

Security “Plus” Annuities: Secure, Supplemental Income for Life

Turning savings into income that will last throughout retirement is a difficult task. Savers don't know how long they will live, or, therefore, how much they can safely spend each year from the assets they have accumulated. Purchasing a life annuity with a portion of savings reserved for retirement is one solution to the problem.⁴³

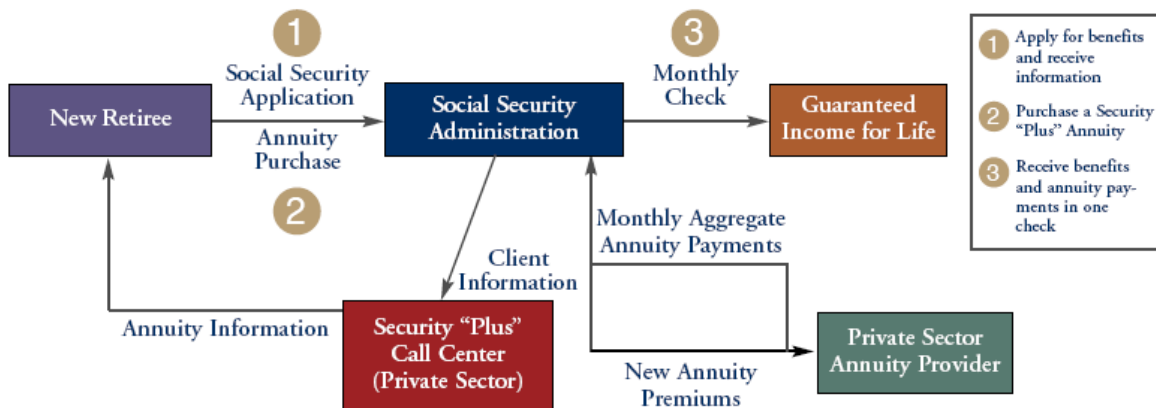
Over the next 20 years, more than 80 million baby boomers will retire. Many of the 76 million eligible for Social Security will need some annuity income beyond those benefits in retirement.

The Security “Plus” Plan is designed to jump-start a market for life annuities for baby boomers. It would provide America's retirees with an opportunity to buy an extra layer of secure income on top of Social Security through a simple and convenient government-facilitated program.

Basic Features

- All new retirees are eligible to buy a Security “Plus” annuity.
- Retirees have a one-time opportunity in their first year of receiving Social Security benefits to buy as large a Security “Plus” annuity as they wish (up to \$100,000 in purchase amount).
- For married retirees, Security “Plus” annuities will offer spousal benefits.
- Security “Plus” annuity payments are automatically added to monthly Social Security checks.
- Through a competitive bidding process, the federal government pre-selects a private market annuity provider to underwrite Security “Plus” annuities on a group basis.
- The federal government provides record-keeping, marketing, distribution and other administrative services at modest cost, keeping Security “Plus” annuities low-cost and a good value.

SECURITY “PLUS” ANNUITIES STRUCTURE



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- A private-sector call center under contract to Social Security is available to explain Security “Plus” annuities, provide individualized cost estimates and purchase assistance, and remind retirees when their eligibility will end.

Why Security “Plus” Annuities Are Different—And Necessary

Few retirees buy life annuities today. Many don’t understand how annuities work, and financial advisors and brokers often fail to recommend them. Few plans offer annuities because they impose extra legal liability on plan sponsors. Only about 25 percent of 401(k) plans offer a life annuity, and few participants in these plans choose to buy one.⁴⁴ And assets rolled over to IRAs are seldom used to buy annuities.

Annuities also have some significant problems. The market for life annuities is underdeveloped, and they are often unattractively priced for individual consumers. State-based guarantee funds, designed to protect purchasers in the event of insurance company insolvency, may fail to cover all claims and consumers. In addition, annuities can be subject to high fees, taxes and expenses under state law.

It’s widely recognized that annuities will need to play an important role in securing the retirement income of baby boomers. Two options are generally proposed to encourage their use.

First, many advocate requiring annuities in 401(k) plans to be a payout option, to be the default payout option, or to be the only payout option. Plan sponsors will strongly resist this proposal unless they receive relief from legal liability.

A second problem is that the decision to purchase an annuity is highly personal. The academic literature suggests that deciding when to purchase an annuity, and how much, depends on many individual, highly-variable factors. Requiring annuities without accounting for individual circumstances doesn’t make sense. It is also likely to discourage saving in 401(k)-type plans, particularly by younger workers with other savings goals.

The second option encourages more annuity purchases through tax incentives. Tax subsidies and incentives are always of greater value to higher-income taxpayers. They wouldn’t encourage low- and moderate-income workers to buy annuities.

Why Security “Plus” Annuities Are The Way Forward

Security “Plus” annuities directly take on the systemic problems troubling today’s life annuities market. This proposal offers a basic life annuity, priced on a group basis, that is low-cost, simple, widely-available, easy to understand and purchase, and offered with consumer protections beyond those available today.

Security “Plus” annuities use the federal government as an intermediary to market and distribute annuities, provide supportive administrative services and select annuity providers. This keeps the private sector in its customary role as an underwriter of group annuities and prices annuities at current market rates but without premium taxes or advisor fees.

Benefits and Costs

- Security “Plus” annuities simplify the annuity purchase decision for the two to four million baby boomers expected to retire each year between now and 2030.
- Security “Plus” annuities minimize the risk that retirees will outlive or lose their savings. If just 10 percent buy a Security “Plus” annuity, that means 200,000-400,000 Americans each year will increase their financial security in retirement.
- As life expectancy increases and the baby boom generation retires, the aging of America will increase the fiscal pressures on the federal government. Security “Plus” annuities enlist the help of the private sector in providing some additional secure lifetime income for retirees.
- Security “Plus” annuities educate millions of Americans about the benefits of annuities while helping the private life annuity market develop to meet the needs of an aging America.

Questions and Answers about Security “Plus” Annuities

Are Security “Plus” annuities really necessary?

Yes. The U.S. needs a vibrant life annuities market to help secure retirement income. Americans need to understand annuities better, and better annuities need to be available to them. Such a market currently doesn't exist.

What types of annuities will be available?

Security “Plus” annuities are intended to be simple and low-cost. The basic annuity will be a single life annuity for single retirees and a joint-and-survivor annuity for married retirees. Additional options could include an annuity with a cash refund of premium feature and an annuity with a 10-year certain feature.

Will Security “Plus” annuities protect against inflation like Social Security benefits?

Social Security benefits currently have a built-in adjustment for inflation. It is desirable for Security “Plus” annuities to do so as well but this may not be feasible. The private annuities market in the U.S. today does not offer inflation-protected annuities. Whether Security “Plus” annuities can be inflation-protected will depend on the willingness and ability of the private sector to offer this feature as well as its costs and benefits.

Won't this just create another inefficient government agency?

No. Security “Plus” annuities would be delivered through an existing agency currently in charge of the primary retirement income of millions of Americans with private-sector players providing supplemental services. A private-sector call center will provide the information and customer contact function as it exists in 401(k) plans today.

Using the Social Security Administration is appropriate because it already has the personal data on potential annuity purchasers. It is also the most logical marketing point. Americans will learn about

annuities when they sign up for Social Security benefits—a moment when a decision to purchase an annuity is highly relevant. Finally, this agency can make annuity payments efficiently by adding them to monthly benefit checks.

Why is there a 12-month time window and \$100,000 limit on annuity purchases?

Security “Plus” annuities are not intended to turn the Social Security Administration into an insurance company, or to supplant the private annuities market. Consumers who wish to purchase larger annuities when Social Security benefits begin or additional annuities later in life can always obtain them from the private sector.

How much extra income could a Security “Plus” annuity provide?

That depends on how much a retiree decides to invest as well as current interest rates and other cost factors. As an example, using today's annuity purchase rates from the Thrift Savings Plan for federal employees, a retiree at age 67 could purchase an additional \$308 in monthly income for life for \$40,000.

How significant is the income that a Security “Plus” annuity could provide?

That depends on how large an annuity is purchased and current interest rates. Using today's rates, a \$50,000 investment would produce a \$385 monthly check. This would replace about 15 percent of pre-retirement income for a worker earning \$30,000 a year and 6.5 percent for a \$70,000 worker.

What role would private-sector annuity companies play in Security “Plus” annuities?

The federal government provides the marketing, administration, payment and customer service functions that a private annuity company usually performs. The insurance company would be asked to do just what it does best: invest funds in order to provide a guarantee of lifelong payments.

What is the anticipated size of the market for Security “Plus” annuities?

Assuming that five percent of new retirees buy a Security “Plus” annuity, about 3.8 million new annuities would be purchased between 2008 and 2030. If ten percent purchased these annuities, there would be 7.6 million new annuities. With \$20,000 on average in purchase amount, Security “Plus” annuities would generate \$76 billion in new funds under management at a five percent take-up rate and \$152 billion at a ten percent take-up rate. Similar figures for a \$50,000 average purchase amount would be \$190 billion and \$385 billion, respectively.

Instead of offering annuities directly, why doesn't the Social Security Administration just provide new enrollees with information about private-sector annuities?

Experience from 401(k) plans indicates that informational material alone is not effective in helping people make complex financial decisions. A turn-key product that is easy to understand and has few choices helps people not just make a decision, but make a good decision. The Security “Plus” Plan is intended to be that turn-key product for annuities.

Security “Plus” Annuities in the Real World

Delroy, Francine and Jason all turn 67 in 2075, and each decides to retire and apply for their Social Security benefits.

Delroy has done well. He became an accountant and worked for several manufacturing businesses. He contributed to his employers' 401(k) plans and rolled over his savings to an IRA, which is worth about \$500,000 in today's dollars. Delroy knows he could easily live another 25 years and is concerned about making sure his money will last. He is uncertain about how much of his IRA he should spend on an annuity, and when he should do so—or, indeed, whether he should do so at all. So he decides that a good first step would be to spend about 20 percent of his IRA on a Security “Plus” annuity. Investing \$100,000 in a Security “Plus” annuity will buy him an additional \$770 a month, or over \$9,000 every year, in secure, guaranteed income for life.⁴⁵

Francine's business has given her an adequate income for most of her life but, due to ill health, she is forced to work less, beginning in her 50s. She arrives at retirement with her mortgage paid off, but with only modest savings. She also has an America's IRA, but her account at retirement is worth only about \$30,000 in today's dollars. She decides that having more secure income is critical to maintaining her standard of living. So she buys a Security “Plus” annuity with \$25,000 of her savings, keeping \$5,000 for emergencies. The Security “Plus” annuity gives her an additional \$192 in monthly income, or over \$2,300 in annual income for life.

Jason's primary income in retirement comes from Social Security. He has no home and his America's IRA represents his only savings. His income just before he retires is about \$60,000 in 2075 dollars. Jason expects to work one or two days a week for several more years to increase his retirement income. He believes he will need about 80 percent of his pre-retirement income when he fully retires. His Social Security benefits will equal about 56 percent of his pre-retirement income. By buying a Security “Plus” annuity with his America's IRA, he can increase his retirement income by 20 percent. Between Social Security and his annuity, Jason will have 76 percent of his pre-retirement income for the rest of his life.