefit to defined contribution plans, longer life spans, and the rising costs of health care are among the challenges that will put a significant retirement savings and income burden on the shoulders of individual consumers, in particular middle-income Americans. This reality underscores the critical importance of a regulatory environment that provides consumers access to products that meet their need to protect against longevity risk. Insurance companies and their distribution partners are the only providers of guaranteed lifetime income products.

Background

Seventy-nine million Baby Boomers today face immediate and unprecedented retirement income challenges—challenges that simply did not exist in earlier generations. At the peak in 1985, over 114,000 private-sector defined benefit plans were in place, but by 2015 less than 24,000 of these defined benefit plans remained. Only 18 percent of workers had access to a defined benefit plan in 2015. In addition to this, individuals are living longer than ever. Our research has shown that, between 2000 and 2010, the number of 60 to 64-year old Americans has increased by more than 50 percent, from 10.5 million to more than 16.2 million. According to the Society of Actuaries' Mortality Tables, a 65-year-old male has a 30 percent chance of living to 90, a 65-year-old female has a 42 percent chance. A couple age 65, has a 60 percent chance of one or both being alive at 90, and a 35 percent chance of one spouse living to age 95.

Testimony of Catherine Weatherford

April 5, 2017

As the population in the U.S. ages and more Boomers retire or approach retirement, concerns about financial preparedness remain high, according to an overwhelming number of reports. The combination of longer life spans and a declining birth rate mean the ratio of workers to retirees will continue to decline, increasing pressure on public and private pensions systems, and health care systems. People are living longer, and savings have to last through retirements that can span 20 to 30 years or more. According to IRI's 2017 Annual Update on the Retirement Preparedness of the Boomer Generation Report, only 54 percent of the Baby Boomer generation have retirement savings – the lowest recorded in the seven years since the report has tracked the figure. Only four in ten Boomers have even tried to calculate how much they need to save to retire, and of these, only six in ten factor healthcare into their costs. Shockingly, only 23 percent of Baby Boomers believe they will have enough money to last throughout retirement.

As compared to prior generations, Boomers and Generation Xers bear more of the risk and responsibility for retirement savings and income generation. Traditional defined benefit (DB) pension plans in the private sector are increasingly being frozen or terminated; virtually all replacement and new plans are definite contribution (DC) plans, such as 401k plans. Historically low personal savings rates, coupled with general insufficiency of DC plan savings, mean many retirees will have to consider alternative sources of retirement income, such as working in retirement and tapping into home equity. IRI's 2016 "It's All About Income: Inaugural Study on the American Retirement Experience" research estimates that as many as 56 million Baby Boomers will not receive retirement income from a pension, and future retirees may need upwards of \$400,000 to make up for this income shortfall.

The shift from DB to DC plans has shifted much of the burden for retirement security from employers to individuals. Employees have to make decisions about whether to participate in a DC plan, how much to

Testimony of Catherine Weatherford

April 5, 2017

save, and how to invest, and at retirement, participants have to figure out how to make their nest egg last for life—while managing the risks that accompany this responsibility.

The Role of Insured Retirement Products

Annuities are the only financial instruments available today, other than Social Security and pensions, that guarantee a lifetime stream of income during retirement. With the proper use of annuity products and other guaranteed lifetime income products, retirees can be assured they will not outlive their assets. One of the most interesting findings in IRI's 2017 Baby Boomer Report revealed that while only eight percent of Baby Boomers consider using their retirement savings to fund an annuity, a full 85 percent say that it is very or somewhat important to have a source of guaranteed lifetime income besides Social Security. Clearly, the majority of those about to retire or recently retired believe an annuity to be an important part of a retirement portfolio, yet may not be connecting the annuity to the concept of a traditional pension.

Annuities appeal to individuals of all income levels and people who don't have another retirement savings vehicle. In fact, annuity owners are overwhelmingly middle-income. Seven in 10 annuity owners had annual household incomes of less than \$100,000. That is what makes annuities such a versatile tool in an individual's retirement portfolio.

The Role of Professional Financial Advice

The importance of working with a financial professional in planning for retirement cannot be emphasized enough. The 2017 IRI Baby Boomer Report found that savers who work with financial professionals are consistently likelier to save for retirement—in fact, 75 percent of those who work with financial professionals have saved at least \$100,000 for retirement, compared to less than one-half of those who do not have a relationship with a financial professional. In fact, nearly six in 10 retirees have

Testimony of Catherine Weatherford

April 5, 2017

worked with a financial professional and 93 percent of them say the advice and guidance they have received has been effective.

Now more than ever, legislation and regulations should seek to protect financial guidance, instead of limiting it. The Department of Labor's fiduciary rule will significantly harm retirement savers by limiting professional advice, reducing service provider choice and products, and raising the cost of saving for retirement. Policymakers should delay the implementation of the rule in order to seek further public comment as to the questions of law and policy. At the same time, Congress should enact legislation to establish a consistent best interest standard of care while preserving access to retirement advice and a wide array of lifetime income products for America's retirement savers.

Proposals for Retirement Savings in Employer-Sponsored Plans and Preserving Tax Treatment

Americans today face many challenges and obstacles in saving for retirement. Today, most Americans rely on defined contribution savings plans, such as 401k or Individual Retirement Accounts (IRAs), which make individuals responsible for ensuring their own retirement outcomes. The Insured Retirement Institute recently released its 2017 Retirement Security Blueprint outlining common sense, bipartisan policies to help Americans achieve their retirement goals for financial security.

Provide Multiple Employer Plans (MEPs) with Lifetime Income Options

All small employers should be able to join multiple employer plans, or MEPs, which will result in more workers having access to retirement plans. There is bipartisan support in Congress to make MEPs available to all start-ups and small businesses. However, these businesses currently face financial and administrative challenges, as well as legal risks, in offering a retirement plan to employees. Allowing small businesses to band together to offer their employees a retirement plan will greatly reduce the number of workers without access to a workplace plan. Given that lifetime income strategies have been

Testimony of Catherine Weatherford

April 5, 2017

proven to decrease the risk of outliving retirement savings, these plans should be required to make a lifetime income option available to employees.

The proposal within the president's 2017 budget would remove the "common bond" requirement for using a MEP, and as a result, would enable employers to take advantage of "open MEPs", while adding significant new safeguards to ensure workers are protected. This will allow more small businesses to offer cost-effective, pooled plans to their workers, and certain nonprofits and intermediaries will be able to create plans for contractors and other self-employed individuals who do not have access to a plan at work. As an added benefit, if an employee moves between employers participating in the same open MEP, or is an independent contractor participating in a pooled plan using the open MEP structure, the employee can continue contributing to the same plan after starting work for a different company. Provisions to expand the use of MEPs were included in Chairman Hatch and Ranking Member Wyden's Retirement Savings and Enhancement Act (RESA) of 2016, which was unanimously passed out of the Senate Finance Committee in late 2016. Congress should enact or re-introduce legislation to remove regulatory and legal barriers to facilitate small businesses' use of MEPs and these plans should be required to make a lifetime income option available to their employees.

Enable Annuity Portability

In addition to expanding coverage for American workers, retirement programs need to ensure that workers in an increasingly mobile economy can carry their benefits with them across an entire career. Congress should amend a technicality in the tax code to make a record keeping change a distributable event for annuities with lifetime income benefits. This change will ensure that workers do not lose the

Testimony of Catherine Weatherford

April 5, 2017

lifetime income guarantees they have already paid for if their employer decides to change annuity products or service providers.

Unfortunately, to avoid this possibility, many employers simply choose not to offer lifetime income options to their workers. Necessary changes to the tax code regarding lifetime income portability were included in Chairman Hatch and Ranking Member Wyden's 2016 RESA Bill and would help to solve this problem.

Increase Auto-Enrollment and Auto-Escalation Default Rates in 401(k) Plans

The Pension Protection Act allows employers to automatically enroll employees in 401(k) plans. Currently, the majority of private-sector employees using automatic enrollment set the default rate at 3 percent of pay, the starting point for the auto-enrollment safe harbor. This rate is far too low to generate adequate retirement savings. Research by EBRI has found that a 6 percent default savings rate would lead to significantly better retirement outcomes for workers, without causing a marked increase in workers opting out of the plan. Workers across all income brackets are more likely to participate when their employers have auto-enrollment, but will need higher savings thresholds to reach their retirement savings goals. Starting the deferral rate at six percent at the time of automatic enrollment with automatic escalation up to 15 percent would greatly increase retirement savings for Americans. The 2016 RESA bill included a proposal for legislation removing the cap on current auto-escalation levels, specifically highlighting the increase in retirement savings and expansion of contributions that this would encourage.

Require Lifetime Income Estimates on Workers' Benefit Statements

To help workers save appropriately for retirement, they need to be aware of how much monthly income their nest egg will generate in retirement. The Lifetime Income Disclosure Act (S. 868) was recently

Testimony of Catherine Weatherford

April 5, 2017

reintroduced by Representatives Luke Messer and Mark Pocan in the House of Representatives and by Senators Johnny Isakson and Chris Murphy in the Senate. The bill ensures that employers provide 401(k) participants with a projection of their monthly income at retirement, based on the current balance of the account. Research by IRI found that more than 90 percent of workers want these estimates and find them helpful, while a full 75 percent of workers said they would increase their savings level by a few percentage points or more after seeing these retirement income estimates.

Update Required Minimum Distribution (RMD) Rules to Reflect Longer Lifespans

Legislation should be enacted to increase the RMD age from 70 and $\frac{1}{2}$ to at least 75, and mortality tables should be updated to reflect longer life expectancies. The RMD age has not changed in over 50 years and mortality tables represent considerably shorter lifespans than today's aging averages. Workers now face an increased risk of outliving retirement assets as a result of longer life spans. Increasing the RMD age will give individuals more time to ensure their savings grow, while allowing them to take larger distributions in the future.

Protect Seniors from Financial Abuse

Unfortunately, millions of older Americans are victims of financial fraud each year. Those who are affected by this exploitation are left in financial ruin as their savings – built up over a lifetime – are erased by predatory family, friends, and others who manage senior finances. Financial elder abuse is estimated to cost \$2.9 billion per year, and is estimated to be than 12 times greater due to under-reporting. With a population of aging Americans expected to double in size to nearly 84 million by 2050, this will only make efforts to protect vulnerable seniors more necessary than ever before.

The SeniorSafe Act of 2017, re-introduced recently by Senator Susan Collins, is designed to protect vulnerable adults from financial exploitation. The bill was also introduced in 2016 and was passed

Testimony of Catherine Weatherford

April 5, 2017

unanimously by the Senate Finance Committee. This legislation creates necessary education opportunities and reporting procedures for financial professionals that suspect cases of elder fraud, while removing barriers that currently exist in alerting appropriate officials. Congress should work to expeditiously enact legislation which would enable financial advisors to protect their clients from financial abuse and protect the millions of older Americans who suffer financial exploitation each year.

Maintain Tax-Deferred Treatment for Retirement Savings

The deferral of taxes on the investment growth within a retirement savings product is one of the cornerstones of retirement planning. This deferral of growth leads to a significantly larger retirement nest egg for savers. For example, a 45-year old investor at the 15 percent tax bracket who makes a one-time \$1,000 contribution before taxes into a tax-deferred retirement account, earning a six percent interest rate, will at age 60, have accumulated \$2,397, but must pay a 15 percent tax – or \$359 – upon withdrawing the savings from the account. After taxes, there will be \$2,038. If the same investor used after-tax dollars contributed to a taxable account, the value of the account at age 60 would be \$1,793, or \$245 less than the tax deferred savings.

American consumers place a high level of importance on tax deferral – consumers and financial advisors both cite tax deferral as a top reason for purchasing an annuity. More than four in 10 American private sector workers do not have access to a tax-deferred defined contribution retirement plan through their employer, so annuities provide a vehicle for these workers to access tax-deferred retirement savings. Among middle-income Baby Boomers, 77 percent said that tax deferral is an important consideration when selecting a retirement product.

Is it important to distinguish that taxes on retirement savings and annuities are deferred, not exempt or excluded. While the tax-deferred treatment of annuities help consumers reach a higher level of savings,

Testimony of Catherine Weatherford

April 5, 2017

the interest and earnings credited to annuities are taxed when distributions are taken at retirement.

Thus, while the removal of annuities' tax-deferred status would not necessarily generate additional tax

revenue over the long term, it would have a negative effect on Americans' ability to save for retirement.

Americans today are more responsible than earlier generations for saving for retirement and any policy

that discourages savings will diminish retirement security overall.

Conclusion

Thank you again for the opportunity to present this testimony. We hope you will find it useful, and we

would welcome the opportunity to work with the Subcommittee in the future as you consider additional

legislative and regulatory changes to help all Americans achieve real retirement security.



April 5, 2017

The Honorable Tom Cotton
 Chairman
 Subcommittee on Economic Policy
 Committee on Banking, Housing,
 and Urban Affairs
 United States Senate
 534 Dirksen Senate Office Building
 Washington, D.C. 20510

The Honorable Heidi Heitkamp
 Ranking Member
 Subcommittee on Economic Policy
 Committee on Banking, Housing,
 and Urban Affairs
 United States Senate
 534 Dirksen Senate Office Building
 Washington, D.C. 20510

Re: The Current State of Retirement Security in the United States

Dear Chairman Cotton and Senator Heitkamp:

The Save Our Savings Coalition, an alliance of advocates and businesses dedicated to protecting Americans' retirement savings as Congress undertakes tax reform, thanks the Committee for its attention to the issue of retirement security. Our priority is ensuring Americans will continue to have access to the private sector retirement system and to meaningful savings incentives, two items critical to retirement security in this country.

Millions of Americans are covered by the private sector retirement system, which makes it an integral building block of retirement savings. Seventy-five percent of private sector workers are offered a retirement plan at work and 82% of those workers who are offered a plan choose to participate¹. And employers play a vital role in helping their workers save for retirement, with 88% of defined contribution participants belonging to plans with employer contributions². The private sector system is working to help Americans save.

The existing private sector retirement system benefits everyone, especially middle class families. Eighty percent of participants in workplace defined contribution plans earn less than \$100,000 annually³. Access to a private sector retirement plans is a key step toward building retirement security for workers earning \$30,000 to \$50,000: when an employer-sponsored plan is offered, 70% of workers in that bracket participate, but when no workplace plan is offered, only 5% of those workers will contribute on their own to an IRA⁴.

¹ "Retirement Plan Coverage by Firm Size: An Update," Social Security Bulletin, Vol. 75, No. 2, page 45.

² Employee Benefits Research Institute Issue Brief #426, page 14.

³ Written testimony of Judy A. Miller, Executive Director of American Society of Pension Professionals & Actuaries to the Senate Finance Committee on February 26, 2014. Available at <http://www.finance.senate.gov/hearings/retirement-savings-for-low-income-workers>

⁴ Based on unpublished estimates by the Employee Benefits Research Institute.

We hope the committee will take steps to help preserve, enhance, and expand the system that's helping millions of hardworking Americans save for retirement. Thank you again for your attention to this issue, and we look forward to a positive working relationship. If you or your staff have further questions, please contact info@saveoursavings.org.

Sincerely,

The Save Our Savings Coalition

STRENGTHEN SOCIAL SECURITY

...don't cut it.

Statement of the Strengthen Social Security Coalition
 U.S. Senate Committee on Banking, Housing, and Urban Affairs Subcommittee on Economic Policy
 Hearing on "The Current State of Retirement Security in the United States."
 April 5, 2017

The Strengthen Social Security Coalition is a broad-based coalition of over 320 national and state organizations representing 50 million Americans, including seniors, workers, women, people with disabilities, children, young adults, veterans, people of low income, people of color, communities of faith, and others. We recognize that the expansion of our Social Security system is a solution to a number of challenges facing our nation, including a looming retirement income crisis.

The question whether to expand or cut Social Security is one of values, not affordability. As the richest country on Earth, at the richest point in our history, expanding Social Security to address the retirement income crisis is something we can easily afford. Indeed, the Coalition believes we cannot afford to do otherwise.

The United States' Looming Retirement Income Crisis

Americans today face a retirement income crisis of significant—and growing—proportions. The Center for Retirement Research at Boston College has estimated that more than half (52 percent) of all working-age households are at risk of being unable to maintain their standards of living in retirement. When health and long-term care expenses, which 70 percent of all U.S. seniors are expected to face some day, are taken into account, the number of households at risk swells to over two-thirds (68 percent). Moreover, recent polling from the National Institute for Retirement Security shows that even greater numbers of Americans are concerned about their prospects for a secure retirement, with 88 percent agreeing that the nation faces a retirement income crisis, and 85 percent saying that their leaders in Washington do not understand "how hard it is to prepare for retirement."

Even as Americans are concerned about their economic security in retirement, the tools and resources that they have to prepare for retirement are vanishing. Over the past few decades, wages for the bottom 90 percent of earners have effectively stagnated, leaving most Americans with little to no disposable income to set aside for retirement. Today, traditional defined benefit (DB) pensions, which were long a key component of retirement security, have all but disappeared in the private sector. Private-sector employers now favor inadequate and risky defined contribution plans that benefit only the highest earners. As a result, the vast majority of Americans are left only with the foundation of the U.S. retirement system: Social Security.

Social Security: The Foundation of a Secure Retirement

Social Security is the foundation of retirement security for virtually all Americans, and it is incredibly successful. Now in its 82nd year, our Social Security system has allowed generations of working Americans to earn critical retirement protections for themselves and their families. Today, 44.5 million Americans receive Social Security retirement benefits on the basis of their own earnings or those of a

working spouse or parent. These benefits are inflation protected, and cannot be outlived, even when savings and all other income have been exhausted. Social Security benefits are a guaranteed source of income, permitting those who receive them to retire with dignity and independence. Indeed, two-thirds of retirees rely on Social Security for half or more of their incomes. One out of three rely on Social Security for virtually all of their income.

Social Security is the nation's most universal, fair, portable, secure, and efficient source of retirement income. Less than a penny of every dollar is spent on administration. The remaining more than 99 cents is paid in benefits. Moreover, unlike private insurance companies and employers, the federal government will never go out of business. Social Security's one shortcoming is that its benefits are modest by virtually any measure.

The average retirement benefit in 2017 is just \$15,819—less than \$4,000 above the poverty line for an individual. Moreover, although these benefits, which cannot be outlived, are adjusted each year to keep up with inflation, these adjustments do not reflect the high increases in healthcare costs for the majority of Social Security beneficiaries who are seniors and people with disabilities. As a result, many Social Security beneficiaries see their already modest benefits eroded by increases in out-of-pocket healthcare costs over the course of many years.

A Clear and Affordable Solution: Expand Social Security Now

Our coalition applauds this Committee for focusing on the current state of retirement income in the United States. We urge you to conclude that Social Security should be expanded, not cut.

In addition to efficiently and fairly addressing the retirement income crisis, expanding Social Security helps to reduce the growing squeeze on middle class families and address the perilous and growing income and wealth inequality confronting us. Moreover, benefits can be implemented immediately, with no start-up costs, and can benefit current, as well as future beneficiaries, people with disabilities and survivors, as well as retirees. Finally, increasing Social Security is a boon to local economies, particularly in rural areas, because benefits tend to be spent immediately on necessities.

An expanded Social Security is fully affordable. Social Security will be its most expensive at the end of the century. At that time, it will cost just six percent of GDP, a smaller percentage than most other industrialized nations spend on their counterpart programs today. It is totally self-financed and has no borrowing authority. Consequently, it does not add a penny to the deficit. A number of bills introduced in this Congress and last expand benefits while restoring Social Security to long-range balance, by spreading the costs equitably, without unduly burdening anyone. Indeed, a common provision of these bills is modifying the wage cap so that millionaires and billionaires pay the same percentage on their earnings, as the vast majority of working Americans – including minimum wage workers – pay on theirs. Numerous polls show that the American people overwhelmingly oppose cutting Social Security, and support that financing change.

To repeat, the question whether to expand or cut Social Security is one of values, not affordability. As the richest country on Earth, at the richest point in our history, expanding Social Security to address the retirement income crisis is something we can easily afford. Indeed, the Coalition believes we cannot afford to do otherwise.