



Securing Our Financial Future:

# Report of the Commission on Retirement Security and Personal Savings

*June 2016*

# *Commission on Retirement Security and Personal Savings*

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## **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.

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# 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.

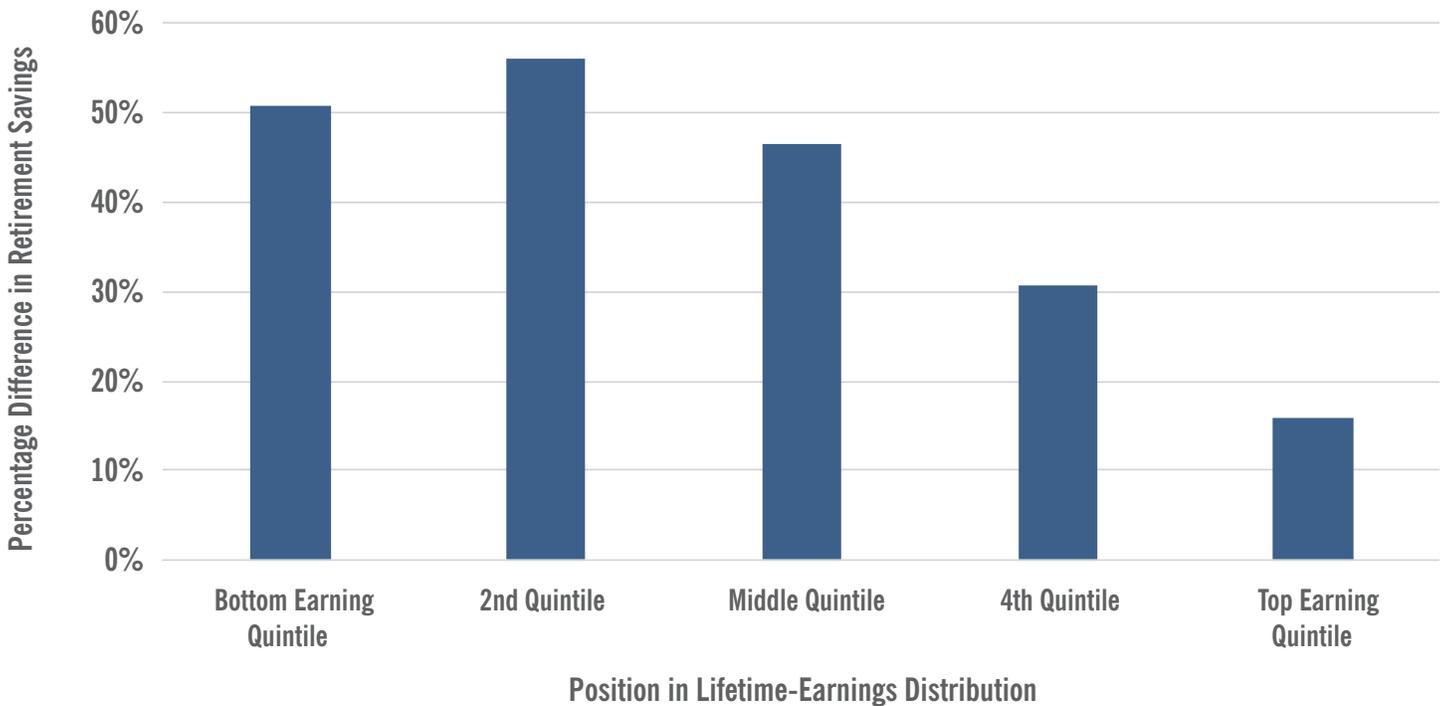
Once these reforms are in place, we recommend establishing a nationwide minimum-coverage standard to pre-empt the patchwork of state-by-state regulation that is already developing. Beginning in 2020, employers with 50 or more employees that do not already offer a retirement plan that meets certain minimal 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.<sup>1,2</sup> 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.<sup>3,4</sup> 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.”<sup>5</sup> 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.

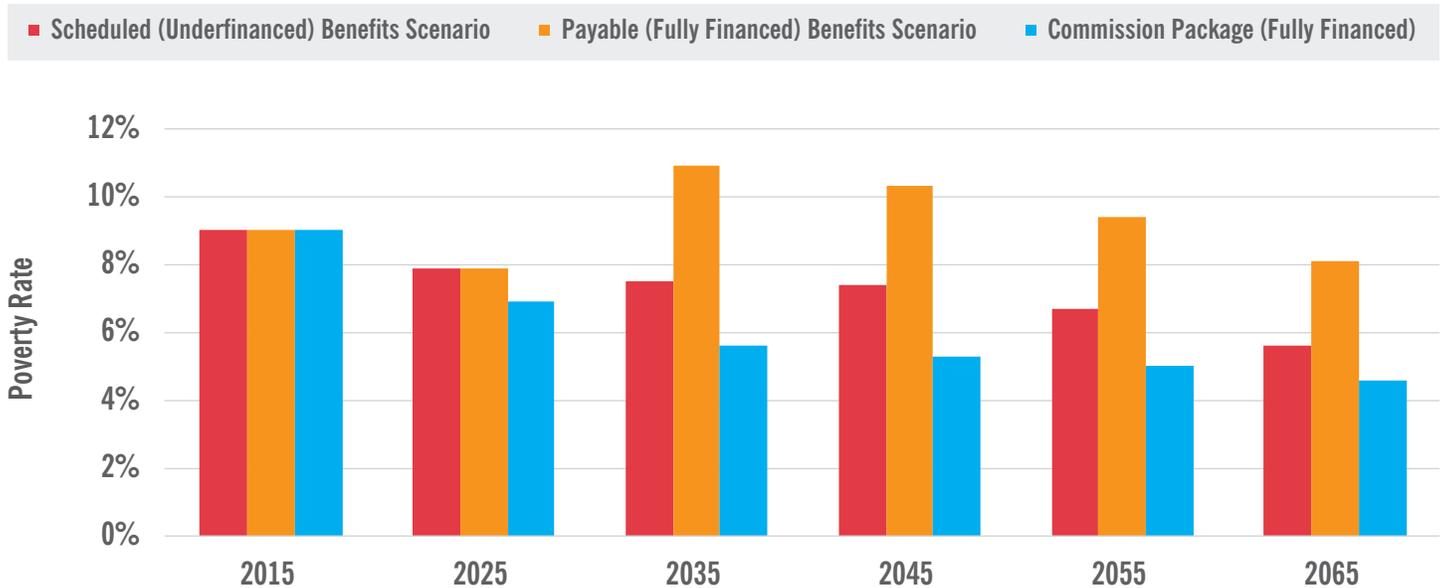
We recommend adjustments to Social Security’s tax and benefit levels to 1) reflect changing demographics; 2) better target benefits on those who are most vulnerable in old age, including surviving spouses and workers in low-earning occupations; 3) preserve reasonable intra- and inter-generational equity; 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.<sup>6</sup> 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.

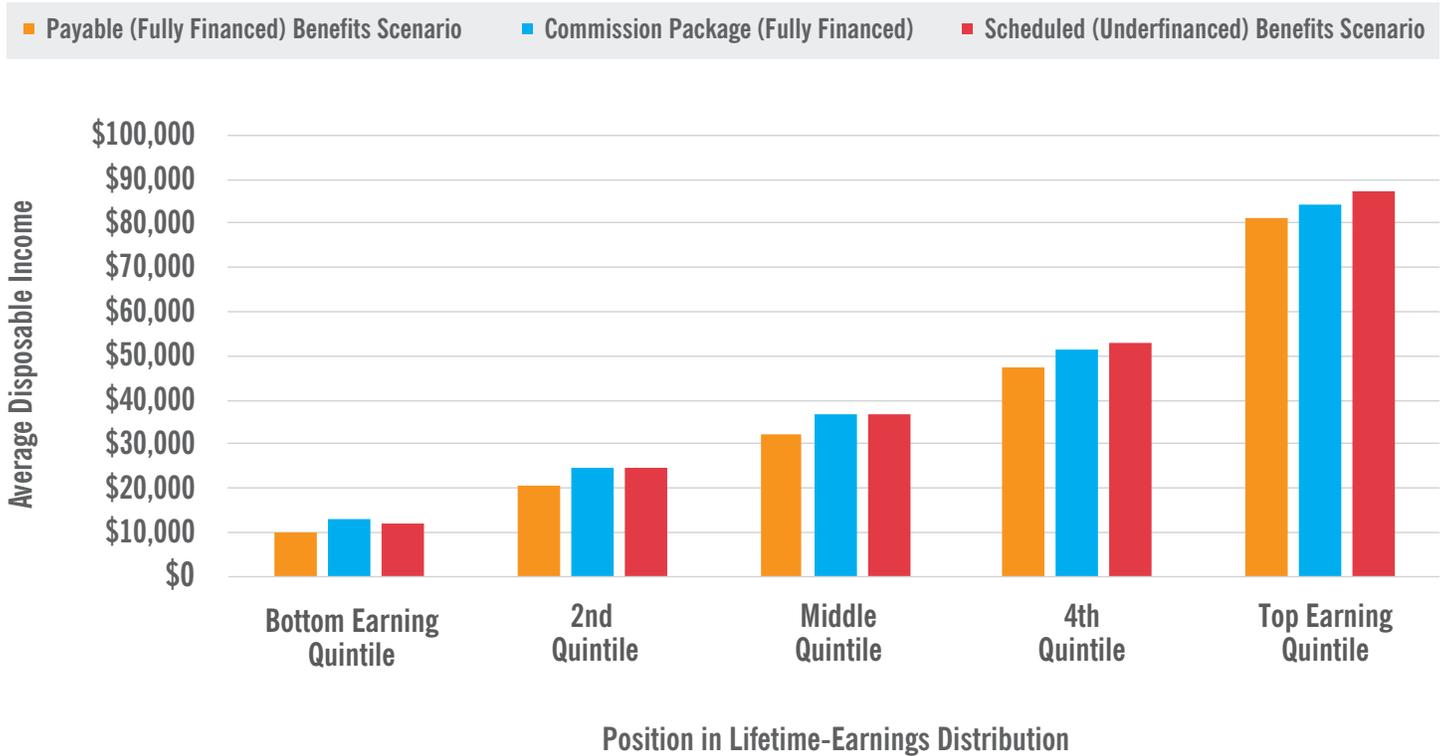
**Source:** The Urban Institute - DYNASIM3

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.

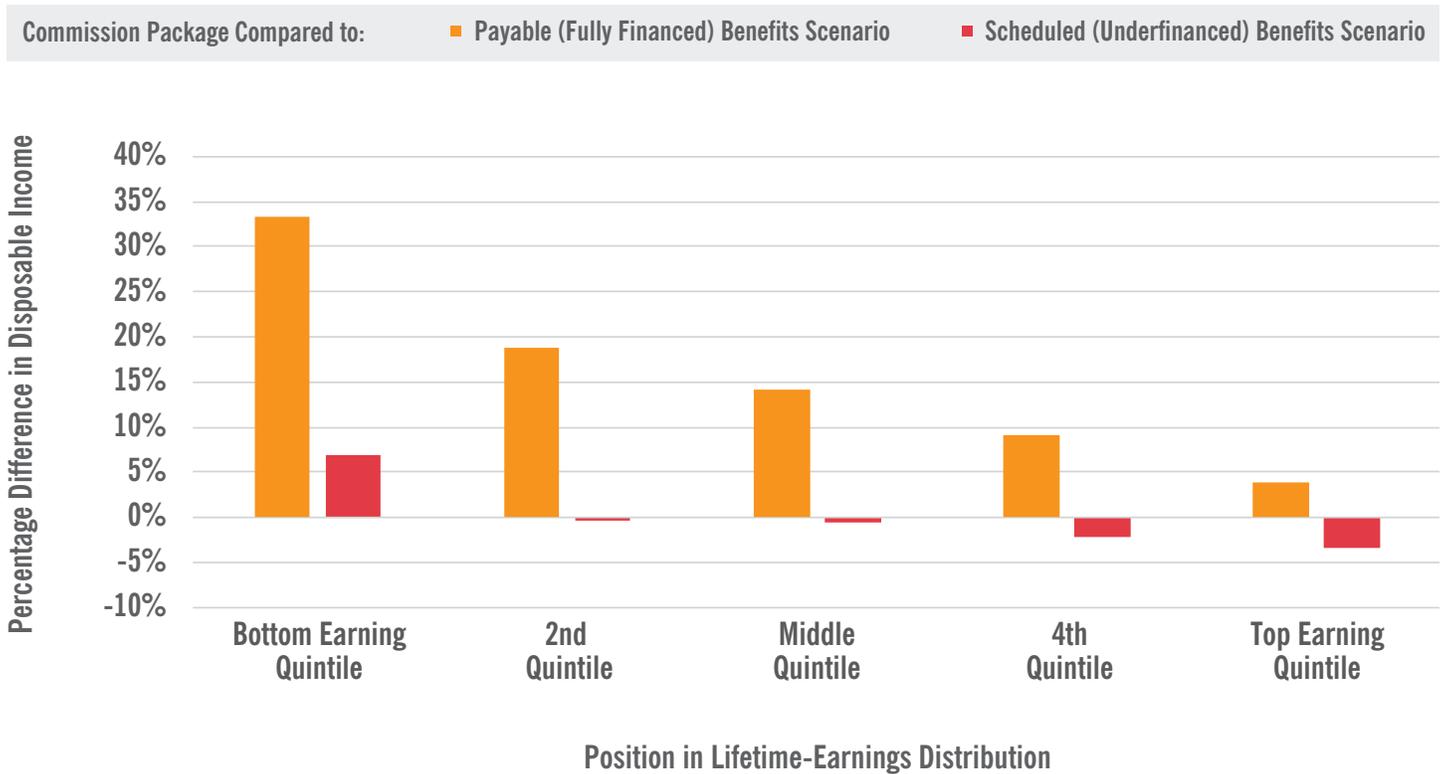


**Note:** Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition 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.<sup>7</sup>

Many are right to worry. Various measures indicate that a large proportion of American workers will experience a lower standard of living in retirement.<sup>8</sup> 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.<sup>9</sup> 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.<sup>10</sup> 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.

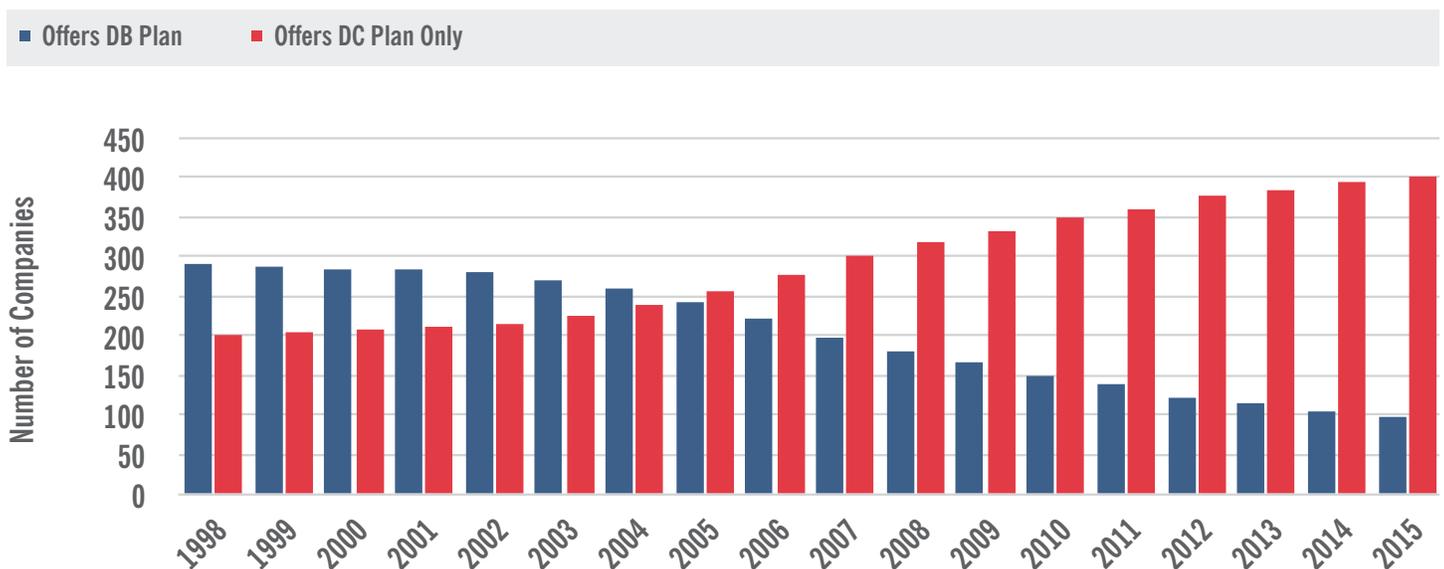
When 401(k) plans were introduced in 1978, they were designed to supplement DB plans, not replace them. Over time, however, employers realized that DC plans could help employees accrue significant retirement savings without the generally higher cost and risk to the employer of sponsoring a DB plan. The 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.<sup>11</sup> Today, the vast majority of plan participants are in DC plans.<sup>12</sup> Those plans now hold more than double the assets of private-sector DB plans: \$6.7 trillion compared to \$2.9 trillion.<sup>13</sup>

## 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 Watson<sup>14</sup>

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.<sup>15</sup>

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.<sup>16</sup> In contrast, only 12 percent of those who will have access to a DC plan for at least 20 more years will run short.<sup>17</sup> 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.<sup>18</sup>

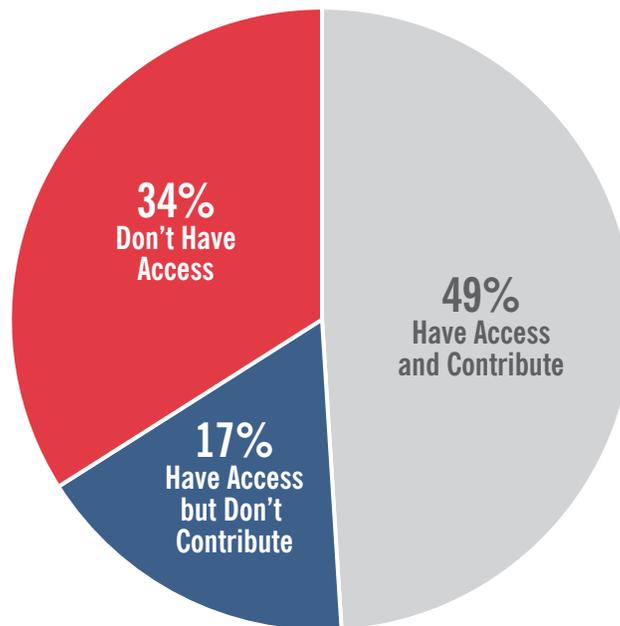
Yet, tens of millions of American workers lack access to retirement plans. Some employers choose not to sponsor plans, while others limit eligibility to certain employees. Even among workers who have access to a plan, many choose not to participate.

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.<sup>19</sup> As a result, for too many workers, the pension leg of the retirement security stool is either too short or simply does not exist.

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

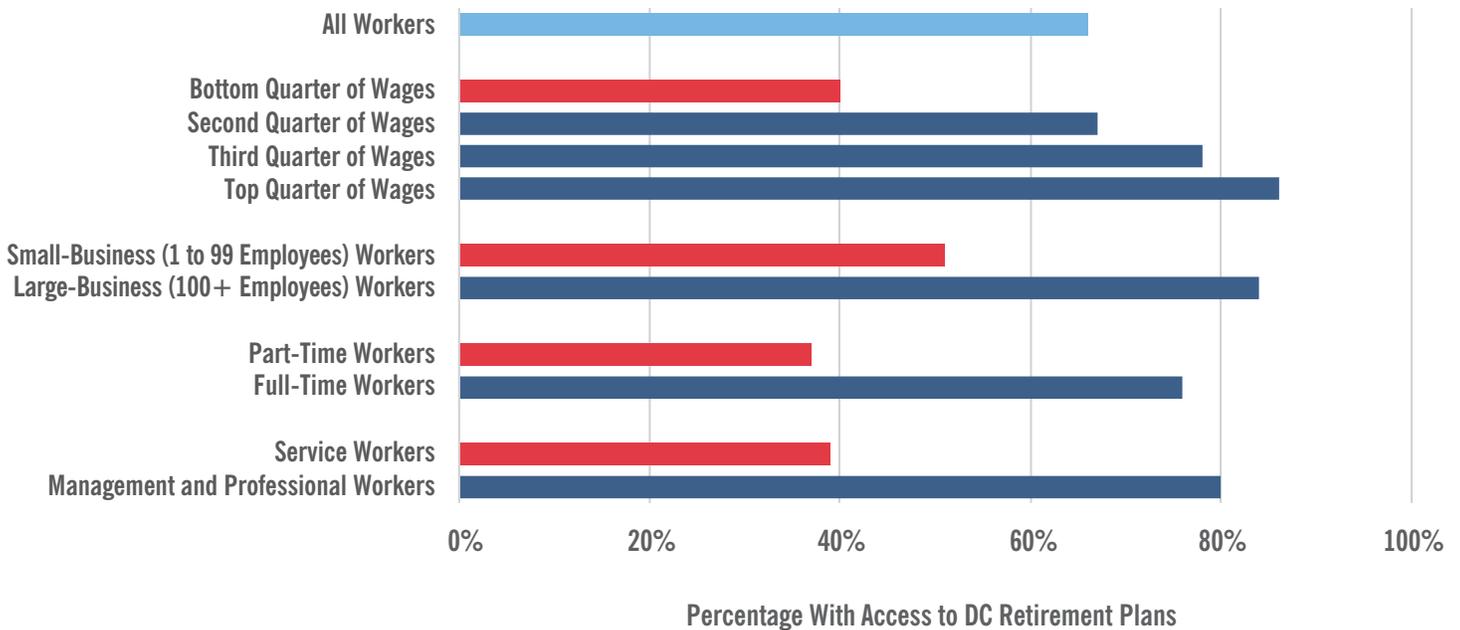
Access to workplace retirement savings plans among private-sector workers.



Source: U.S. Bureau of Labor Statistics<sup>20</sup>

## 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 Statistics<sup>24</sup>

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.<sup>21</sup> 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.<sup>22</sup>

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.<sup>23</sup>

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;

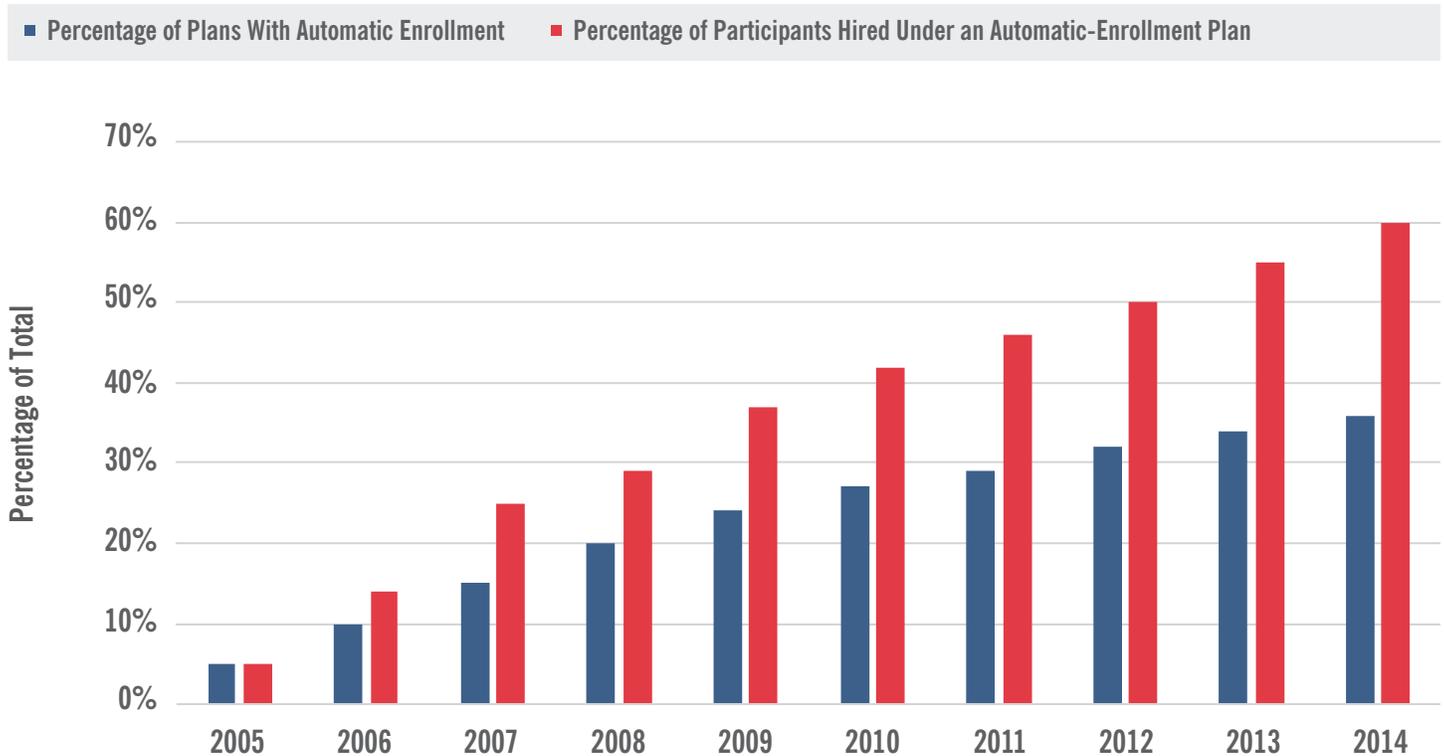
hire a trustee; establish a recordkeeping system; and accept a degree of fiduciary responsibility, which means the employer must act prudently and in the sole interest of participants. In addition, employers are responsible for negotiating and controlling the fees associated with their employees' accounts. 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: Vanguard<sup>30</sup>

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.<sup>25</sup> 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.<sup>26,27</sup> 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.<sup>28</sup>

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.<sup>29</sup> 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.<sup>31</sup>

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.<sup>32</sup> 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.<sup>33</sup> Even with a generous employer match, that is far too low for most Americans who seek to maintain their standard of living in retirement.<sup>34</sup>

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.<sup>35</sup> 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***

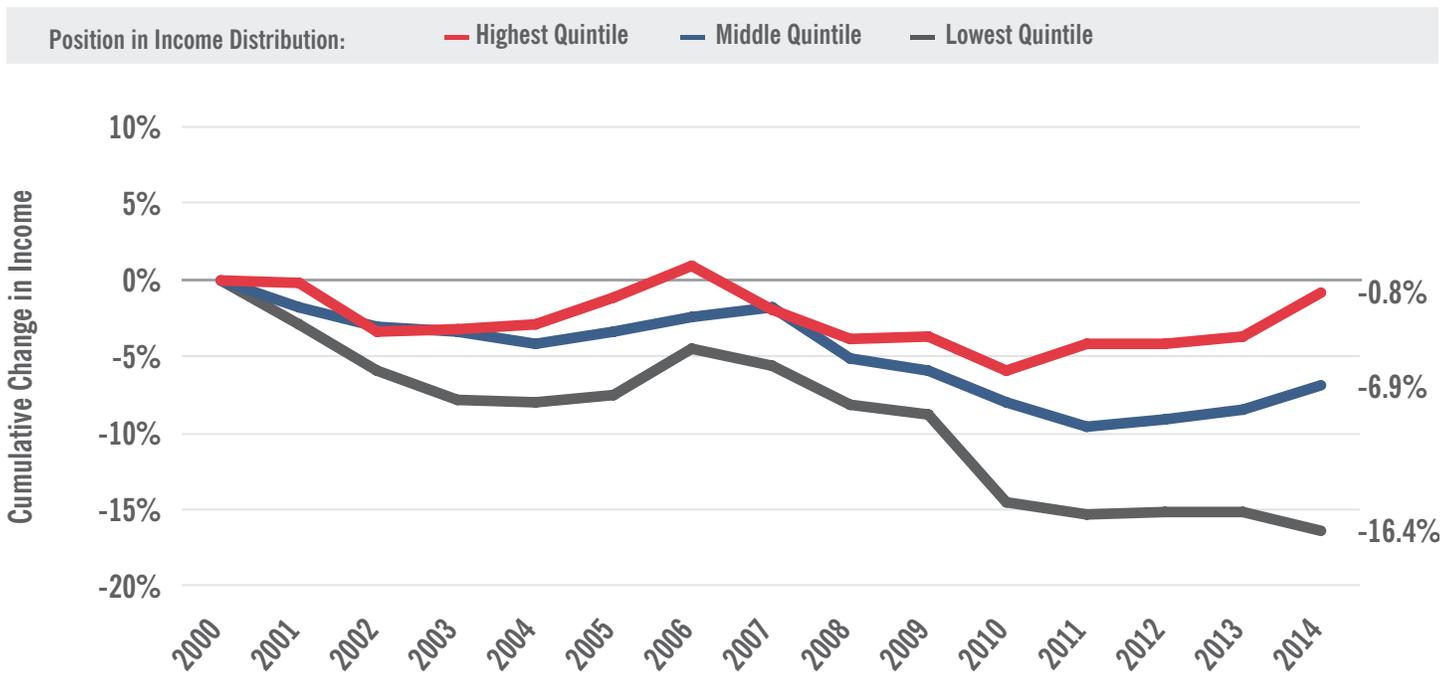
Saving for short-term needs can be just as important as saving for retirement. An emergency fund can serve as crucial protection from unexpected shocks — accidents, health problems, or even car repairs. Without short-term savings, individuals are more likely to rely on debt or tap into their retirement 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.<sup>36</sup>

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.<sup>37</sup>

## 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 Bureau<sup>38</sup>

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.<sup>39</sup> 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.<sup>40, 41</sup> 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.<sup>42</sup>

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.<sup>43</sup> 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).<sup>44</sup> Leakage can occur from both DC plans and IRAs, and can reduce the availability of assets during retirement.<sup>45</sup>

Research suggests that between 1 and 1.5 percent of 401(k)-plan and IRA assets are lost to leakage each year.<sup>46, 47</sup> 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.<sup>48</sup> 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.<sup>49</sup> The bottom line

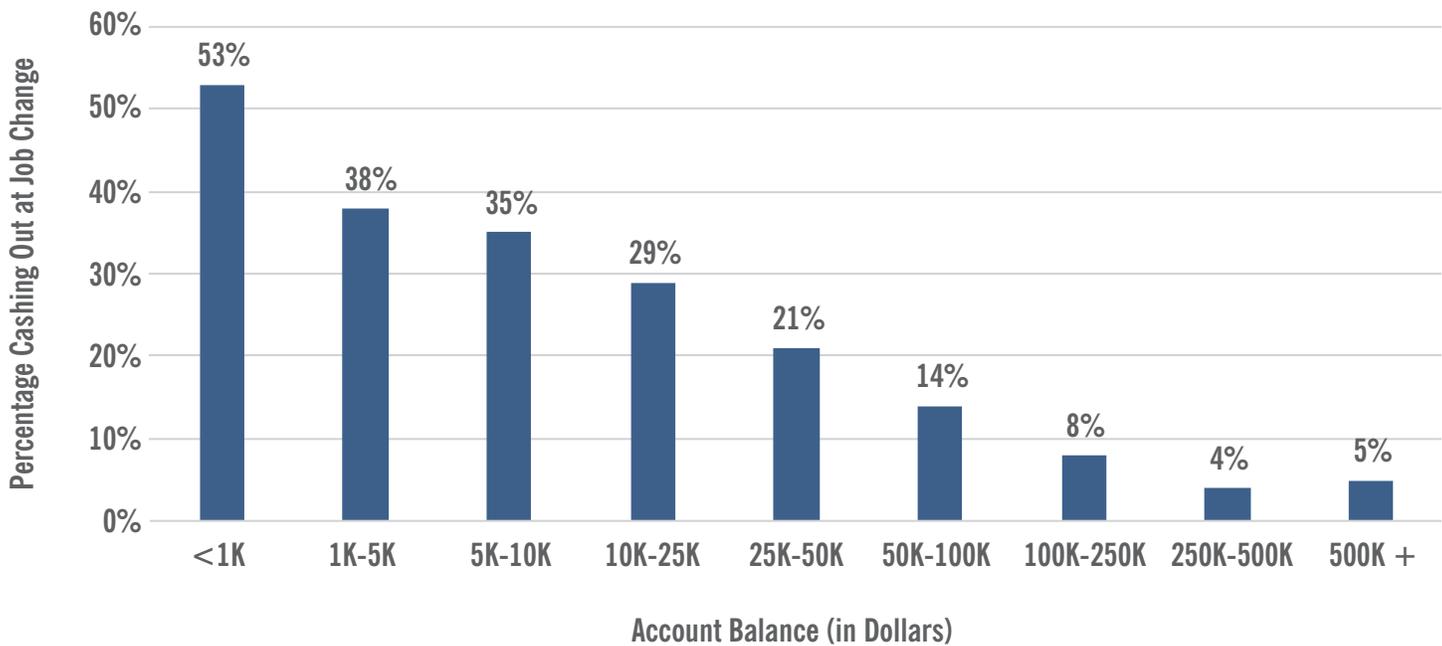
is, of the \$14 trillion of retirement savings, hundreds of billions leak away each year to pre-retirement withdrawals.<sup>50</sup>

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.<sup>51, 52</sup> Participants with balances under \$1,000 may be forced by their former employers to withdraw funds upon termination.<sup>53, 54</sup> 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.<sup>55</sup>

## 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:** Vanguard<sup>56</sup>

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.<sup>57</sup> 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.<sup>58, 59</sup>

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).<sup>60</sup> 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.<sup>61</sup> 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.<sup>62</sup>

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).<sup>63</sup>

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

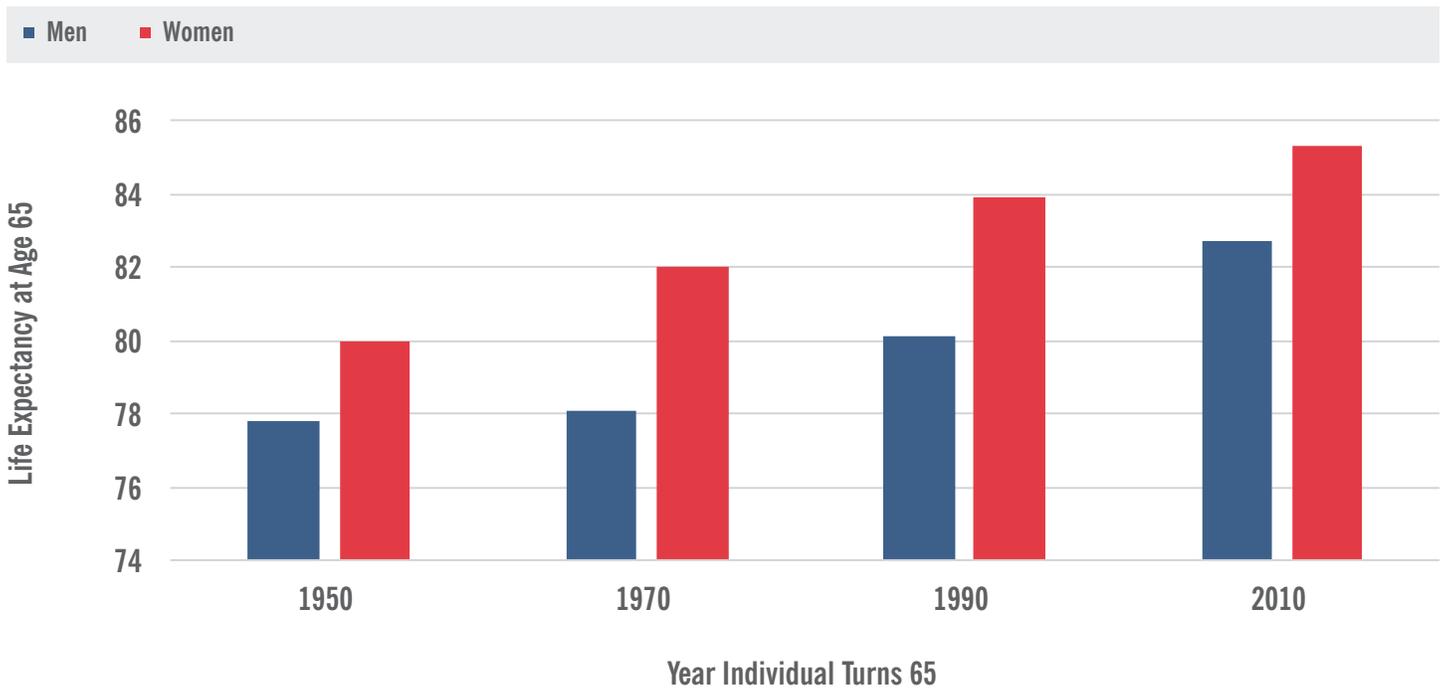
their working years are far more likely to leave the workforce in a strong financial position. Preserving savings over the course of a retirement that could last decades, however, is no small challenge under today's circumstances.

### ***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.<sup>64</sup> 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.



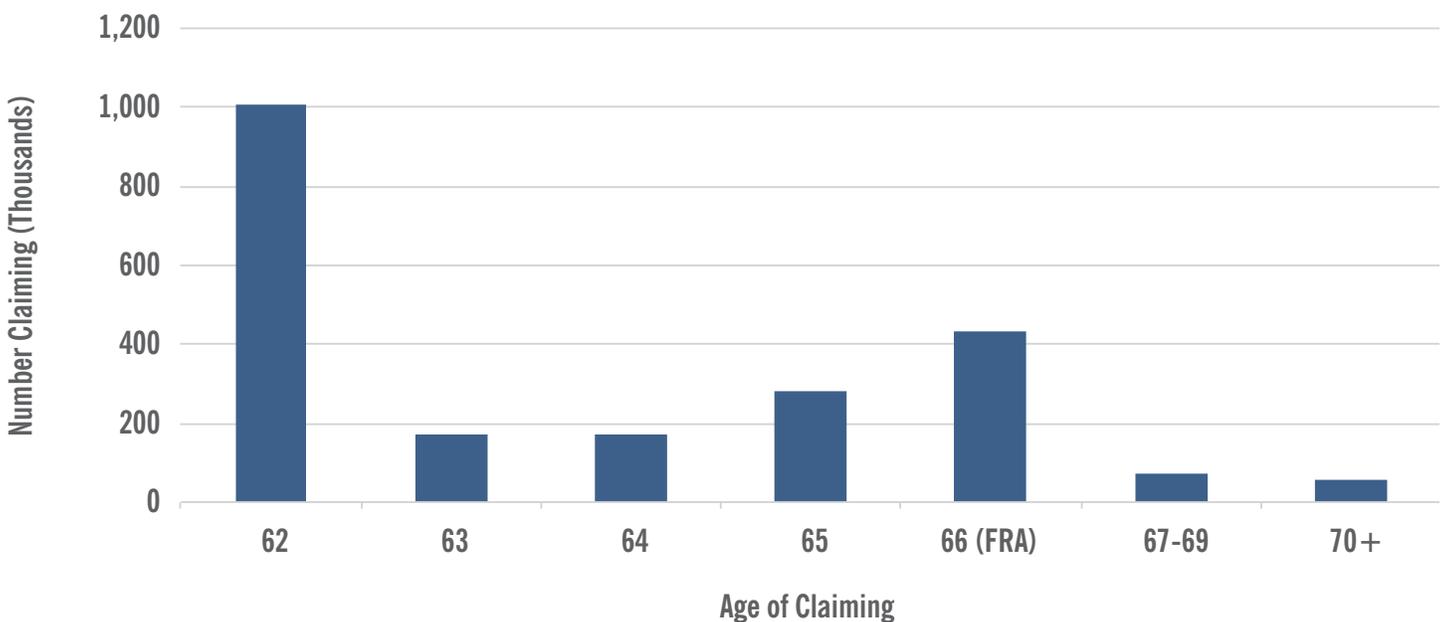
Source: U.S. Centers for Disease Control and Prevention<sup>65</sup>

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.<sup>66, 67</sup> 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.<sup>68</sup> 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<sup>69, 70</sup>

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.<sup>71</sup> 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.<sup>72</sup> 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.<sup>73, 74</sup> 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.<sup>75</sup> 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.<sup>76</sup>

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.<sup>77</sup>

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.<sup>78</sup> 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.<sup>79</sup> 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.<sup>80</sup>

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.<sup>81</sup> 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.<sup>82, 83</sup> 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.<sup>84</sup> 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.<sup>85</sup>

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.<sup>86</sup>

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.

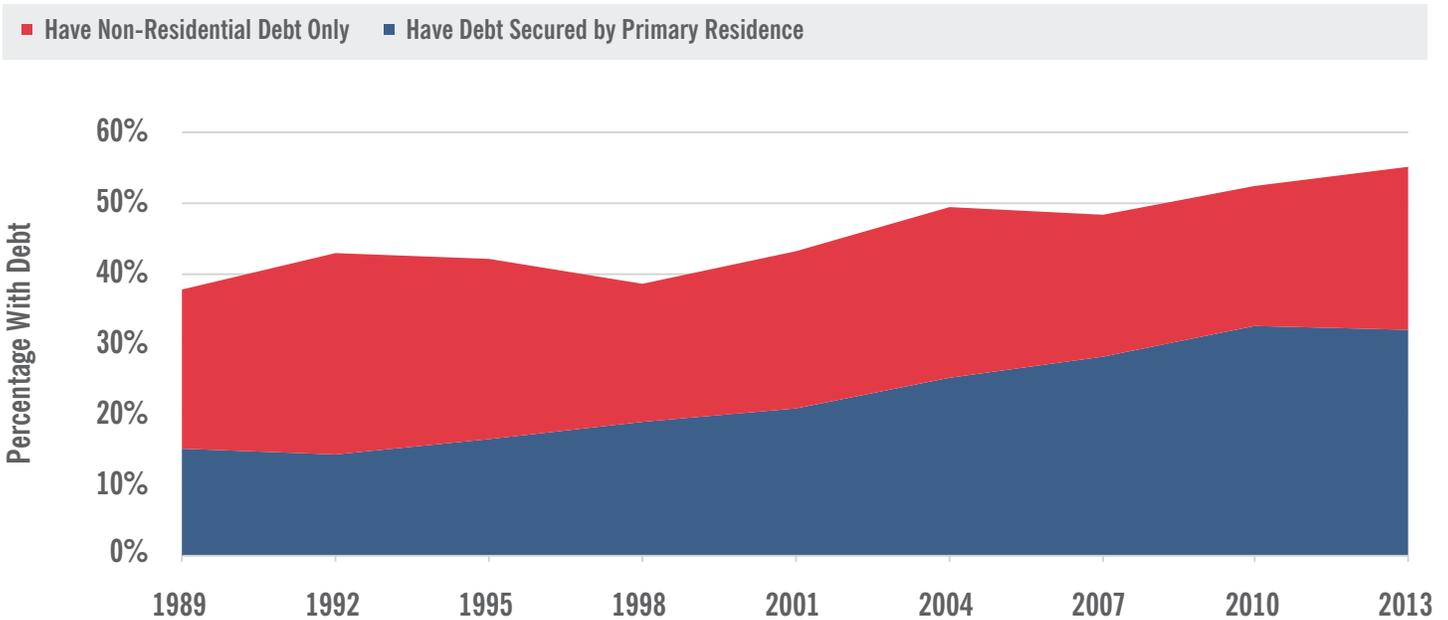
Whereas second mortgages and HELOCs require homeowners to make regular payments, reverse mortgages are different in that they require no mortgage payments until the owner passes away or sells their home. Interest accrues throughout the life of the loan, and most reverse mortgages are federally backed 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.<sup>87</sup> 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.<sup>88, 89</sup>

## 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 Finances<sup>90</sup>

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.<sup>91</sup>

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.<sup>92</sup>

The National Financial Capability Study (NFCS) also demonstrates that Americans lack basic financial capability.<sup>93</sup> 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.<sup>94</sup>

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.<sup>95</sup> 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.<sup>96</sup>

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.<sup>97,98</sup>

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.<sup>99</sup> 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.<sup>100</sup> 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.<sup>101</sup> 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.<sup>102</sup> 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.<sup>103, 104</sup>

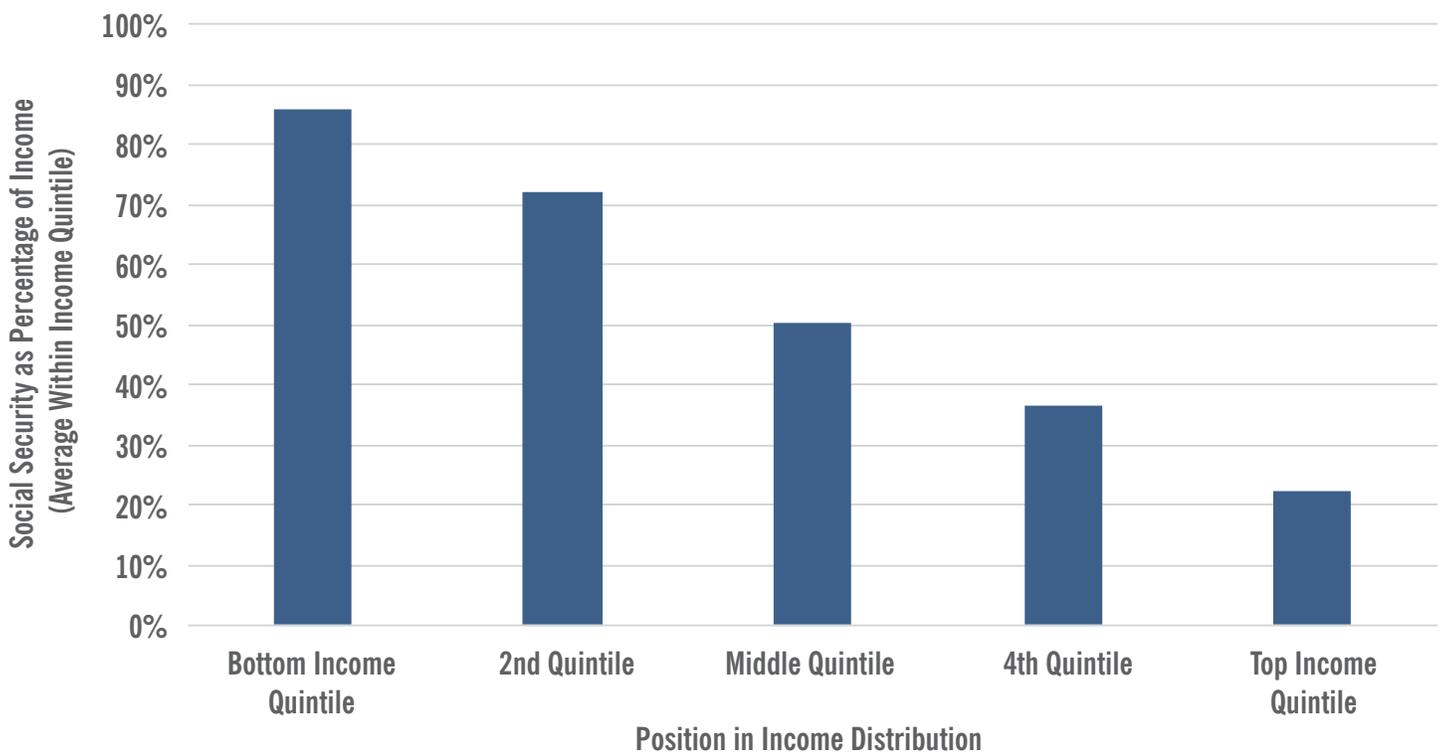
Such expansions, combined with demographic changes, have grown the program substantially over its lifetime. In 2014, 48 million beneficiaries collected \$707 billion in benefits from Social Security's OASI program.<sup>110</sup> The Social Security payroll tax, now at 6.2 percent

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.<sup>111</sup>

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.<sup>112</sup> Despite the critical support that Social Security provides, 10 percent of Americans over the age of 65 still live in poverty.<sup>113</sup> 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.<sup>114</sup>

### 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

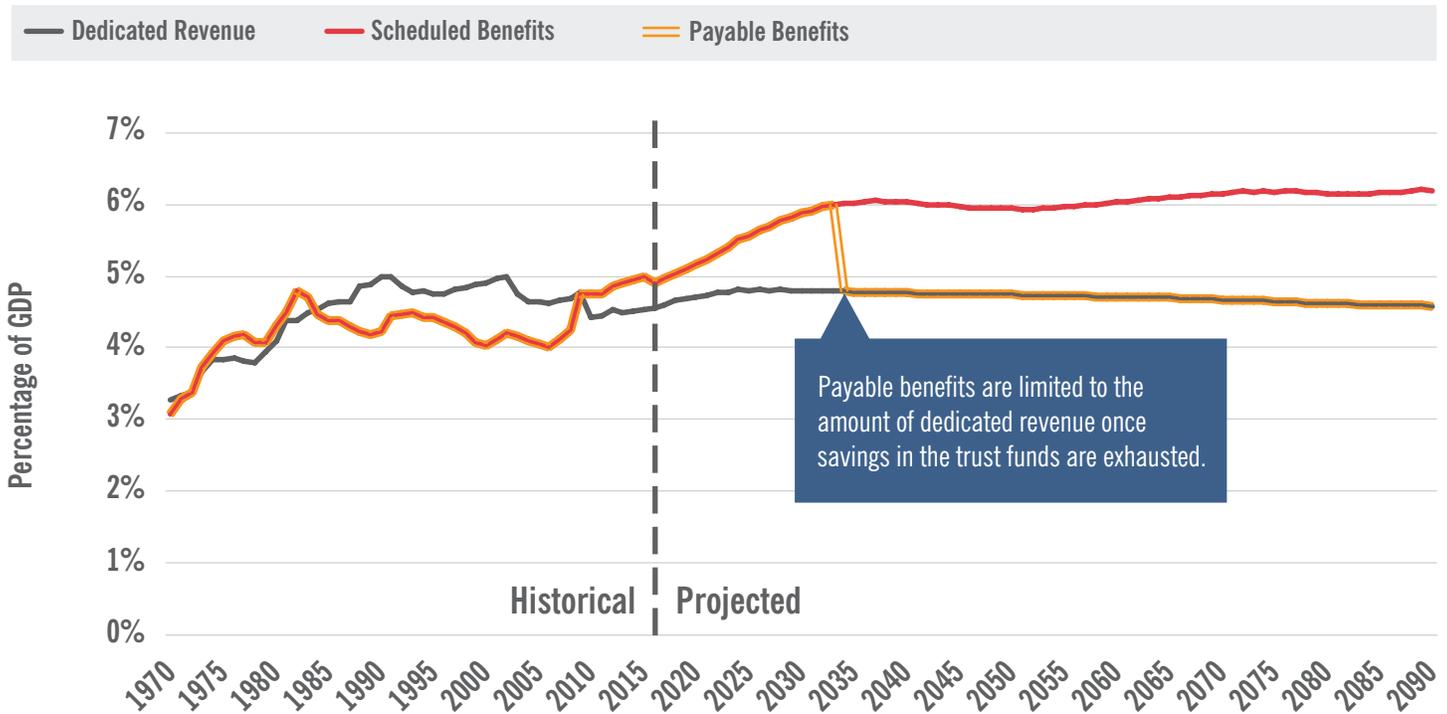
Unfortunately, the Social Security system faces major financing challenges. Today, the program is paying out more in benefits each year than it collects in dedicated revenue.<sup>115, 116</sup> This shortfall is being met by redeeming the Treasury securities that the program has built up in the Social 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).<sup>117</sup> 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.<sup>118</sup> 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.<sup>119, 120, 121, 122, 123</sup>

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.<sup>126</sup> The ratio is projected to drop to just over 2-1 by 2030 as Baby Boomers continue to retire.<sup>127</sup> 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<sup>124, 125</sup>

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.

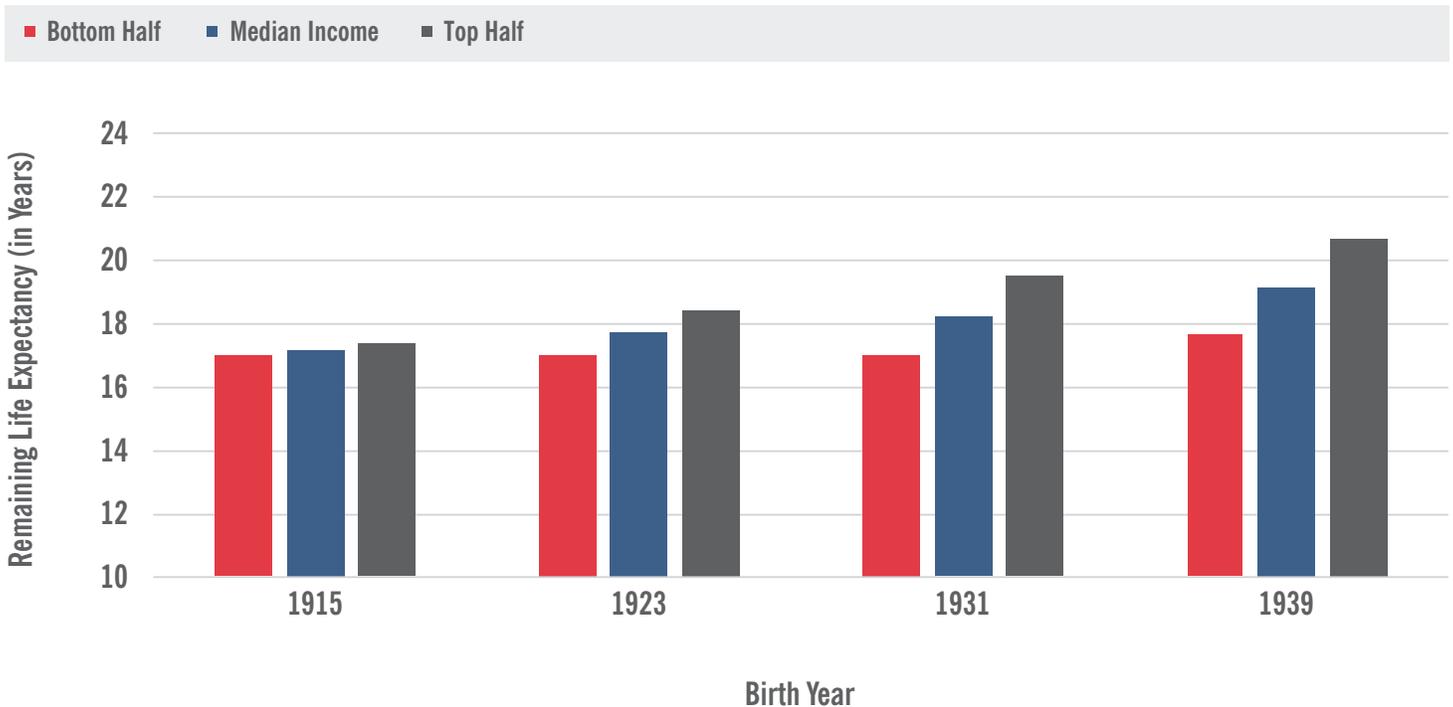
Social Security benefits are linked to earnings. After many years of work, however, the program provides less incentive to stay in the workforce, because workers still owe full payroll taxes but receive little or no additional benefits. The lack of additional benefits for working more years encourages 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.<sup>128</sup> 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:** Goda, Shoven, and Slavov<sup>30</sup>

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.<sup>129</sup>

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.<sup>131, 132</sup> 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.<sup>133</sup> 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.<sup>105</sup>

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.<sup>106</sup> 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.<sup>107</sup> 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.<sup>108</sup> Our recommendations focus mostly on the OASI program. A separate BPC [working group](#) made recommendations pertaining to the DI program in 2015.<sup>109</sup>

# *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.<sup>134</sup> 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.<sup>135</sup> Other bills would encourage employers to offer workplace retirement plans or encourage employers with existing plans to adopt automatic enrollment.<sup>136</sup>

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.<sup>137</sup> (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.<sup>138, 139</sup>

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.<sup>140, 141</sup>

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.<sup>142</sup> 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 Harbor<sup>143</sup>**

	<b>Current Automatic-Enrollment Safe Harbor</b>	<b>New Enhanced Automatic-Enrollment Safe Harbor</b>
<b>Automatic Enrollment into Plan</b>	Required for newly eligible employees.	Required for both newly eligible participants and already eligible non-participating employees (once every three years).
<b>Employer Contributions</b>	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.
<b>Initial Deferral Rate</b>	At least 3 percent and no more than 10 percent of pay.	Same.
<b>Automatic Escalation</b>	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).
<b>Default Investments</b>	Must choose a default investment. Liability for investment losses limited by selecting a QDIA, such as life-cycle or balanced funds.	Same.
<b>Contribution Limits</b>	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:</i> full 402(g) limits (\$18,000 plus a \$6,000 catch-up for participants over age 50 in 2016).  <i>No contribution:</i> 40 percent of 402(g) limits (\$7,200 plus a \$2,400 catch-up for participants over age 50 in 2016).  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.<sup>144</sup> 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.<sup>145</sup> 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.<sup>146</sup>

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.

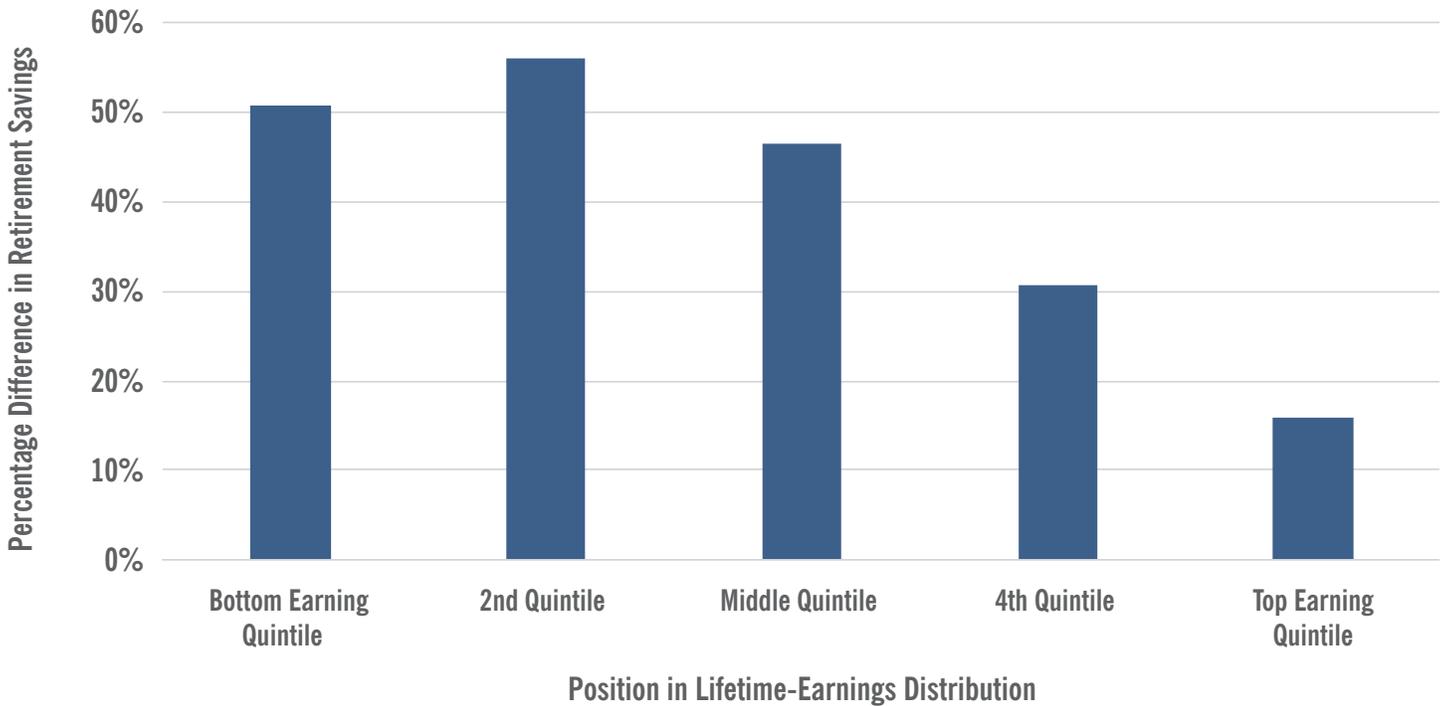
We recommend a nationwide minimum-coverage standard that would expand access to workplace retirement savings in a manner that would be less burdensome for employers. The standard would take effect in 2020, after the simpler alternatives for employers (Retirement Security Plans and an enhanced myRA) have 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.<sup>147</sup>

## 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

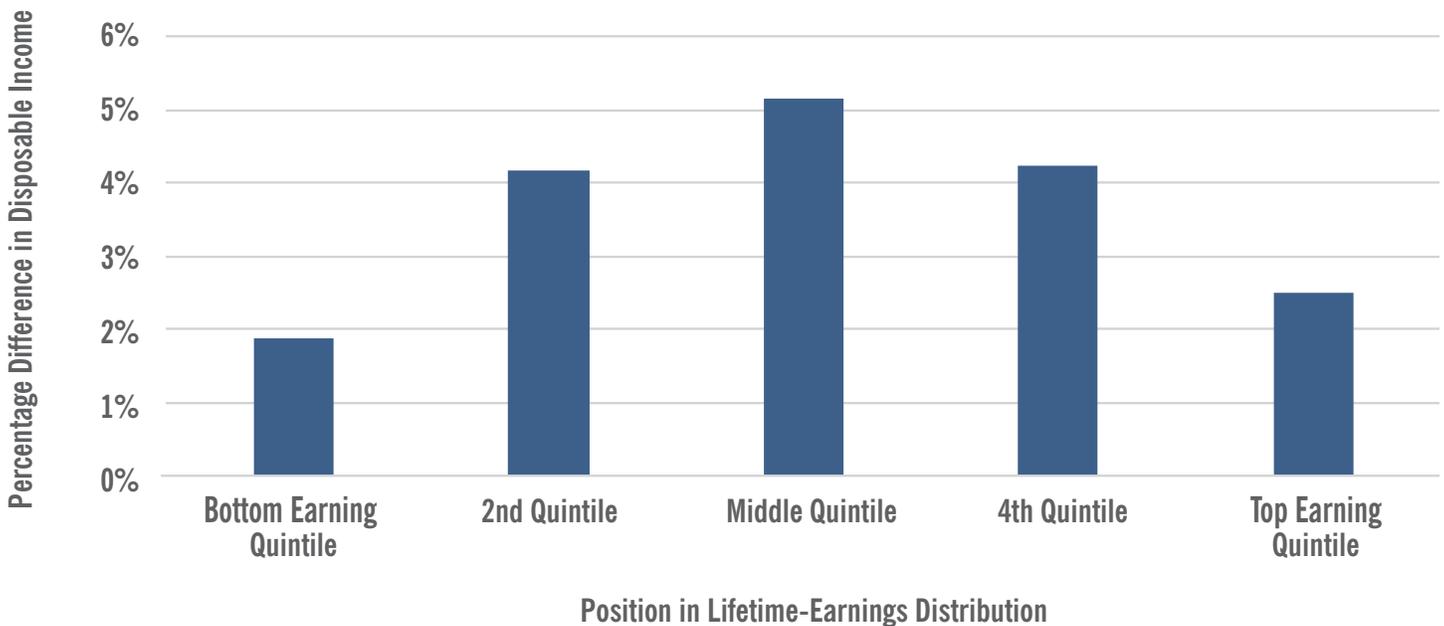
Increased retirement savings would translate into higher incomes during retirement. Per-capita net cash income — which includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums — is projected to increase 5.1 percent by 2065 for older Americans who had been middle earners.<sup>148</sup> 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.<sup>149</sup> 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.<sup>150</sup>

## 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.<sup>151</sup> 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.<sup>152</sup> 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.<sup>153</sup>

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.<sup>155</sup> 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.<sup>156</sup> 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.<sup>157</sup> 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.<sup>158</sup> 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.<sup>159, 160</sup> 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.<sup>161</sup>

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.

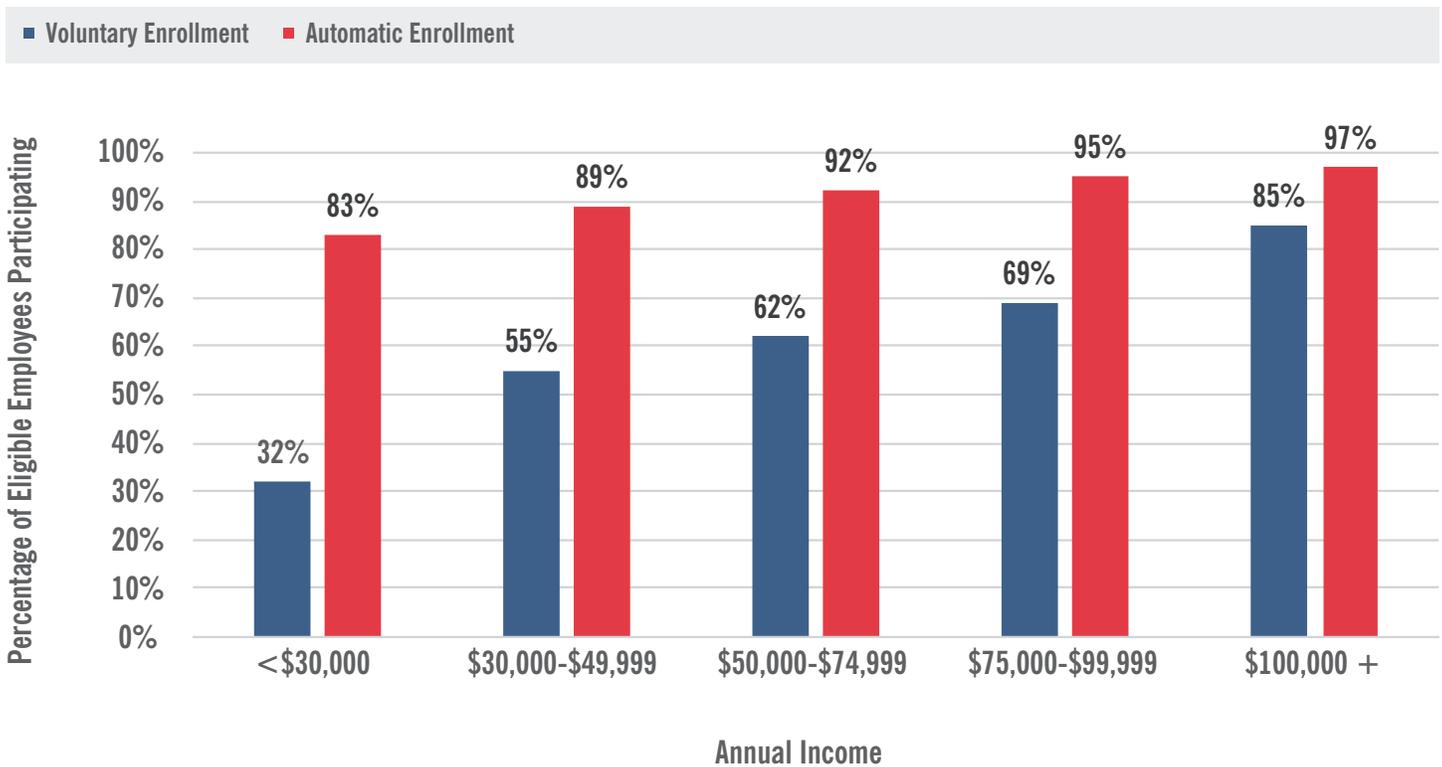
We recommend that Congress direct the Congressional Budget Office and the Joint Committee on Taxation to estimate retirement-related tax expenditures using a long-term approach based on the discounted net present value of the projected revenue changes. Better cost estimates would help lawmakers appropriately 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.<sup>162</sup>

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: Vanguard<sup>164</sup>

**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).<sup>163</sup>

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.<sup>165</sup> 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.<sup>166</sup> 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).<sup>167</sup>

### **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.<sup>168, 169</sup> 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.<sup>170</sup>

### **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.<sup>171</sup> 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.<sup>172</sup>

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.<sup>173, 174</sup> 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.<sup>175, 176</sup>

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.<sup>177</sup> 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.<sup>178</sup> 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.<sup>179</sup> 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.<sup>180</sup> 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.<sup>181</sup>

Policymakers 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.<sup>185</sup> 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.<sup>186</sup> 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.<sup>187</sup> 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.<sup>188</sup> 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.<sup>189</sup> 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.<sup>190</sup>

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.<sup>191</sup> 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.<sup>192</sup> 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**

	<b>Tax-Deferred DC Plans<sup>1</sup></b>	<b>Traditional IRAs</b>	<b>Proposed Rules</b>
<b>Pre-Retirement Withdrawals</b>	<p>Only allowed for reasons that the plan may specify (so long as they constitute an “immediate and heavy financial need”).<sup>2</sup> The IRS has a list of circumstances that automatically qualify as immediate and heavy:</p> <ol style="list-style-type: none"> <li>1. Certain medical expenses</li> <li>2. Tuition and related educational fees</li> <li>3. Burial or funeral expenses</li> <li>4. Purchase of a principal residence</li> <li>5. Payments to prevent eviction from or foreclosure on a principal residence</li> <li>6. Certain expenses for the repair of damage to a principal residence</li> </ol>	Always allowed.	<p>Follow current DC-plan regulations, <i>with added exemptions for early withdrawals in the cases of involuntary unemployment and health/disability-related expenses.</i></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>
<b>Taxation of Withdrawals</b>	<p>Individuals must pay income tax on withdrawals and an additional 10-percent early-distribution tax.<sup>3</sup> The penalty is waived in the case of the death or total and permanent disability of the participant, as well as other limited exceptions.</p>	<p>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.</p>	<p>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.</p>
<b>Suspension of Contributions</b>	<p>Individuals cannot make contributions to their plan in the six months following a hardship withdrawal.</p>	No suspension of contributions.	Follow current IRA regulation.

<sup>1</sup>Tax-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.

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

<sup>3</sup>A 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 those

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.<sup>193</sup>

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.<sup>194</sup> 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.<sup>195</sup> 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.<sup>196</sup>

The IRS has also clarified that plan sponsors may include longevity annuities as part of a target-date fund.<sup>197, 198</sup> 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.<sup>199</sup> 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.<sup>200</sup> (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;<sup>201</sup>
- 2) Products that guarantee a lifetime stream of withdrawals from an account balance to which the participant has continued access;<sup>202</sup> 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.<sup>203</sup> 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.<sup>204</sup>

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.<sup>205</sup>

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.<sup>206</sup>

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.<sup>207</sup> 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.<sup>208</sup> 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.<sup>209</sup>

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.<sup>210</sup> Under the HECM program, borrowers can receive payments in a lump sum, regular installments, or a combination of the two.<sup>211</sup> 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.<sup>212</sup> 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.<sup>213</sup>

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.<sup>214</sup> As a result, the HECM portfolio is currently valued at \$7.9 billion, up from -\$1.2 billion in 2014.<sup>215</sup>

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.<sup>216</sup> 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.<sup>217</sup> 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.<sup>218, 219</sup>

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.<sup>220</sup> 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.<sup>221</sup> 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.<sup>222</sup> 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.<sup>223, 224, 225</sup> 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.<sup>226, 227</sup> 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.<sup>228</sup>

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.<sup>229</sup> 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).<sup>230</sup>

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.<sup>231</sup> 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.<sup>232</sup>

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.<sup>233</sup> 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.<sup>234</sup>

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.<sup>235, 236</sup> 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.<sup>237</sup> Twelve percent stated that they refuse to check their bank-account balances out of nervousness.<sup>238</sup> 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.<sup>239</sup> 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.<sup>240</sup>

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.<sup>241, 242</sup> 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.<sup>243</sup>

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.<sup>246</sup> 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.<sup>247</sup> 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.<sup>248</sup> 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.<sup>244</sup>

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).<sup>245</sup>

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.<sup>249</sup> The withholding occurs at a rate of \$1 for every \$2 that the worker earns above that threshold.<sup>250</sup> 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.<sup>251</sup> Moreover, for one-third of these beneficiaries, monthly Social Security income was less than \$1,050.<sup>252</sup>

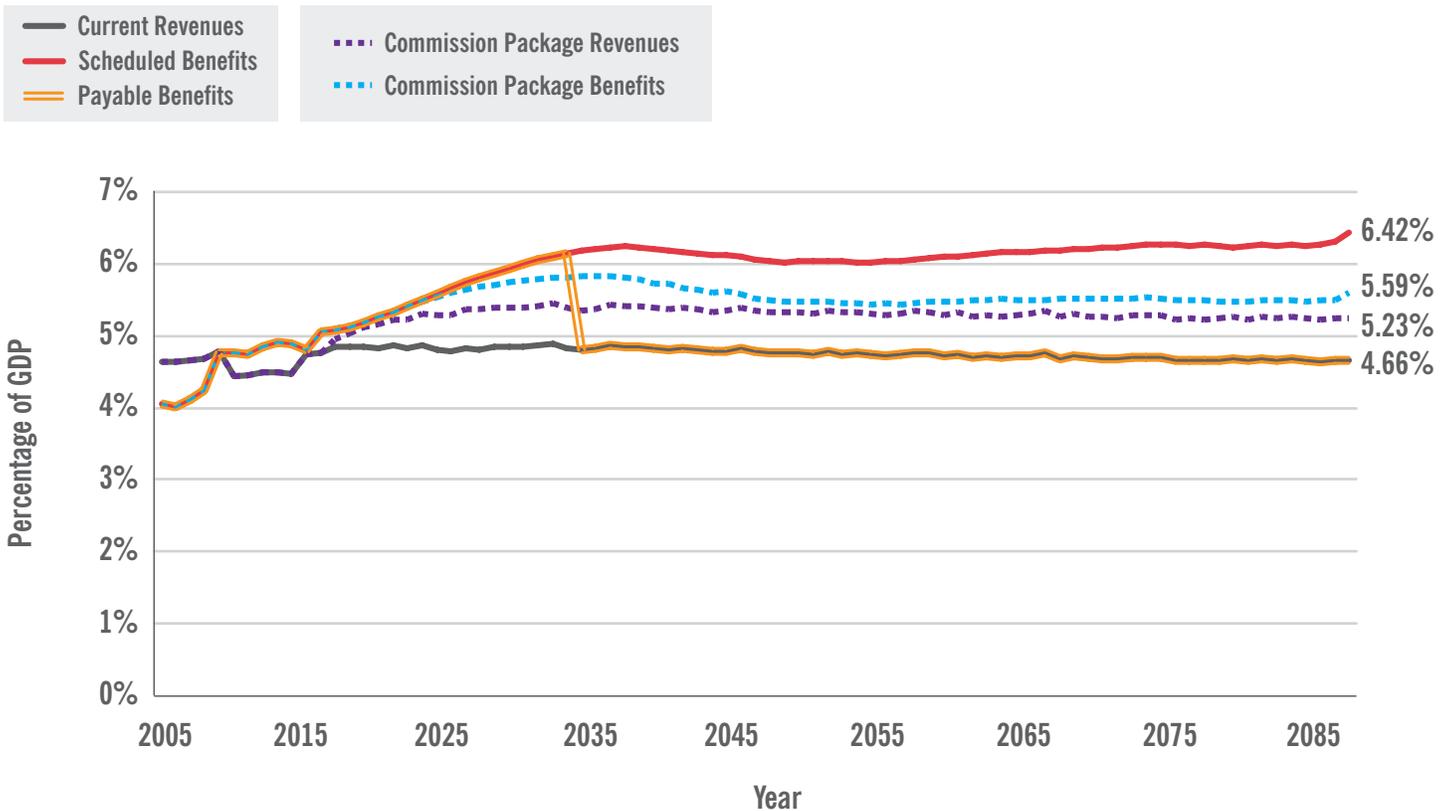
Social Security also provides weak marginal work incentives toward the end of an individual’s working life. As workers near retirement, they continue to pay taxes on earnings to support the program, yet often accrue little or no additional benefits as a result. This sends the wrong message to workers. 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.<sup>253</sup> **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?

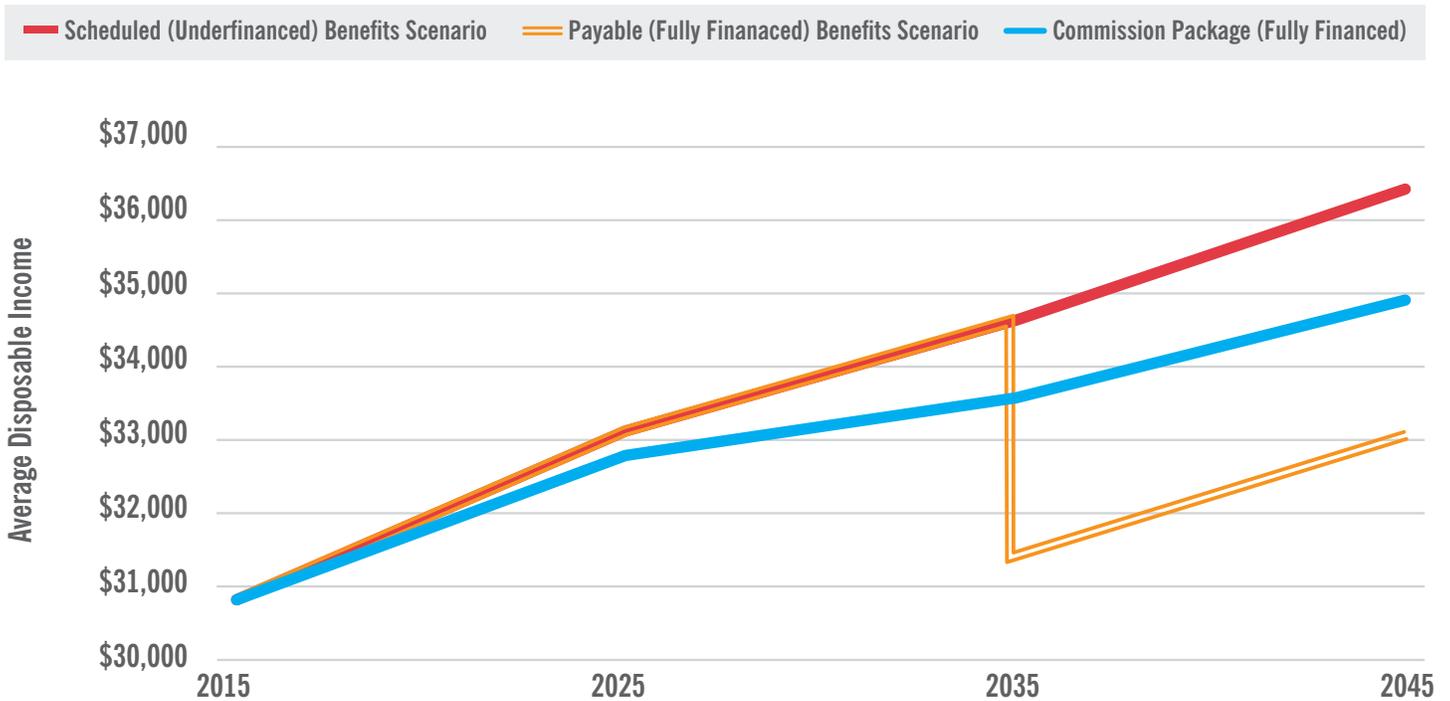
Under current law, if the Social Security trust funds are empty, Social Security cannot spend more on benefits than it collects in program revenues. The OASI Trust Fund is projected to be depleted in 2035.<sup>254</sup>

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.<sup>255</sup>

## 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

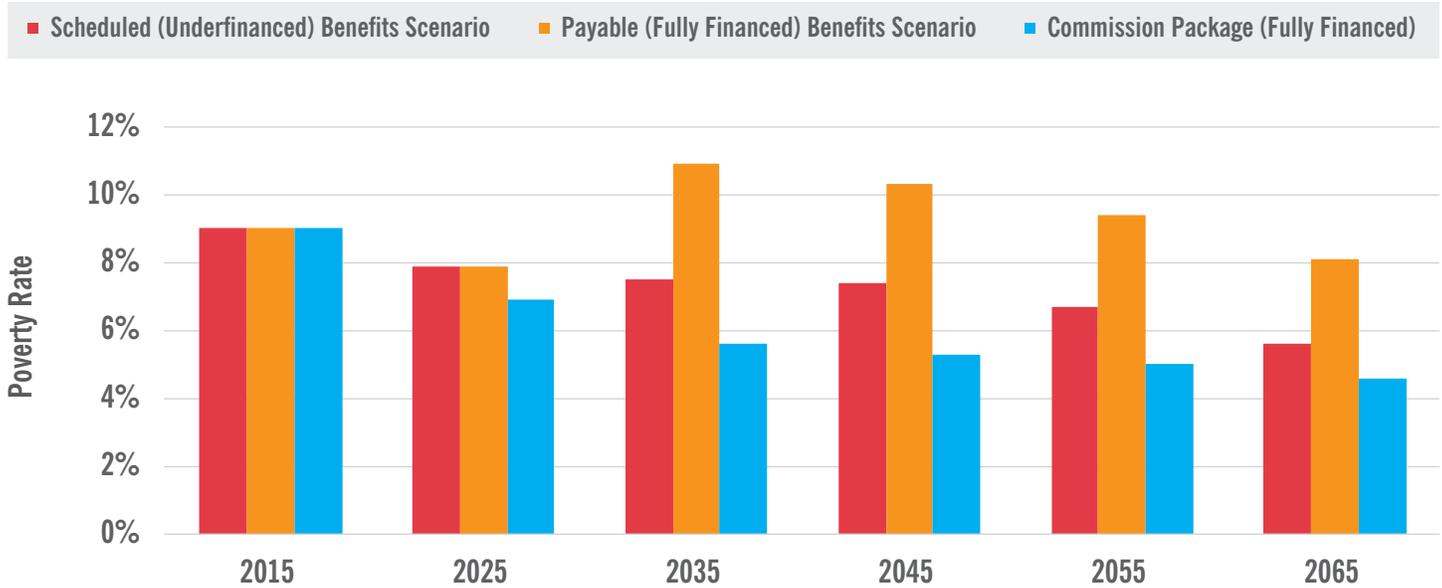
Importantly, we call for a gradual phase-in of these reforms, as shown in **Figure 21**, to provide time for future beneficiaries to adjust their plans accordingly. This would result in average benefit levels that initially track closer to scheduled levels and move gradually closer to a mid-point between 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).<sup>256</sup> 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

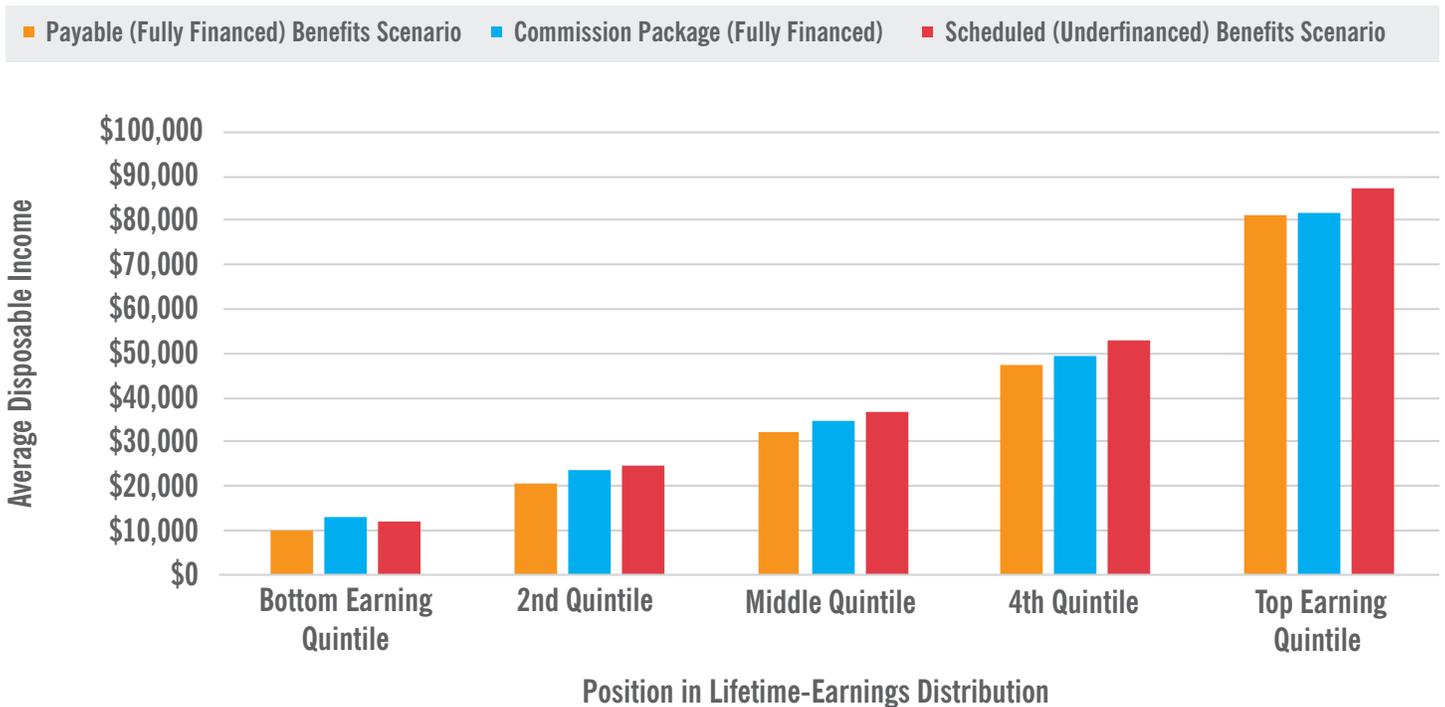
scheduled-benefits and payable-benefits scenarios.

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.

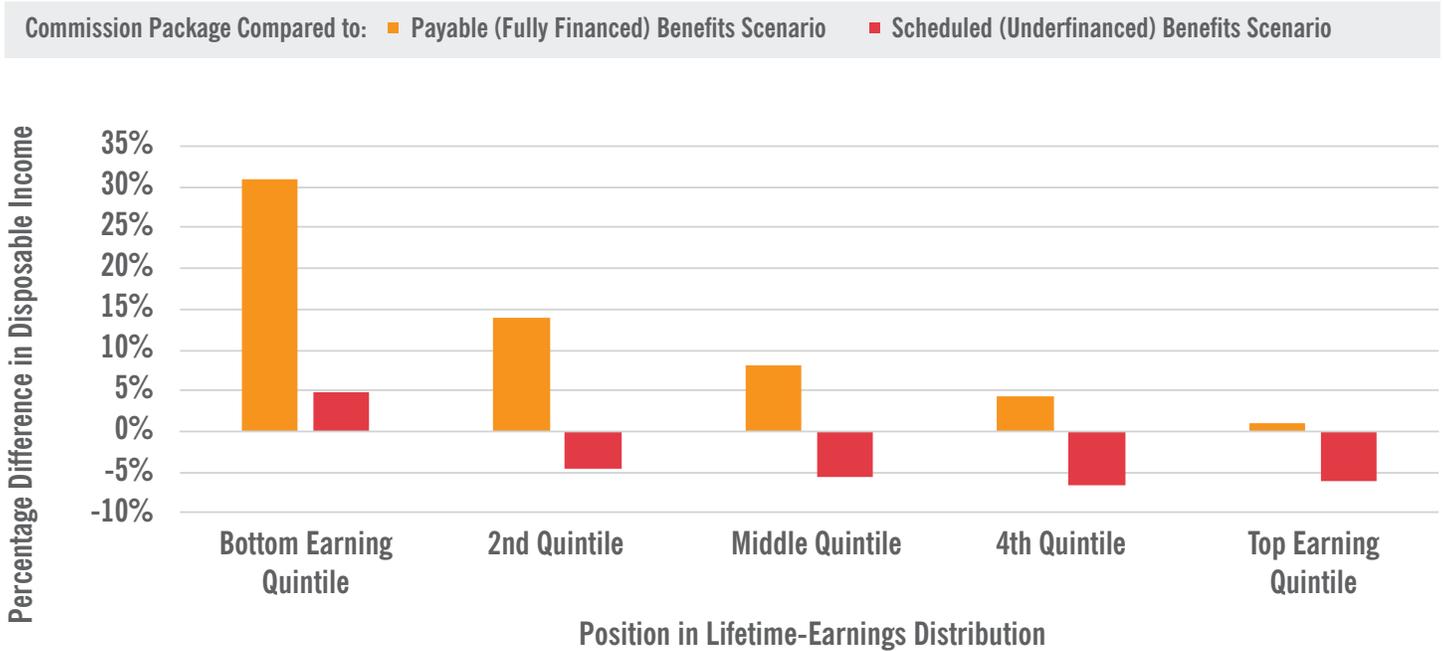


**Note:** Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition 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										
	Single Individual					Two-Earner Couple (equal earnings)				
Work Years	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										
	Single Individual					Two-Earner Couple (equal earnings)				
Work Years	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%	120%	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.<sup>257</sup> 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.<sup>258</sup> 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.<sup>259</sup> 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.<sup>260</sup> 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)**.<sup>261</sup>

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.<sup>262</sup> 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.<sup>263</sup> 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).<sup>264</sup> 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.

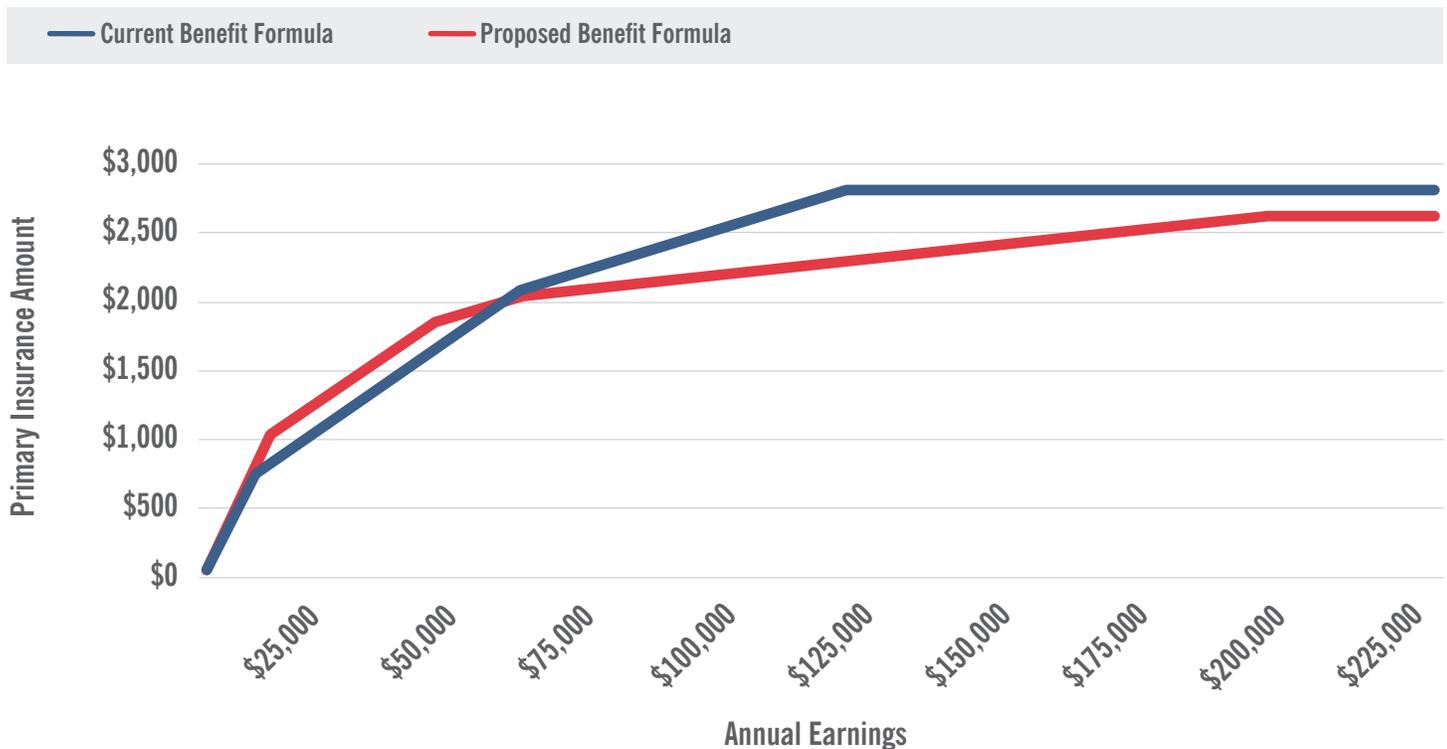
Figure 26. Current-Law and Proposed Bend Points and PIA Factors

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.

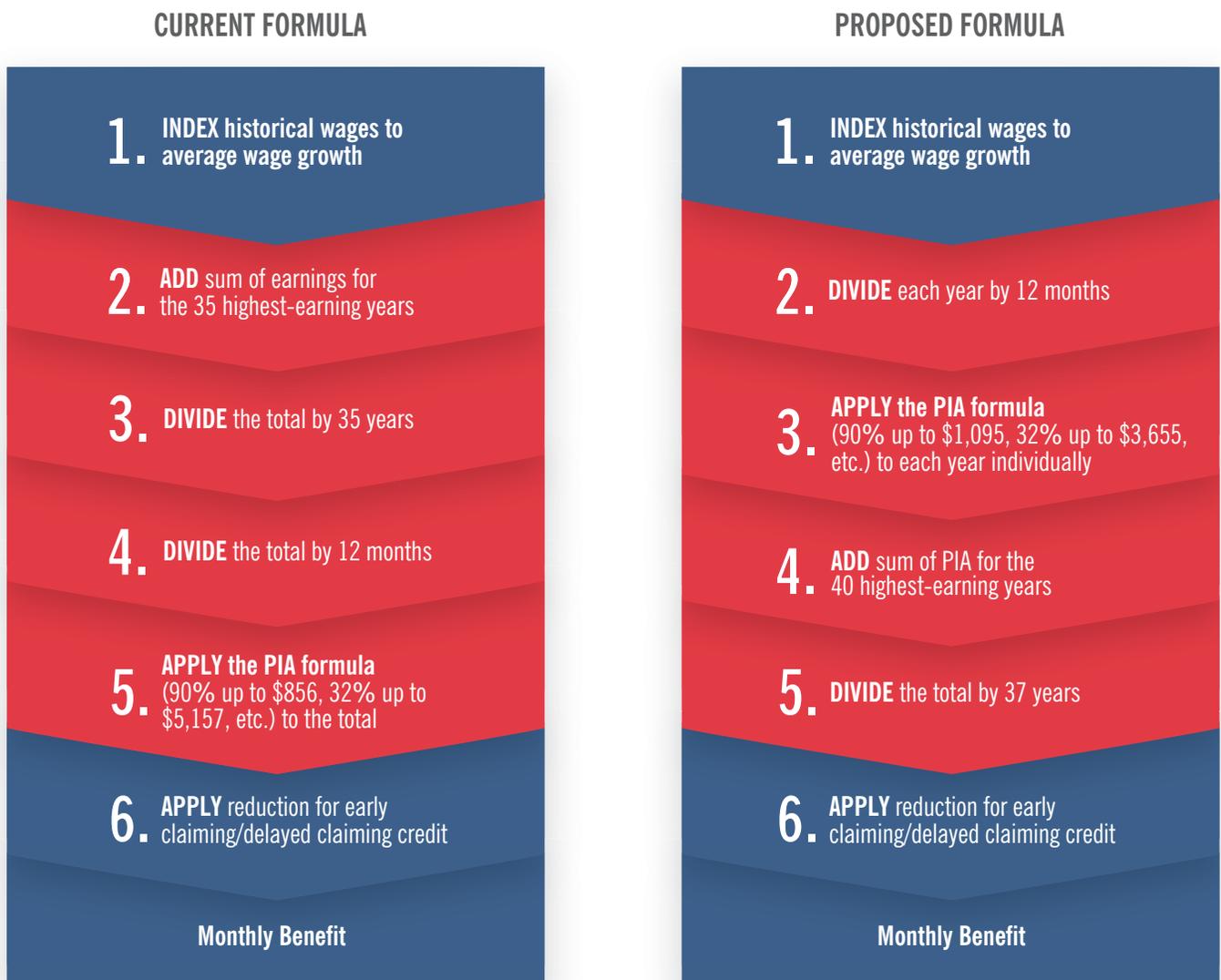
A related issue is that Social Security provides limited work incentives to nearly all workers as they reach older ages. These problematic work incentives are mainly caused by two aspects of the current benefit formula. First, the formula only counts a worker’s 35 highest-earning years. Thus, once an 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.<sup>265</sup> 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.<sup>266</sup> 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.<sup>267</sup> 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.<sup>268</sup> 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.

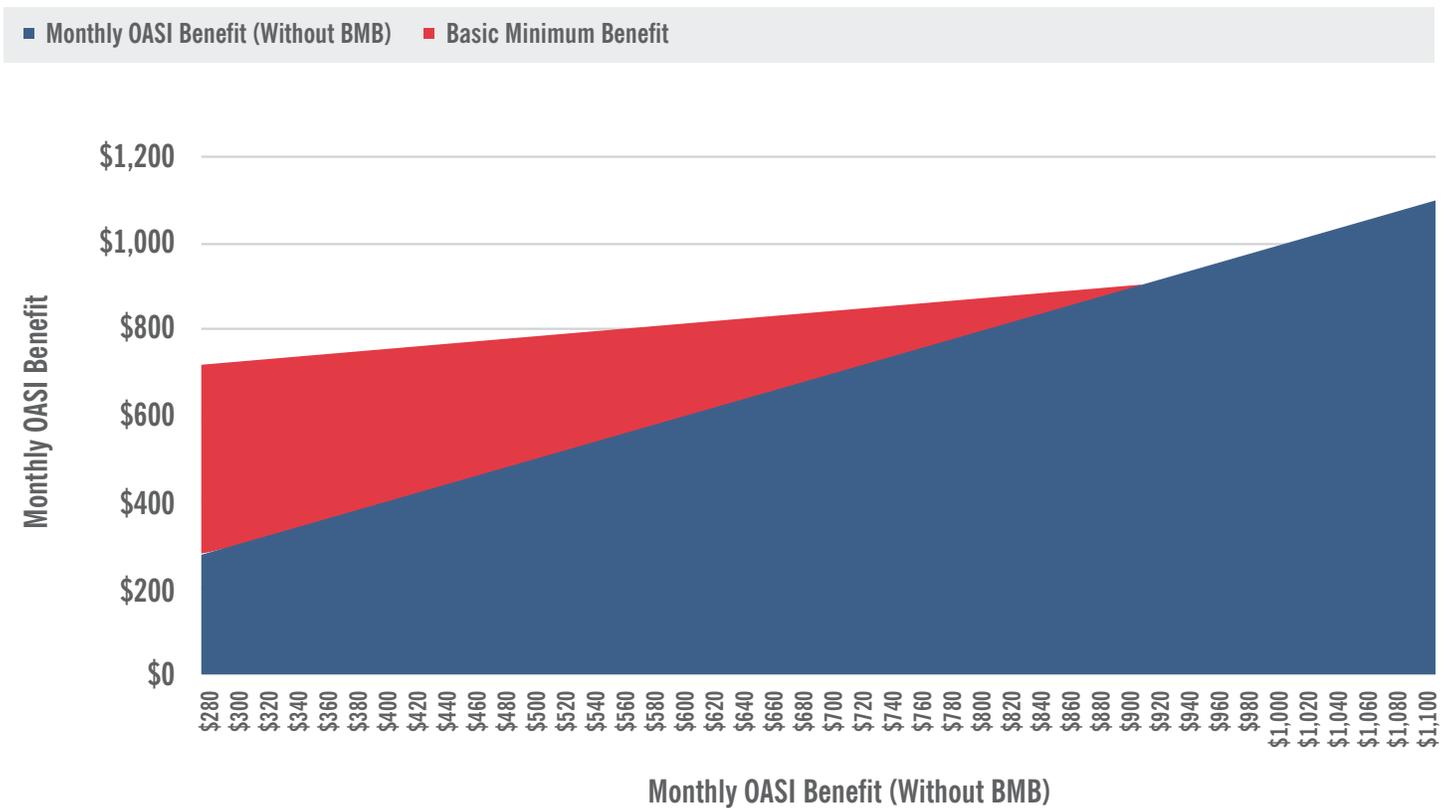
The average annual OASI benefit for current beneficiaries who are in the bottom quintile of the lifetime-earnings distribution is less than \$9,100 — significantly below the federal poverty level.<sup>269</sup> For these individuals, most of whom are also among the least able to accumulate significant 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.<sup>270</sup> 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.<sup>271</sup> 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.<sup>272</sup>

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.<sup>273</sup> 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.<sup>274</sup>

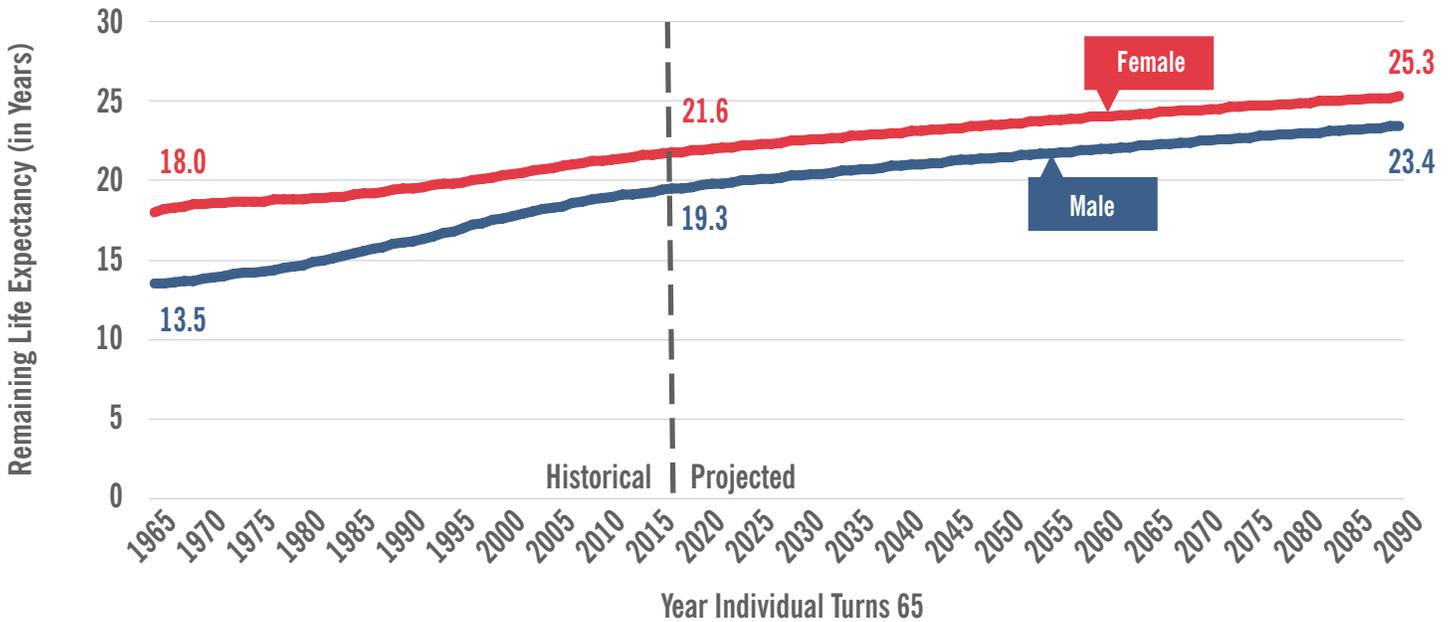
The Social Security Administration administers SSI, but the program is funded with general revenues, not by the payroll and self-employment taxes that finance Social Security. Participation among older Americans in SSI increases by age, as retirees experience drops in income, exhaust assets, and thus 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.<sup>275</sup> 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 Administration<sup>276</sup>

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.<sup>277</sup> 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.<sup>278</sup> 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).<sup>279</sup>

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.<sup>280</sup> 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.<sup>281</sup> 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.<sup>282</sup>

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.<sup>283</sup> 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.<sup>284</sup> 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.<sup>285, 286</sup> 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.<sup>287, 288</sup>

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.<sup>289</sup> 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.<sup>290</sup> 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.<sup>291</sup>

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.<sup>292, 293</sup>

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.<sup>294</sup> 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.<sup>295</sup>

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.<sup>296</sup> The chief actuary estimates that the new taxable maximum would cover approximately 85.6 percent of total national earnings in 2020.<sup>297</sup>

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.<sup>298, 299</sup> 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.<sup>300</sup> 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.<sup>301</sup>

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.<sup>302</sup>

### **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.<sup>303</sup> 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.<sup>304</sup>

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.<sup>305</sup>

## 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*

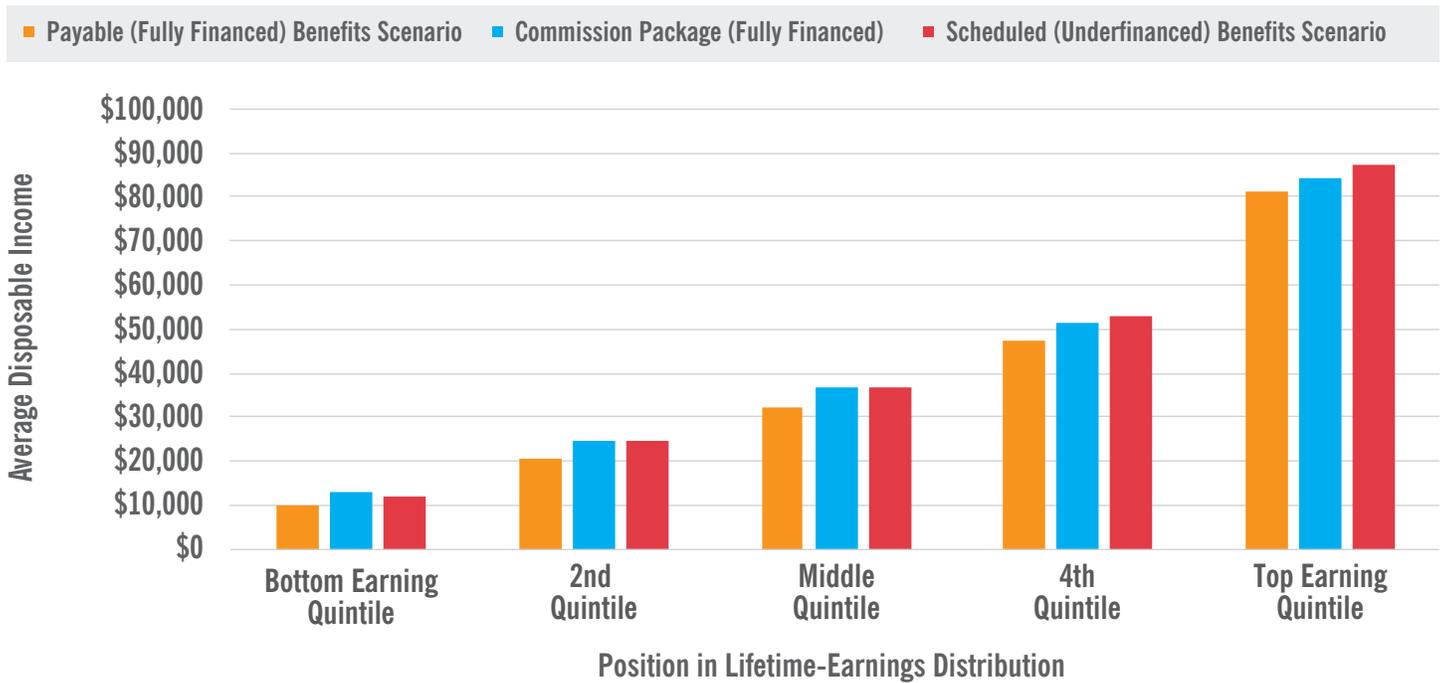


Our recommendations on Social Security, pensions, and other savings complement one another in a variety of ways. Greater access to workplace retirement savings plans, and less pre-retirement leakage from those plans, would especially benefit the middle class. Reforms to Social Security would secure this 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.

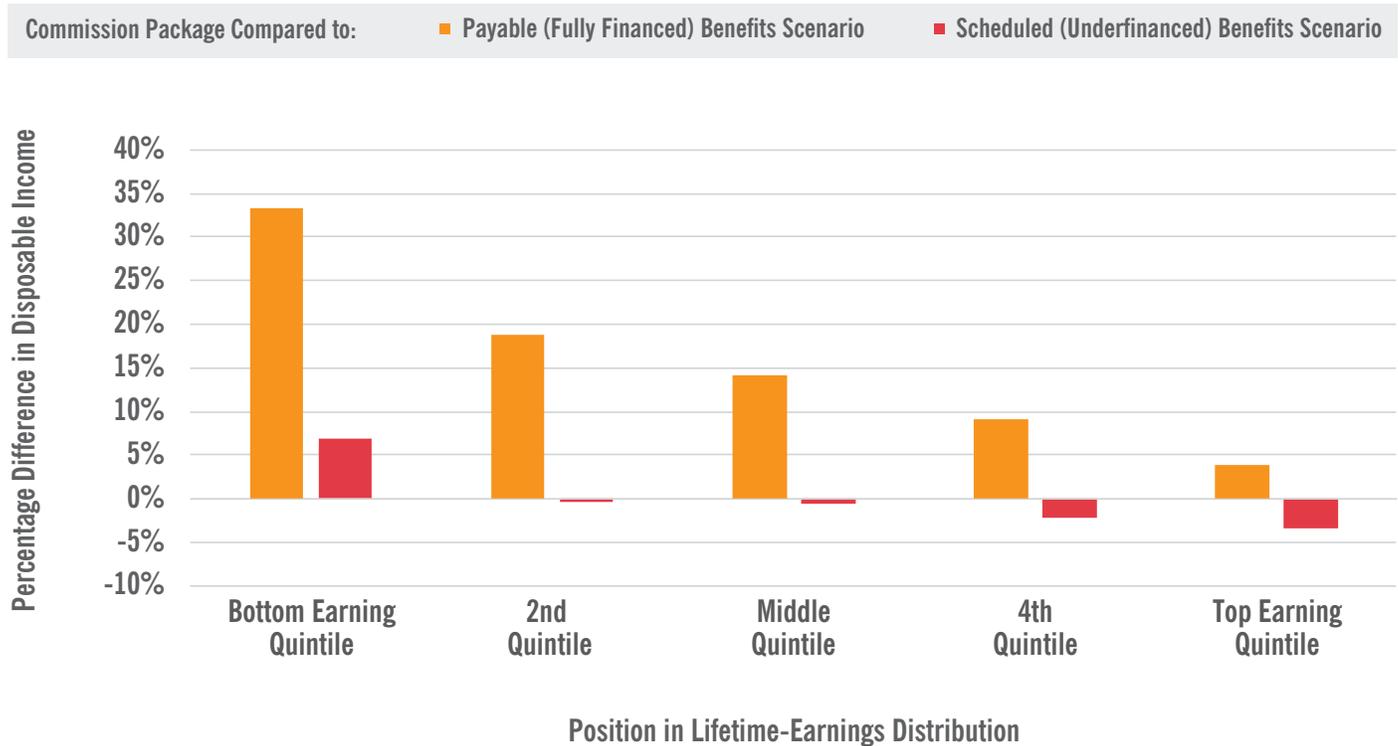
**Source:** The Urban Institute - DYNASIM3

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
<b>Employer Contributions</b>	Not allowed	Allowed, count toward contribution limit
<b>Automatic Enrollment</b>	Not allowed	Allowed at a default contribution rate of 2-6 percent of pay
<b>Contribution Limit</b>	IRA limit (\$5,500)	IRA limit (\$5,500)
<b>Account Size Limit</b>	\$15,000	\$15,000
<b>Investment Option</b>	Treasury debt	Treasury debt
<b>Administration &amp; Oversight</b>	Treasury Department	Treasury Department
<b>Rollover Process (once account balance limit reached)</b>	Not yet determined	Propose criteria by which trustees would select service providers for auto-rollover; service providers must be willing to serve as fiduciaries
<b>Tax Treatment</b>	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.<sup>306</sup>
- **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).<sup>307</sup>

- **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.<sup>308</sup>

# 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.<sup>309</sup>

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.<sup>310</sup>

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.<sup>311</sup>
- **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.<sup>312</sup> 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.<sup>313</sup> 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.<sup>314</sup> 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.<sup>315</sup> 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).<sup>316</sup> 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.<sup>317</sup>

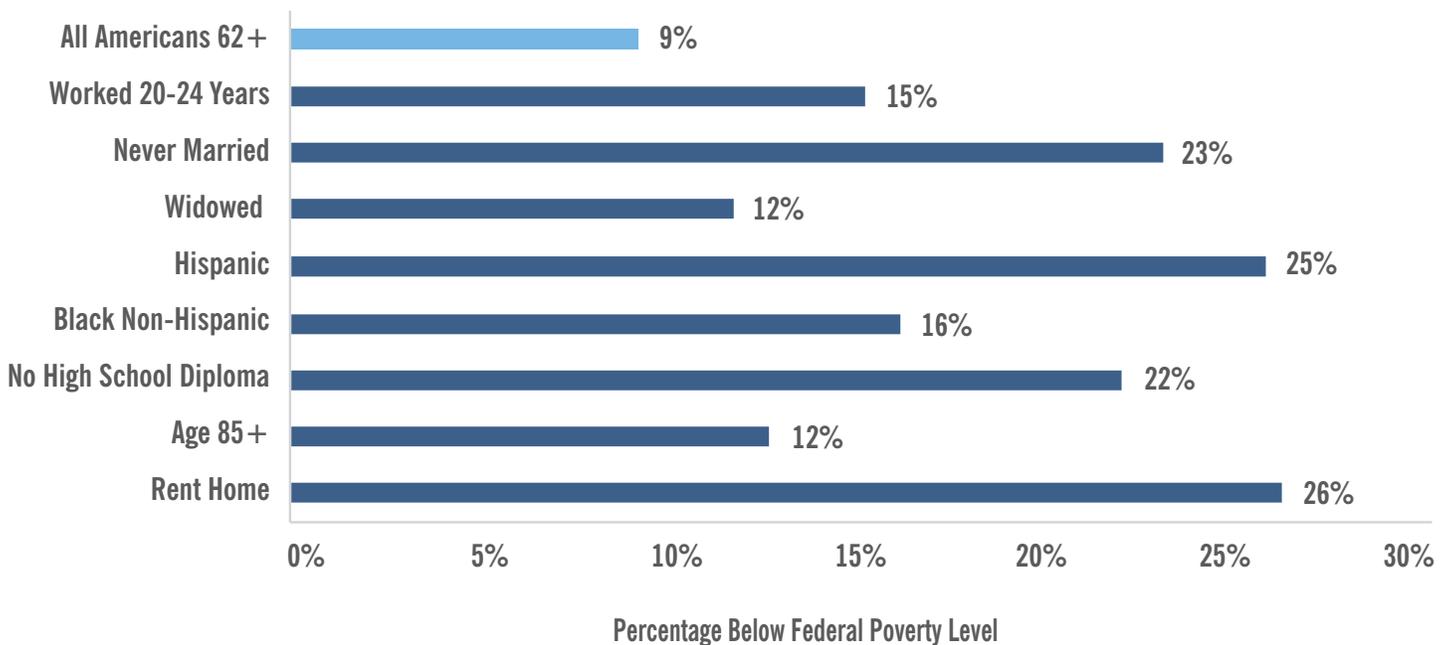
## What Exactly Are the Poverty Thresholds? And How Are They Used?

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.<sup>318</sup>

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**).<sup>319</sup> 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

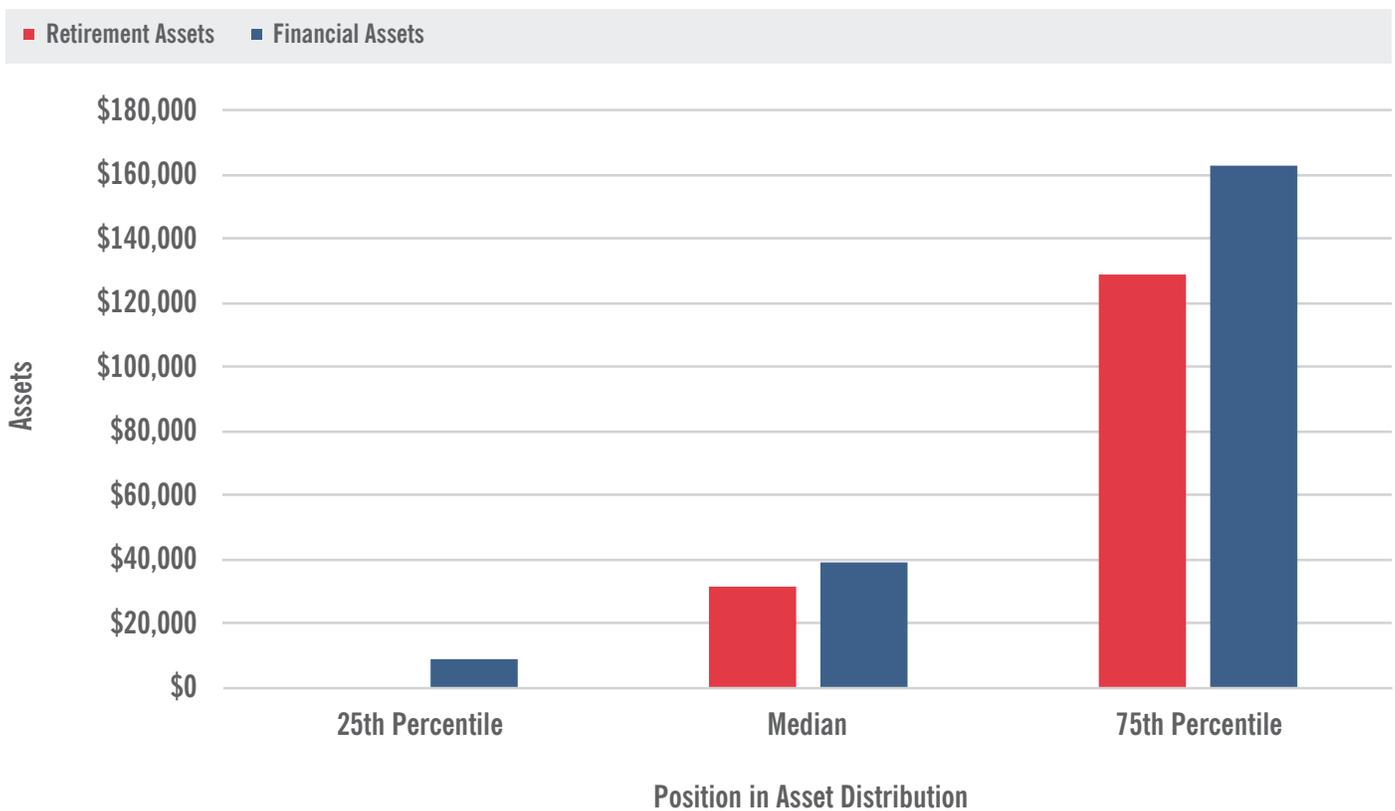
## Retirement and Financial Assets<sup>320</sup>

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.<sup>321</sup> 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).<sup>322</sup>

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.

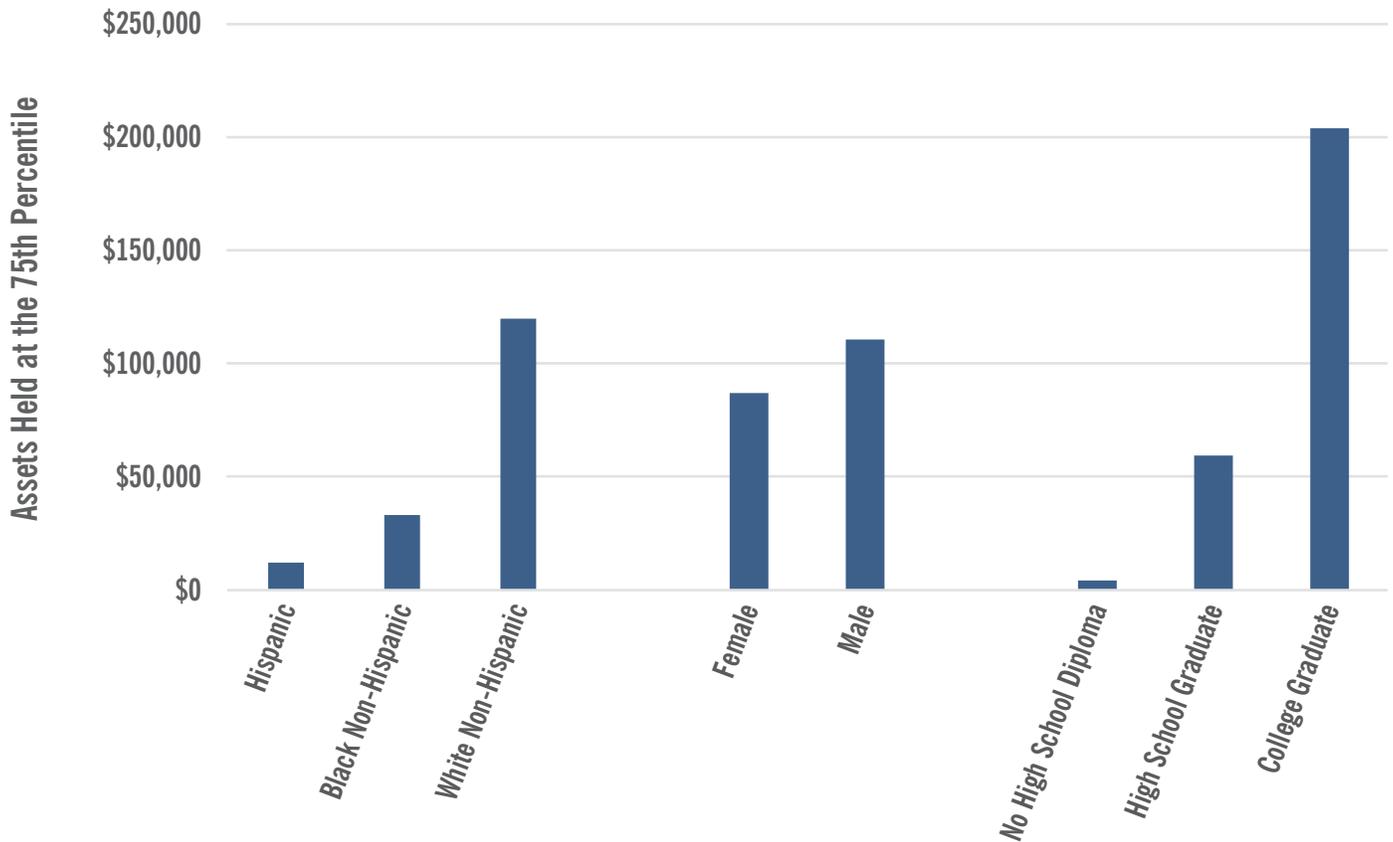


**Note:** Retirement assets include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Financial assets include savings, checking, money market, certificate of deposits, stock, bond, farm and business equity, and vehicle 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**).<sup>323</sup>

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.<sup>324</sup> 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.<sup>325</sup>

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,

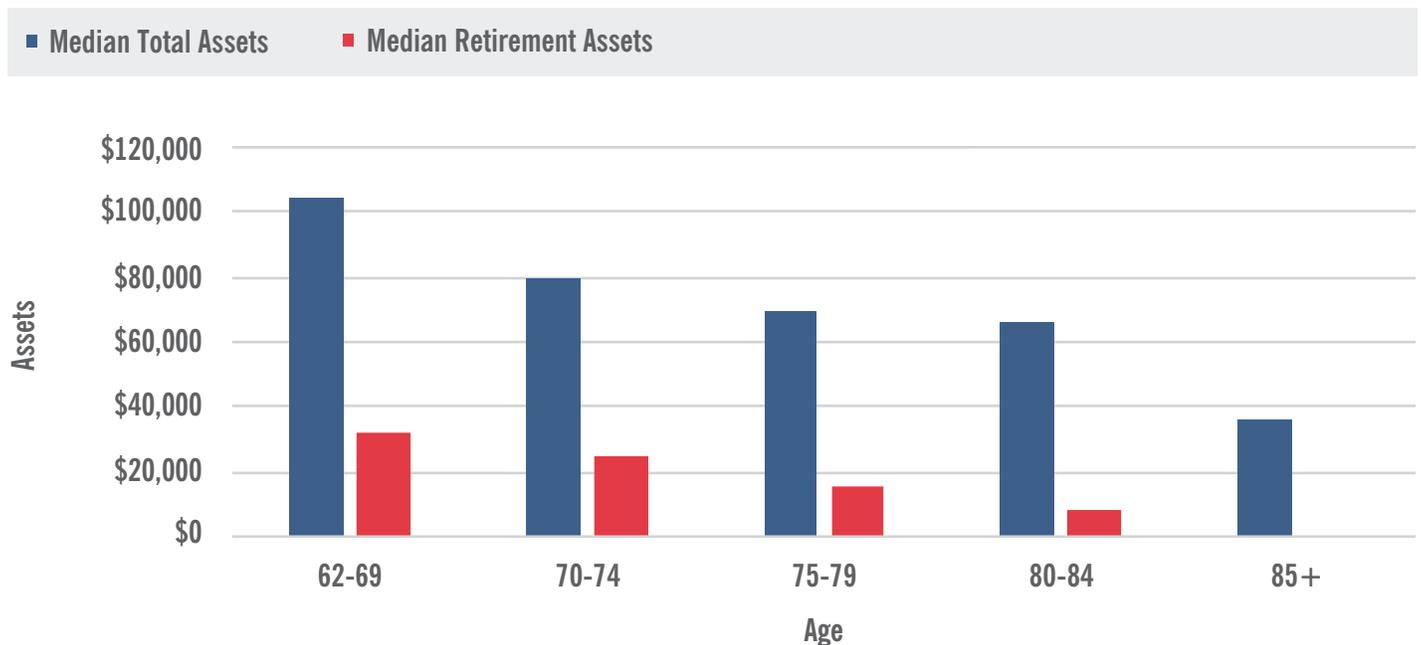
median, per-capita total assets stood at around \$105,000 in 2015, while the 85+ demographic had just around \$36,000 in total assets (**Figure 36**).

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.<sup>326, 327</sup>

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.

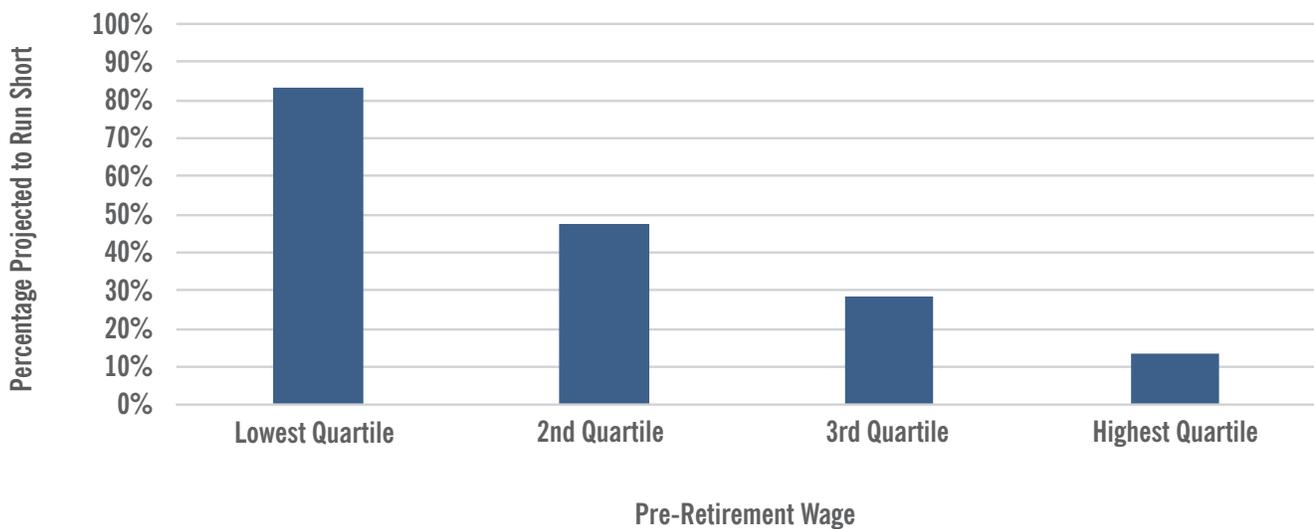


**Note:** Total assets include retirement assets, financial assets, and home equity. Retirement assets include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Financial assets include savings, checking, money market, 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 Institute<sup>329</sup>

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**).<sup>328</sup>

### ***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**).<sup>330, 331</sup>

#### **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.<sup>332</sup> 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.<sup>333, 334</sup>

Medicare’s trustees have identified significant long-range financial challenges for the program that will need to be addressed with legislation.<sup>335</sup> 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.<sup>336</sup>

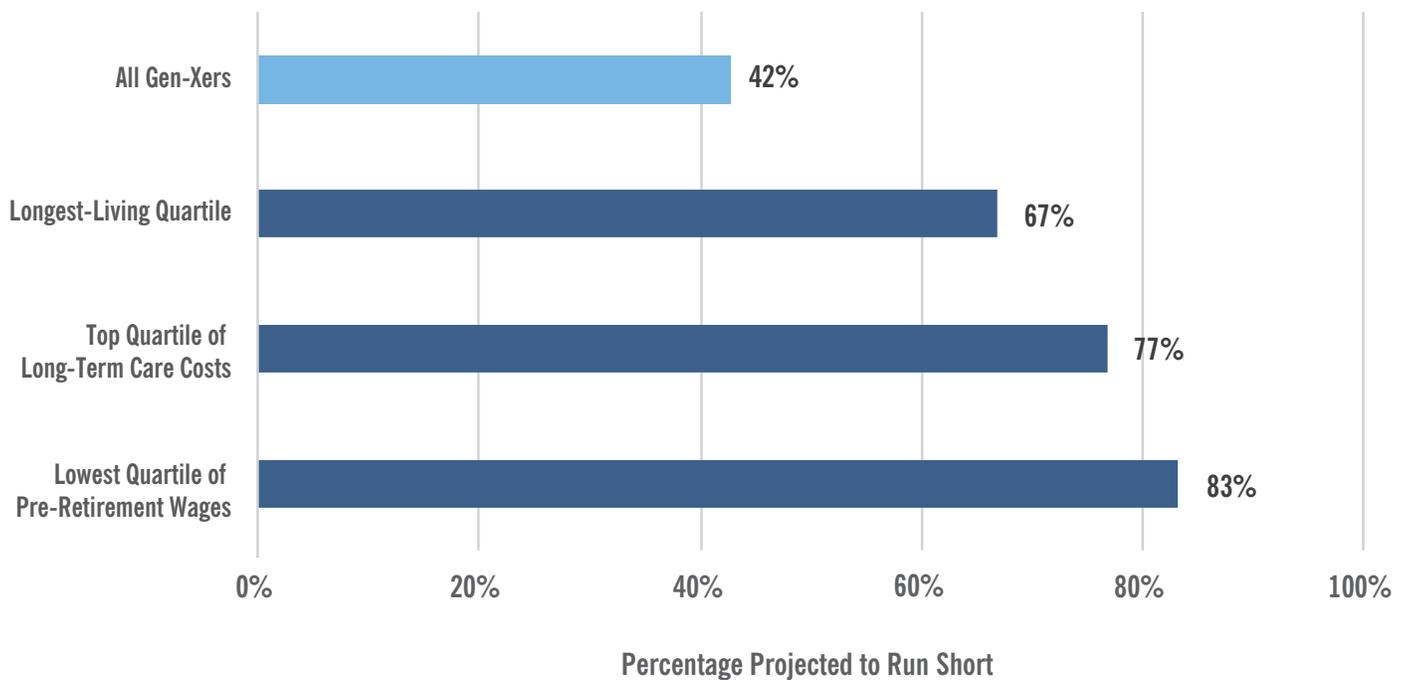
**Long-Term Care:**

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.<sup>337</sup> 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 Institute<sup>342</sup>

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.<sup>338, 339</sup>

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.<sup>340</sup>

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.<sup>341</sup> 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

- <sup>1</sup> See, Board of Governors of the Federal Reserve System. 2016. Financial Accounts of the United States: Fourth Quarter 2015. P. 134. <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.
- <sup>2</sup> See, Investment Company Institute. 2015. Report: The U.S. Retirement Market, Fourth Quarter 2015 (xls). Table 1. <https://www.ici.org/research/stats/retirement>. Retirement savings include assets in DC plans and IRAs.
- <sup>3</sup> See, *e.g.*, Investor Education Foundation. 2012 National Financial Capability Study. P. 3. [http://www.usfinancialcapability.org/downloads/tables/U.S.\\_2012.pdf](http://www.usfinancialcapability.org/downloads/tables/U.S._2012.pdf).  
See also, Mottola, Gary R. “The Financial Capability of Young Adults – A Generational View.” FINRA Investor Education Foundation (March). <http://www.usfinancialcapability.org/downloads/FinancialCapabilityofYoungAdults.pdf>.
- <sup>4</sup> Sherrard Sherraden, Margaret. 2010. “Financial Capability: What is It, and How Can It be Created?” Center for Social Development. Working Paper No. 10-17. <http://csd.wustl.edu/publications/documents/WP10-17.pdf>.
- <sup>5</sup> 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. H. Rep. 114-51, P. 6. <https://www.ssa.gov/oact/TR/2015/tr2015.pdf>.
- <sup>6</sup> *Id.* at 3.
- <sup>7</sup> McCarthy, Justin. 2016. “Americans’ Financial Worries Edge Up in 2016.” Gallup. <http://www.gallup.com/poll/191174/americans-financial-worries-edge-2016.aspx>.
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- <sup>10</sup> 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.
- <sup>11</sup> 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.
- <sup>12</sup> Committee on Finance. 2015. “The Savings & Investment Bipartisan Tax Working Group Report.” United States Senate. 114th Congress. P. 4. <http://www.finance.senate.gov/download/the-savings-and-investment-bipartisan-tax-working-group-report>.
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- <sup>17</sup> VanDerhei. "What Causes EBRI Retirement Readiness Ratings to Vary" at 7.
- <sup>18</sup> Helman, Ruth, Craig Copeland, and Jack VanDerhei. 2016. "The 2016 Retirement Confidence Survey: Worker Confidence Stable, Retiree Confidence Continues to Increase." Employee Benefit Research Institute Issue Brief, no. 422, P. 7. [https://www.ebri.org/pdf/surveys/rcs/2016/EBRI\\_IB\\_422.Mar16.RCS.pdf](https://www.ebri.org/pdf/surveys/rcs/2016/EBRI_IB_422.Mar16.RCS.pdf).
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- <sup>25</sup> Lucas, Lori, Joshua Deitch, Suzanne van Stavren, Catherine Peterson, Bridget Bearden, and Catherine Collinson. 2015. DCIIA Plan Sponsor Survey 2014: Focus on Automatic Plan Features. Defined Contribution Institutional Investment Association. P. 5. [https://www.transamericacenter.org/docs/default-source/resources/tcrs2015\\_wp\\_dciia\\_plan\\_sponsor\\_survey.pdf](https://www.transamericacenter.org/docs/default-source/resources/tcrs2015_wp_dciia_plan_sponsor_survey.pdf).
- <sup>26</sup> Because larger plans in the sample are more likely to adopt automatic features, 60 percent of newly hired participants are covered by plans that enroll new employees by default.
- <sup>27</sup> Vanguard. 2015. "How America Saves 2015: A report on Vanguard 2014 defined contribution plan data." Pp. 23-24. <https://institutional.vanguard.com/iam/pdf/HAS15.pdf>.
- <sup>28</sup> Id. at 58.
- <sup>29</sup> Id. at 31.
- <sup>30</sup> Id. at 23.
- <sup>31</sup> Lucas, *et al.* DCIIA Plan Sponsor Survey 2014 at 5.
- <sup>32</sup> 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.

- <sup>33</sup> Lucas, *et al.* DCIIA Plan Sponsor Survey 2014 at 15.
- <sup>34</sup> See, Bipartisan Policy Center. 2014. A Diversity of Risks: The Challenges of Retirement Preparedness in America. Pp. 27-29. <http://bipartisanpolicy.org/library/retirement-security-personal-savings/>. For example, a worker earning roughly \$50,000 annually who saves 4.5 percent of pay for 30 years would accumulate between \$119,000 and \$167,000 for retirement, depending on investment returns.
- <sup>35</sup> See, National Employment Savings Trust. New Pension Rules. <http://www.nestpensions.org.uk/schemeweb/NestWeb/public/pensions/contents/new-pension-rules.html>. For more information about the new pension rules in the U.K.
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- <sup>53</sup> United States Department of Labor. FAQs about Retirement Plans and ERISA. [http://www.dol.gov/ebsa/faqs/faq\\_consumer\\_pension.html](http://www.dol.gov/ebsa/faqs/faq_consumer_pension.html).
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- <sup>61</sup> Lu, Timothy, Olivia Mitchell and Stephen Utkus. 2010. An Empirical Analysis of 401(k) Loan Defaults. Financial Literacy Center. P. 11. [http://www.rand.org/content/dam/rand/pubs/working\\_papers/2010/RAND\\_WR799.pdf](http://www.rand.org/content/dam/rand/pubs/working_papers/2010/RAND_WR799.pdf).
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- <sup>115</sup> While Social Security now annually spends more on benefits than it receives in tax revenue, total income (which includes the interest credited to the program's combined trust funds) will continue to exceed annual spending on benefits until 2020.
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- <sup>118</sup> *Id.* at 64.
- <sup>119</sup> In 1982, the Social Security Trustees intermediate assumptions projected a 75-year actuarial deficit of between 0.82 and 1.82 percent of the program’s taxable base. (At that time, the trustees produced two sets of intermediate projections.) In 2015, the long-term actuarial deficit in the intermediate assumption was 2.68 percent of taxable payroll.
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- <sup>122</sup> Between the 1991 and 1994 trustees reports, the projected 75-year actuarial shortfall more than doubled as a percentage of taxable payroll (from 1.08 to 2.13), raising the alarm for both the public and policymakers alike.
- <sup>123</sup> Schieber, Sylvester and John Shoven. 1999. *The Real Deal: The History and Future of Social Security*. New Haven: Yale University Press. P. 4.
- <sup>124</sup> 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 IV.B1. Annual Income Rates, Cost Rates, and Balances. United States House of Representatives. 114th Congress. 1st session. H. Rep. 114-51. <https://www.ssa.gov/oact/TR/2015/lr4b1.html>.
- <sup>125</sup> 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 VI.G5. Ratio of OASDI Taxable Payroll to GDP. United States House of Representatives. 114th Congress. 1st session. H. Rep. 114-51. <https://www.ssa.gov/oact/TR/2015/lr6g5.html>.
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- <sup>128</sup> The Urban Institute. 2016. DYNASIM3. Estimate is net of taxes and Medicare premiums.
- <sup>129</sup> Bosworth, Barry P. and Kathleen Burke. 2014. Differential Mortality and Retirement Benefits in The Health and Retirement Study. The Brookings Institution. <http://www.brookings.edu/research/papers/2014/04/differential-mortality-retirement-benefits-bosworth>.  
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See also, Retirement Security Act of 2015. S. 266. 114th Congress. <https://www.congress.gov/bill/114th-congress/senate-bill/266/text>.
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See, Employee Benefits Security Administration. 2015. "Interpretive Relating to State Savings Programs That Sponsor or Facilitate Plans Covered by the Employee Retirement Income Security Act of 1974." 29 CFR Part 2509. Federal Register 80, no. 222 (November 18): 71936. <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28540>.
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- <sup>144</sup> See, United States Department of the Treasury. *myRA*. <https://myra.gov/>.

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- <sup>148</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>149</sup> Internal Revenue Service. 2015. FAQs – Auto Enrollment – What is an automatic contribution arrangement in a retirement plan? <https://www.irs.gov/Retirement-Plans/FAQs-Auto-Enrollment-What-is-an-automatic-contribution-arrangement-in-a-retirement-plan>.
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- <sup>155</sup> Schneyer, Fred. 2004. “Many Americans Carry Multiple Retirement Plans.” Plansponsor. <http://www.plansponsor.com/NewsStory.aspx?Id=6442466503>.
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- <sup>158</sup> Utkus, Stephen P. and Jean A. Young. 2014. The evolution of company stock in defined contribution plans. Vanguard. <https://institutional.vanguard.com/iam/pdf/CRREVO.pdf>.
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- <sup>166</sup> Urban's estimate assumes no behavioral change due to the presence of the Starter Saver's Match (i.e., participants do not contribute more than they otherwise would have because of the new availability of the match). The estimate also assumes that participation among those who qualify for the Starter Saver's Match is 100 percent, because it would be automatically deposited into the accounts of eligible savers. The current Saver's Credit has a much lower take-up rate; Urban estimates that only 64 percent of eligible savers receive the Saver's Credit, which requires filing a longer version of form 1040 and a separate form 8800. Taxpayers cannot claim the Saver's Credit on form 1040-EZ, which is typically used by lower earners.
- <sup>167</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>168</sup> GAO's analysis did not include estimates for the size of accumulated savings in DC plans.
- <sup>169</sup> Government Accountability Office. 2014. IRS Could Bolster Enforcement on Multimillion Dollar Accounts, but More Direction from Congress Is Needed. P. 17. <http://www.gao.gov/assets/670/666595.pdf>.
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- <sup>171</sup> Internal Revenue Service. 2016. Retirement Plan and IRA Required Minimum Distributions FAQs. <https://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions>.
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- <sup>175</sup> Social Security Administration. 2015. Spotlight on Resources – 2015 Edition. <https://www.socialsecurity.gov/ssi/spotlights/spot-resources.htm>.
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members with disabilities, and for other purposes. 2014. 113th Congress. Public Law 113-295. <https://www.congress.gov/113/plaws/publ295/PLAW-113publ295.pdf>.

<sup>178</sup> The Urban Institute. 2016. DYNASIM3.

<sup>179</sup> The Pew Charitable Trusts. 2015. Americans' Financial Security: Perception and reality. P. 1. [http://www.pewtrusts.org/~media/assets/2015/02/fsm-poll-results-issue-brief\\_artfinal\\_v3.pdf](http://www.pewtrusts.org/~media/assets/2015/02/fsm-poll-results-issue-brief_artfinal_v3.pdf).

<sup>180</sup> Goldberg, Melissa. 2015. "The SAVINGS Act and Preserving Tax-Time Savings." Corporation for Enterprise Development. [http://cfed.org/blog/inclusiveeconomy/the\\_savings\\_act\\_and\\_preserving\\_tax-time\\_savings/](http://cfed.org/blog/inclusiveeconomy/the_savings_act_and_preserving_tax-time_savings/).

<sup>181</sup> SAVINGS Act. 2015. United States House of Representatives. 114th Congress. 1st session. H.R. 1652. <https://www.congress.gov/bill/114th-congress/house-bill/1652/text>.

<sup>185</sup> Internal Revenue Service. 2015. Retirement Plans FAQs Regarding Hardship Distributions. <https://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Hardship-Distributions>.

<sup>186</sup> Internal Revenue Service. 2015. Retirement Topics – Exceptions on Tax on Early Distributions. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Tax-on-Early-Distributions>.

<sup>187</sup> Internal Revenue Service. 2015. Retirement Plans FAQs Regarding Hardship Distributions. <https://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Hardship-Distributions>.

<sup>188</sup> Id.

<sup>189</sup> Internal Revenue Service. 2015. Retirement Topics – Hardship Distributions. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Hardship-Distributions>.

<sup>190</sup> Fidelity Investments. 2015. Beware of cashing out your 401(k). <https://www.fidelity.com/viewpoints/retirement/cashing-out>.

<sup>191</sup> United States Department of Labor. 2013. What You Should Know About Your Retirement. P. 21. <http://www.dol.gov/ebsa/pdf/wyskgreenbook.pdf>.

<sup>192</sup> 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.

<sup>193</sup> Bipartisan Policy Center staff communications with plan sponsors.

<sup>194</sup> Internal Revenue Service. 2014. Longevity Annuity Contracts. Internal Revenue Bulletin 2014-30. [https://www.irs.gov/irb/2014-30\\_IRB/ar07.html](https://www.irs.gov/irb/2014-30_IRB/ar07.html).

<sup>195</sup> Previously, such long-deferred annuity contracts would have been counted as assets subject to minimum required distributions, which apply to participants beginning at age 70 ½. Under the new rule, the value of the QLAC is exempt from required distributions.

<sup>196</sup> 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>.

<sup>197</sup> 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.

- <sup>198</sup> 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>.  
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- <sup>199</sup> 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.
- <sup>200</sup> 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.
- <sup>201</sup> The proposed laddering safe harbor could be used with QLACs that, under current regulation, provide an exemption from minimum distribution requirements to insured participants.
- <sup>202</sup> Such products in the current market are sometimes called “guaranteed minimum withdrawal benefits” or “guaranteed lifetime withdrawal benefits.”
- <sup>203</sup> 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>.
- <sup>204</sup> 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>.
- <sup>205</sup> Employee Benefits Security Administration. 2013. Pension benefit statements. United States Department of Labor. RIN 1210-AB20. <http://www.dol.gov/find/20130507/2013-10636.pdf>.  
See also, United States Department of Labor. 2013. Fact Sheet: Lifetime Income Illustration. <http://www.dol.gov/ebsa/newsroom/fsanprm.html>.
- <sup>206</sup> 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>.
- <sup>207</sup> 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.
- <sup>208</sup> 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>.
- <sup>209</sup> Board of Governors of the Federal Reserve System. 2014. 2013 Survey of Consumer Finances. <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>.

- <sup>210</sup> United States Department of Housing and Urban Development. 2016. FHA Reverse Mortgages (HECMs) for Seniors. [http://portal.hud.gov/hudportal/ HUD?src=/program\\_offices/housing/sfh/hecm/hecmabou](http://portal.hud.gov/hudportal/ HUD?src=/program_offices/housing/sfh/hecm/hecmabou).
- <sup>211</sup> Munnell, Alicia and Steven Sass. 2014. "The Government's Redesigned Reverse Mortgage Program." Center for Retirement Research at Boston College. No. 14-1 (January). [http://crr.bc.edu/wp-content/uploads/2014/01/IB\\_14-1.pdf](http://crr.bc.edu/wp-content/uploads/2014/01/IB_14-1.pdf).
- <sup>212</sup> The amount of home equity that can be leveraged depends on factors such as liens and borrower's credit risk.
- <sup>213</sup> Munnell. "The Government's Redesigned Reverse Mortgage Program."
- <sup>214</sup> United States Department of Housing and Urban Development. 2014. Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2014. P. 31. [http://portal.hud.gov/hudportal/documents/huddoc?id=FY2014FHAAnnRep11\\_17\\_14.pdf](http://portal.hud.gov/hudportal/documents/huddoc?id=FY2014FHAAnnRep11_17_14.pdf).
- <sup>215</sup> United States Department of Housing and Urban Development. 2015. Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2015. P. 23. <http://portal.hud.gov/hudportal/documents/huddoc?id=2015fhaannualreport.pdf>.
- <sup>216</sup> Consumer Financial Protection Bureau. 2012. Reverse Mortgages Report to Congress. P. 14. [http://files.consumerfinance.gov/a/assets/documents/201206\\_cfpb\\_Reverse\\_Mortgage\\_Report.pdf](http://files.consumerfinance.gov/a/assets/documents/201206_cfpb_Reverse_Mortgage_Report.pdf). Data used for calculations.
- <sup>217</sup> United States Department of Housing and Urban Development. Find a HECM Housing Counselor. [http://portal.hud.gov/hudportal/ HUD?src=/program\\_offices/housing/sfh/hecm/hecmmlist](http://portal.hud.gov/hudportal/ HUD?src=/program_offices/housing/sfh/hecm/hecmmlist).
- <sup>218</sup> United States Department of Housing and Urban Development. 2014. Mortgagee Letter 2014-10. <https://portal.hud.gov/hudportal/documents/huddoc?id=14-10ml.pdf>.
- <sup>219</sup> 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](http://portal.hud.gov/hudportal/ HUD?src=/program_offices/housing/sfh/hecm/hecmml).
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- <sup>222</sup> In some refinancing transactions, known as cash-outs, individuals effectively borrow against their home by increasing mortgage debt, reducing equity, and receiving the difference in cash.  
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](http://portal.hud.gov/hudportal/ HUD?src=/program_offices/housing/sfh/hecm/faqs_hecm).
- <sup>224</sup> 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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- <sup>226</sup> Eschtruth, Andrew D. and Long C. Tran. 2001. "A Primer on Reverse Mortgages." Center for Retirement Research at Boston College. No. 3. October 2001. P. 2. [http://crr.bc.edu/wp-content/uploads/2001/10/jtf\\_3.pdf](http://crr.bc.edu/wp-content/uploads/2001/10/jtf_3.pdf).
- <sup>227</sup> HECM has indeed proved to be quite risky to the federal government. Plunging real-estate prices that triggered the 2008 global financial crisis caused significant losses. In 2012, the economic value of the HECM portfolio was an estimated -\$5.1 billion, with default levels at around 10 percent. The federal government then completely overhauled the program, strengthening lending standards and limiting the amount of home equity accessible to borrowers. As a result, the HECM portfolio is currently valued at \$7.9 billion, up from -\$1.2 billion in 2014.
- <sup>228</sup> Munnell, Alicia and Steven Sass. 2014. "The Government's Redesigned Reverse Mortgage Program." Center for Retirement Research at Boston College. No. 14-1 (January). [http://crr.bc.edu/wp-content/uploads/2014/01/IB\\_14-1.pdf](http://crr.bc.edu/wp-content/uploads/2014/01/IB_14-1.pdf).
- <sup>229</sup> Sherrard Sherraden, Margaret. 2010. "Financial Capability: What is It, and How Can It be Created?" Center for Social Development. Working Paper No. 10-17. <http://csd.wustl.edu/publications/documents/WP10-17.pdf>.
- <sup>230</sup> Mottola, Gary R. 2014. "The Financial Capability of Young Adults – A Generational View." FINRA Investor Education Foundation. <http://www.usfinancialcapability.org/downloads/FinancialCapabilityofYoungAdults.pdf>.
- <sup>231</sup> Urban, Carly, Maximilian Schmeiser, J. Michael Collins, and Alexandra Brown. 2015. "State Financial Education Mandates: It's All About the Implementation." FINRA Investor Education Foundation. <http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p602380.pdf>.
- <sup>232</sup> University of Minnesota. 2016. Benefits of Workplace Comprehensive Financial Education. <http://www.extension.umn.edu/family/personal-finance/about/benefits/>.
- <sup>233</sup> 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>.
- <sup>234</sup> United States Department of the Treasury. 2013. Final Report. President's Advisory Council on Financial Capability. [https://www.treasury.gov/resource-center/financial-education/Documents/PACFC%20final%20report%20revised%2022513%20\(8\)\\_R.pdf](https://www.treasury.gov/resource-center/financial-education/Documents/PACFC%20final%20report%20revised%2022513%20(8)_R.pdf).
- <sup>235</sup> See, National Center for Education Statistics. Program for International Student Assessment (PISA). <https://nces.ed.gov/surveys/pisa/>. U.S. students scored below the OECD average for financial literacy on the 2012 Programme for International Student Assessment (PISA), a standardized test administered to students in 18 OECD countries.
- <sup>236</sup> 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>.
- <sup>237</sup> 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](http://moneymattersoncampus.org/wp-content/uploads/2013/02/MoneyMatters_WhitePaper_2015_FINAL.pdf).
- <sup>238</sup> *Id.* at 14.
- <sup>239</sup> 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>.

- <sup>240</sup> See, President's Advisory Council on Financial Capability. Money as You Learn. <http://www.moneyasyoulearn.org>.
- <sup>241</sup> Social Security Administration. 2015. Annual Statistical Supplement, 2015. Table 6.B5.1. <https://www.ssa.gov/policy/docs/statcomps/supplement/2015/6b.html>.
- <sup>242</sup> See, Munnell, Alicia H. and Anqi Chen. 2015. "Trends in Social Security Claiming." Center for Retirement Research at Boston College. [http://crr.bc.edu/wp-content/uploads/2015/05/IB\\_15-8.pdf](http://crr.bc.edu/wp-content/uploads/2015/05/IB_15-8.pdf). An alternative approach to analyzing claiming ages would be to restrict the analysis to one age cohort (individuals all born in the same year).
- <sup>243</sup> Bipartisan Policy Center. 2014. A Diversity of Risks: The Challenges of Retirement Preparedness in America. P. 24. <http://bipartisanpolicy.org/library/retirement-security-personal-savings/>.
- <sup>244</sup> Social Security Administration. 2015. When to Start Receiving Benefits. Publication No. 05-10147. <https://www.ssa.gov/pubs/EN-05-10147.pdf>.
- <sup>245</sup> Social Security Administration. Early or Late Retirement? [https://www.ssa.gov/oact/quickcalc/early\\_late.html](https://www.ssa.gov/oact/quickcalc/early_late.html).
- <sup>246</sup> See, Social Security Administration. 2016. Sample Social Security Statement. <https://www.socialsecurity.gov/myaccount/materials/pdfs/SSA-7005-SM-SI%20Wanda%20Worker%20Mid-career.pdf>. For a sample Social Security statement sent to mid-career workers.
- <sup>247</sup> See, Social Security Advisory Board. 2009. The Social Security Benefit Statement: How it Can Be Improved. <http://www.ssab.gov/Details-Page/ArticleID/135/The-Social-Security-Statement-How-It-Can-Be-Improved-August-2009>.
- <sup>248</sup> See, Brown, Jeffrey R., Arie Kapteyn, and Olivia S. Mitchell. 2011. "Framing Effects and Expected Social Security Claiming Behavior." Labor and Population Working Paper Series. Rand Corporation. [https://www.rand.org/content/dam/rand/pubs/working\\_papers/2011/RAND\\_WR854.pdf](https://www.rand.org/content/dam/rand/pubs/working_papers/2011/RAND_WR854.pdf).
- <sup>249</sup> Social Security Administration. Exempt Amounts Under the Earnings Test. <https://www.ssa.gov/oact/cola/rtea.html>.
- <sup>250</sup> 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.
- <sup>251</sup> Social Security Administration. 2015. Annual Statistical Supplement. P. 5.31. <https://www.ssa.gov/policy/docs/statcomps/supplement/2015/5b.pdf>.
- <sup>252</sup> *Id.*
- <sup>253</sup> 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.
- <sup>254</sup> 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>.
- <sup>255</sup> *Id.* at 64.
- <sup>256</sup> *Id.*
- <sup>257</sup> 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.

- <sup>258</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>259</sup> 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.
- <sup>260</sup> See, Social Security Administration. Effect of Early or Delayed Retirement on Retirement Benefits. [https://www.ssa.gov/oact/ProgData/ar\\_drc.html](https://www.ssa.gov/oact/ProgData/ar_drc.html). For reductions by birth year and claiming age.
- <sup>261</sup> 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.
- <sup>262</sup> 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."
- <sup>263</sup> 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.
- <sup>264</sup> 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.
- <sup>265</sup> 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.
- <sup>266</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>267</sup> The division by 37 in the new PIA formula is necessary to convert the aggregate amount into an annual figure.
- <sup>268</sup> 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.
- <sup>269</sup> BPC Staff Calculation. The Urban Institute. 2016. DYNASIM3.
- <sup>270</sup> 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).
- <sup>271</sup> 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>.
- <sup>272</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>273</sup> Social Security Administration. 2016. Monthly Statistical Snapshot, January 2016. Table 3. [https://www.ssa.gov/policy/docs/quickfacts/stat\\_snapshot/](https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/).
- <sup>274</sup> Social Security Administration. 2016. SSI Federal Payment Amounts for 2016. <https://www.ssa.gov/oact/cola/SSI.html>.

- <sup>275</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>276</sup> 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>.
- <sup>277</sup> Office of the Chief Actuary. “Provisions Affecting Retirement Age.” Social Security Administration. Number C1.3. <https://www.ssa.gov/oact/solvency/provisions/retireage.html>.
- <sup>278</sup> 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>.
- <sup>279</sup> 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.
- <sup>280</sup> Congressional Budget Office. 2014. *Options for Reducing the Deficit: 2015 to 2024*. <https://www.cbo.gov/sites/default/files/cbofiles/attachments/49638-BudgetOptions.pdf>.
- <sup>281</sup> Federal Reserve Bank of St. Louis. Civilian Labor Force Participation Rate: Women. <https://research.stlouisfed.org/fred2/series/LNS11300002>.
- <sup>282</sup> Schieber, Sylvester. 2012. *The Predictable Surprise*. Oxford University Press. P. 121.
- <sup>283</sup> Upon implementation for claimants turning 62 in 2022, the maximum spousal PIA is projected to be \$843. The Urban Institute. 2016. DYNASIM3.
- <sup>284</sup> 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>.
- <sup>285</sup> 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.
- <sup>286</sup> 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>.
- <sup>287</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>288</sup> 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.
- <sup>289</sup> 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.
- <sup>290</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>291</sup> 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>.

- <sup>292</sup> 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).
- <sup>293</sup> 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](https://www.ssa.gov/oact/solvency/provisions/tables/table_run240.html).
- <sup>294</sup> Tax Policy Center. 2015. Historical Social Security Tax Rates. [http://www.taxpolicycenter.org/taxfacts/content/pdf/ssrate\\_historical.pdf](http://www.taxpolicycenter.org/taxfacts/content/pdf/ssrate_historical.pdf).
- <sup>295</sup> 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>.
- <sup>296</sup> Earnings that are newly taxed by the increase of the cap would receive a 5-percent replacement rate under the new PIA formula.
- <sup>297</sup> Calculations by the Office of the Chief Actuary.
- <sup>298</sup> 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.
- <sup>299</sup> Social Security Administration. Social Security Tax Rates. <https://www.ssa.gov/oact/progdata/oasdiRates.html>.
- <sup>300</sup> Social Security Administration. Benefits Planner: Income Taxes and Your Social Security Benefits. <https://www.ssa.gov/planners/taxes.html>.
- <sup>301</sup> 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](http://crr.bc.edu/wp-content/uploads/2015/04/IB_15-7.pdf).
- <sup>302</sup> 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.
- <sup>303</sup> 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.
- <sup>304</sup> 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.
- <sup>305</sup> 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/>.
- <sup>306</sup> 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>.
- <sup>307</sup> Internal Revenue Service. 2015. Retirement Topics – IRA Contribution Limits. <https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-IRA-Contribution-Limits>.

- <sup>308</sup> Internal Revenue Service. 2016. Distributions from Individual Retirement Arrangements (IRAs). Publication 590-B. P. 30. <https://www.irs.gov/pub/irs-pdf/p590b.pdf>.
- <sup>309</sup> 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.
- <sup>310</sup> Bipartisan Policy Center. Summary Tables of DYNASIM3 Estimates Produced for the Commission on Retirement Security and Personal Savings. 2016. <http://bipartisanpolicy.org/crsps>.
- <sup>311</sup> 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>.
- <sup>312</sup> VanDerhei, 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](http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf).
- <sup>313</sup> Munnell, Alicia H., Wenliang Hou, and Anthony Webb. 2014. "NRRI 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](http://crr.bc.edu/wp-content/uploads/2014/12/IB_14-20-508.pdf).
- <sup>314</sup> Hurd, Michael D. and Susan Rohwedder. 2011. "Economic Preparation for Retirement." NBER Working Paper, no. 17203. <http://www.nber.org/papers/w17203.pdf>.
- <sup>315</sup> 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>.
- <sup>316</sup> 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>.
- <sup>317</sup> Id.
- <sup>318</sup> 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>.
- <sup>319</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>320</sup> 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.
- <sup>321</sup> Government Accountability Office. 2015. Most Households Approaching Retirement Have Low Savings. P. 8. <http://www.gao.gov/assets/680/670153.pdf>.
- <sup>322</sup> Id. at 11.
- <sup>323</sup> The Urban Institute. 2016. DYNASIM3.
- <sup>324</sup> Id.
- <sup>325</sup> 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](https://www.ebri.org/files/RCS_16.FS-5_Gender.pdf).

- <sup>326</sup> 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.
- <sup>327</sup> 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>.
- <sup>328</sup> 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](http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf).
- <sup>329</sup> Id.
- <sup>330</sup> Id. at 13.
- <sup>331</sup> 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.
- <sup>332</sup> 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.
- <sup>333</sup> 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.
- <sup>334</sup> 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](https://www.ebri.org/pdf/notespdf/EBRI_Notes_10_Oct15_HlthSvgs_DB-DC.pdf).
- <sup>335</sup> 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/reportstrustfunds/downloads/tr2015.pdf>.
- <sup>336</sup> 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/>.
- <sup>337</sup> 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>.
- <sup>338</sup> Figures in 2015 dollars.
- <sup>339</sup> 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>.
- <sup>340</sup> 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](http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf).

<sup>341</sup> Bipartisan Policy Center. 2016. "Initial Recommendations to Improve the Financing of Long-Term Care." <http://bipartisanpolicy.org/library/long-term-care-financing-recommendations/>.

<sup>342</sup> 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](http://www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf).

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