INITIATIVE ON FINANCIAL SECURITY

THE ASPEN INSTITUTE

The Aspen Institute Initiative on Financial Security Written Statement for the Record for "The Retirement Challenge: Making Savings Last a Lifetime" Before the United States Special Committee on Aging

June 16, 2010
2:00 PM
Dirksen Senate Office Building, Room 562

The mission of the Aspen Institute Initiative on Financial Security (Aspen IFS) is to promote sound public policy that enables all Americans, especially low- and moderate-income Americans, to build financial security that lasts a lifetime. As President Obama has stated, "Americans who work hard their entire lives have earned the right to retire with dignity and security. That's the promise that each of us wants to be realized within our own families, and it's a promise we must keep for all American families." A dignified and fulfilling life in retirement rests on financial security – financial security that matches longevity and enables seniors to contribute joy, wisdom and other resources to their families rather than burden them financially.

This hearing before the Senate Special Committee on Aging marks an important step towards a national policy on preserving income from savings throughout retirement. Turning savings into income that will last throughout retirement is a difficult task. Over the next 20 years, more than 80 million baby boomers will retire. Many of the 76 million eligible for Social Security—the universal, baseline annuity for all Americans—will need some lifelong income beyond those benefits in retirement. As defined benefit plans continue to disappear, the generations that follow will need even more help in managing the nest eggs they have accumulated in 401(k) plans so that they will last a lifetime.

Framing the nation's first private annuity policy that supplements Social Security will be a difficult and complex task and should be undertaken only with extreme caution. What the government blesses as policy will affect millions of Americans and billions of investment dollars. It could significantly alter the structure of our private savings system and dramatically affect the operation and organization of the financial services industry. Aspen IFS believes that critical work of analysis and debate must be undertaken before the nation embarks upon a broad-based, expansive policy on lifelong financial security.

The Initiative on Financial Security at the Aspen Institute is a leading policy program focused on bold solutions to help all Americans at every stage of life to save, invest, and own.

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It would be tragic if, as a nation, we fail to learn from some of the significant policy failures in 401(k) plans over the last twenty years. Many believe that they originate in what Aspen IFS calls the "people" problem, that is, on the behavioral challenges of turning people into savers and savers into investors. There is a large element of truth in that belief. We have learned the hard way not to place too much investment risk and responsibility on the shoulders of savers and not to burden them with complex choices. Aspen IFS believes, however, that equally important is what it calls the "product" problem, that is, the prevalence of opaque investment options with high fees and expenses. The magnitude of the product problem is well-illustrated by the current controversy over the use of poorly-understood target-date funds as a default 401(k) investment. The world of annuity design and marketing is vast and complex, and its products, like any other investment product, can be subject to high fees and expenses.

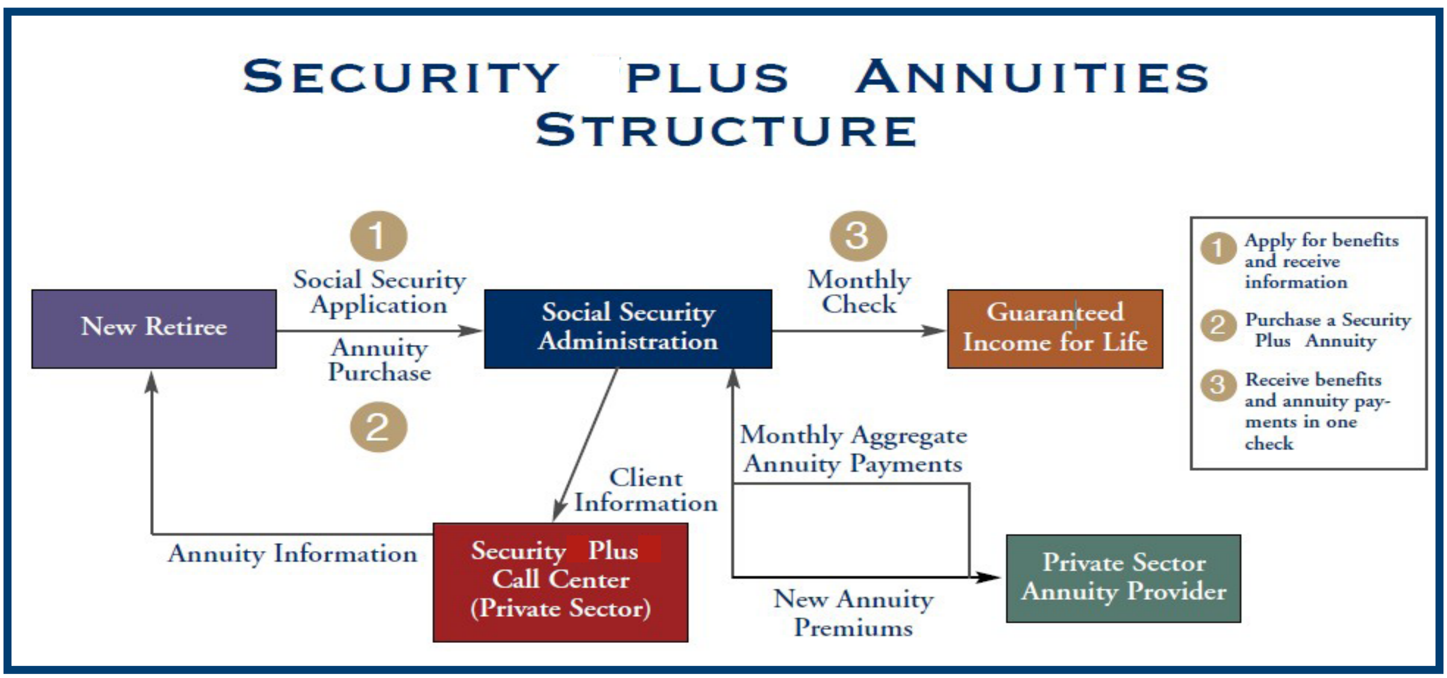
Before we "nudge" or perhaps even mandate millions of Americans into lifelong income products that will bind them for decades, we have an obligation to carefully consider the needs and abilities of diverse groups of savers as well as critical product design and regulatory issues. This is particularly important now that the Obama Administration seeks to expand pension coverage significantly beyond the roughly 70 million active savers now in employer-based defined contribution plans. The Automatic IRA proposal, if passed, would more than double the size of our private retirement saving system by adding some 78 million new savers, many of them low- and moderate-income workers. Millions of them, and millions more savers in 401(k) plans, will be content to remain in default products blessed by statute or regulation. We owe these savers a rigorous debate over the core elements of appropriate lifelong income products before they become a routine feature of investment menus.

This is particularly true because even preliminary questions surrounding lifelong income products as a policy are complex and there are no clear answers. Which savers should purchase such products? How much of their savings should be devoted to lifelong income products? Aspen IFS believes that a sizeable portion of those who do not annuitize at least some of their retirement nest egg could benefit from doing so. The academic literature, however, provides no easy-to-apply rules for potential purchasers. It does suggest that decisions about lifelong income needs in retirement are highly personal and require careful analysis of family circumstances and other financial assets, over and above retirement plan account balances. When should savers purchase such products, i.e., over their work lives, at retirement, or perhaps only for extreme old age? Again, this is a subject of considerable debate among academics and financial professionals.

At the same time, the design of lifelong income products is evolving rapidly. A popular product for today may look very different in five or ten years. How well can we shape public policy to incorporate the dynamic nature of industry innovation? Alternatively, how well can public policy address some persistent issues raised by current lifelong income products? For example, what products – new or old – best serve low and moderate-income savers? What role should an employer play, if any? Is the current state-based regulatory scheme for such products suitable for a diverse, highly mobile workforce? Many state guarantee funds limit their liability to only $100,000 in present value, and protection can vary depending on state of residence. Moreover, while lifelong income products can play an important role in reducing longevity risk, they do not guard against other significant risks to retirement income. For example, few products are available today that protect retirement income against inflation. In addition, lifelong income products remain subject to default risk, the risk that promised payments will not be made if a provider becomes insolvent.

Realistically, given the complexity of the issues, it could take years of consensus-building, legislation and regulation before lifelong income products become routinely available through 401(k) plans and IRAs. In the meantime, however, 3-4 million baby boomers will be reaching retirement age each year without easy access to a simple and secure lifelong income product. To assist them and as a first step toward a national policy for all, we should explore already successful public policies that provide lifelong income. For that, we have only to turn to Social Security. Social Security provides a popular, almost universal annuity that protects against default, inflation and longevity risks. Aspen IFS believes that the popularity of Social Security income could be leveraged as the first stage of a new national policy on lifelong income. Partnering with Social Security would endow lifelong income products with the familiarity, convenience, and trust enjoyed by the Social Security program. This approach also adds the benefit of comparability because monthly Social Security benefits are the yardstick by which those who are about to retire or who have just retired measure their real retirement income.

In its report, Savings for Life, Aspen IFS has proposed utilizing the resources and goodwill associated with Social Security to market and distribute "Security Plus Annuities" through a public/private partnership. A Security Plus Annuity would primarily be a "starter" annuity suitable for savers who would like to annuitize at least a portion of a small nest egg. Retirees who wish to buy larger annuities or additional annuities later in life would be encouraged to obtain them from the private sector. The graphic below provides a depiction of how the Security Plus Annuity proposal works.



A Security Plus Annuity is a basic, immediate, inflation-adjusted, life annuity that would enable retirees to buy an additional amount of Social Security-like income for life. Security Plus Annuities would offer all new retirees a one-time opportunity in their first year of receiving Social Security benefits to buy as large a Security Plus Annuity as they wish available in up to $100,000 in purchase amount. For married retirees, Security Plus Annuities would offer spousal benefits. Security Plus Annuity payments would be automatically added to monthly Social Security benefit checks.

Through a competitive bidding process, the federal government would pre-select a private market annuity provider to underwrite Security Plus Annuities on a group basis. The federal government would act primarily as an intermediary providing record-keeping, marketing, distribution, and other administrative services while the private sector would play its customary role as an underwriter of group annuities. Insurance companies would invest premium payments to support retirees' guaranteed lifelong payments. Moreover, a private-sector call center under contract to Social Security would also be available to explain Security Plus Annuities, provide individualized cost estimates and purchase assistance, and remind retirees when their eligibility will end. A summary of Security Plus Annuity features is provided below.

Security Plus Annuity Features

- A Security Plus Annuity is an immediate, inflation-adjusted, life annuity that provides an initial layer of Social Security-type income.
- Retirees have a one-time opportunity in their first year of receiving Social Security benefits to buy as large 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 added automatically 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.

In conclusion, Aspen IFS believes that many savers will want and need to convert at least some of their retirement nest eggs into lifelong income. Federal policy should assist them to do so. The first step should be to consider how we can build a lifelong income policy based on what is already popular and effective. In addition, any federal policy must be mindful that increasing the take-up of lifelong income products involves more than an effort to fix the "people" problem. It must also involve a serious focus on the "product" problem so that all savers, but especially low- and moderate-income savers, have access to a suitable and secure lifetime income option.

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